CONIFEX

CONIFEX TIMBER INC.

2010 MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of March 8, 2011

*This Management's Discussion and Analysis ("**MD&A**") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the year ended December 31, 2010 relative to 2009, the Company's financial condition and future prospects. This MD&A should be read in conjunction with Conifex's Consolidated Financial Statements and notes thereon for the years ended December 31, 2010 and 2009 filed on SEDAR at www.sedar.com. On August 27, 2010, the British Columbia Securities Commission granted the Company exemptive relief from the requirement to prepare its financial statements in accordance with Canadian generally accepted accounting principles in order to use International Financial Reporting Standards ("IFRS"). The exemptive relief order applies to the preparation of the Company's annual financial statements for years ending on or after January 1, 2010 and interim financial statements for interim periods ending on or after the completion of its Qualifying Transaction with DTR Wood Acquisitionco Ltd. ("DTR") on June 3, 2010 (the "Qualifying Transaction"). Accordingly, the financial information contained in this MD&A has been prepared in accordance with IFRS and in accordance with International Accounting Standard 34 Interim Financial Reporting.*

In this MD&A, reference is made to "EBITDA". EBITDA represents earnings before interest, taxes, depreciation and amortization, as well as before deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures and other investments. The Company discloses EBITDA as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

Unless otherwise noted, all monetary references in this MD&A are in Canadian dollars.

*References in this MD&A to "**Conifex**" and the "**Company**" mean Conifex Timber Inc., together with its subsidiaries, unless the context otherwise requires.*

FORWARD-LOOKING STATEMENTS

Certain statements in this MD&A may constitute "forward-looking statements". Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. When used in this MD&A, words such as "estimates", "expects", "plans", "anticipates", "projects", "will", "intends", "believes", "should", "could", "may" and other similar terminology are intended to identify such forward-looking statements. Forward-looking statements reflect the current expectations and beliefs of the Company's management. Because forward-looking statements involve known and unknown risks, uncertainties and other factors, actual results, performance or achievements of the

Company or industry may be materially different from those implied by such forward-looking statements. Forward-looking statements involve significant uncertainties, should not be read as a guarantee of future performance or results, and will not necessarily be an accurate indication of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including those matters described under "Risks and Uncertainties". Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstances, except as required by law.

OVERVIEW OF 2010

During 2010, Conifex made important and measurable progress towards the realization of its goal to become a public company with over one billion board feet of lumber production and a high degree of timber self-sufficiency:

Become a public company. On June 3, 2010, the Company completed the Qualifying Transaction with DTR. The shares of Conifex Timber Inc. were listed under new trading symbol "CFF" on the TSX Venture Exchange and began trading on June 8, 2010.

Own over one billion feet of lumber production. Concurrent with the completion of the Qualifying Transaction, on June 3, 2010, Conifex completed its acquisition of the Mackenzie Assets (the "Mackenzie Assets"). The Mackenzie Assets included two sawmills with a combined annualized production capacity of approximately 445 million board feet of lumber on a two-shift basis. The total production capacity of the Company is approximately 745 million board feet of lumber and includes capacity of approximately 300 million board feet at its Fort St. James facility acquired in August of 2008.

Achieve a high degree of timber self-sufficiency. The acquisition of the Mackenzie Assets included a forestry licence with an allowable annual cut of approximately 932,500 cubic metres. The Fort St. James acquisition included timber tenure of approximately 640,000 cubic metres. The Company holds long-term renewable rights providing entitlement to maintain an annual harvest of approximately 1.57 million cubic metres. In addition to its harvesting supply, the mills at both locations have good access to purchased fibre.

Conifex views fibre supply self-sufficiency as a key competitive element because the direct control and management of timber resources mitigates the risk of fluctuations in the availability and market price of purchased fibre.

The Company also intends to become a top-quartile performer in its lumber manufacturing segment. *.* At a minimum, this requires a strong financial position to undertake the requisite investments in capital improvements and to withstand the volatility inherent in cyclical commodity industries. Strong financial performance is underpinned by stability and the availability of options to maximize revenue streams.

On June 3, 2010, the Company significantly strengthened its financial position by completing a private placement (the "Private Placement") for gross proceeds of approximately $89 million. A portion of the proceeds were used to complete the purchase of the Mackenzie Assets and to commit to the second phase of the Company's capital expenditure program (the "Cap-Ex Program") at its Fort St. James facility. In the late fall of 2010, the Company committed to invest in the capital improvements and working capital required to begin production at the Site II Mackenzie mill on a one-shift basis.

To date, Conifex's operating results have been hampered by its low operating rates. The Company has incurred fixed costs capable of supporting near capacity operations of approximately 745 million board feet. However, total lumber production in 2010 was 169 million board feet (2009 – 114 million board feet), resulting in an overall operating rate of 23%. One of the key benefits of the Cap-Ex Program will be to enable the Fort St. James mill to commence operation of a second shift late in the first quarter of 2011. The Company also intends to start a second shift at the Site II Mackenzie mill in the second quarter of 2011. Production is expected to reach an annualized rate of approximately 530 million board feet, equivalent to an overall operating rate of over 70% during the second half of 2011. The higher production volume is expected to meaningfully reduce unit manufacturing costs.

The stability and optimization of revenue streams are important contributors towards the achievement of top-quartile performance. Conifex pursues diversity in its markets and its products in order to position itself to generate strong financial results through the business cycle.

During 2010, the Company reduced its reliance on the North American lumber market by increasing export shipments from 22% of total shipments in 2009 to 46% of total shipments in 2010. The Cap-Ex Program is designed to enhance revenues by increasing the percentage of higher quality lumber the mill produces, improving lumber recoveries and enhancing the potential for product diversification from improved flexibility in its grading process.

The Company views the development of the "green" energy business in British Columbia as an opportunity to capture revenue from previously discarded logging and sawmill waste and to achieve higher prices on its residuals as a result of increased competition for biomass fibre. Conifex's recently announced plans to generate electricity for sale to the BC Hydro power grid are expected to provide a stable revenue source largely unrelated to the price volatility in commodity lumber.

These significant developments are discussed more fully below.

SIGNIFICANT DEVELOPMENTS

Completion of Qualifying Transaction

On June 3, 2010, Conifex, formerly called West Fourth Capital Inc. ("Fourth"), completed the Qualifying Transaction with DTR pursuant to a plan of arrangement (the "Arrangement") under the *Business Corporations Act* (British Columbia). Pursuant to the Arrangement, Conifex acquired all of the issued and outstanding securities of DTR in exchange for securities of Conifex. The Arrangement was a "qualifying transaction" under the policies of the TSX Venture Exchange. In connection with the Arrangement, Fourth changed its name to "Conifex Timber Inc.". On June 8, 2010, the Company's common shares began trading on the TSX Venture Exchange under the new trading symbol "CFF".

The acquisition of the securities of DTR was accounted for as a reverse asset acquisition. Accordingly, the Company's consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiaries from the date of completion of the Qualifying Transaction. The comparative amounts included in the consolidated financial statements are those of DTR. DTR, incorporated on October 22, 2004, was formed for the purpose of investing in the forest industry in the interior region of British Columbia and elsewhere in Canada.

In connection with the Qualifying Transaction, the Company changed its fiscal year end to December 31. Prior to the Qualifying Transaction, DTR's fiscal year end was the 52 or 53 weeks ending the last Saturday of December and customarily consisted of four 13-week quarters, with every sixth year including 53 weeks. References in this MD&A to 2009 means the year ended December 26, 2009 and to 2010 means the period December 27, 2009 to December 31, 2010.

Acquisition of Mackenzie Assets

On March 24, 2010, the Company and Abitibi-Consolidated Company of Canada ("Abitibi") entered into an Asset Purchase Agreement, as amended, for the acquisition of certain sawmill and other assets located at Mackenzie, British Columbia. The Company completed the acquisition (the "Mackenzie Acquisition") on June 3, 2010. Total consideration paid included cash of $33.5 million plus an amount for net working capital and assumed long-term liabilities.

The Mackenzie Assets include two sawmills, including planer mills, with a combined annual production capacity of 445 million board feet of lumber on a two-shift basis, a forest licence in the Mackenzie timber supply area with an allowable annual cut of approximately 932,500 cubic metres, a steam/power plant and associated turbine and boiler, and a paper mill (excluding the headbox). The Company does not intend to operate the paper mill, has disposed of a portion of the paper mill assets subsequent to the purchase and holds the remaining redundant assets as "assets held for sale" on its balance sheet. The Company will retain the power generation assets and associated land and building in its bioenergy operating segment. The Company assumed certain liabilities of Abitibi including reforestation, environmental and certain employee related liabilities.

The Mackenzie Acquisition was financed by a portion of the proceeds of the Private Placement, described below.

The purchase price of the Mackenzie Assets has been allocated to the fair value of the assets acquired and related liabilities arising from the transaction based on management's best estimates.

Completion of Private Placement

In connection with the Mackenzie Acquisition, DTR completed a private placement (the "Private Placement") consisting of the sale of 10,787,878 subscription receipts at a price of $8.25 per subscription receipt for gross proceeds of approximately $89 million. Each subscription receipt was, pursuant to the Arrangement, exchanged for DTR common shares from treasury on a one-to-one basis without further payment or consideration. The Company used the proceeds of the financing to fund the purchase of the Mackenzie Assets, to support the Cap-Ex Program and for working capital and general corporate purposes.

Capital expenditure program at Fort St. James

Conifex purchased the Fort St. James assets in August 2008. The sawmill had been idled by its previous owner in September 2007 due to market conditions and only a nominal amount had been invested in the facility in recent years. The Fort St. James mill commenced manufacturing operations on a one-shift basis in March of 2009.

The Company has committed approximately $30 million to the Cap-Ex Program at this manufacturing facility. The program is designed to increase EBITDA by reducing costs of drying and finishing lumber and by capturing additional lumber revenue by increasing the percentage of higher quality lumber the mill produces. The completion of the project to increase planer speed will enable the mill to add a second shift on a cost effective basis. One of the main constraints to moving to two-shift operations at this site has been the hourly planing and finishing throughput which is approximately one-half the hourly capacity of the sawmill.

The major elements of the Cap-Ex Program and key benefits they are designed to provide upon completion are summarized below.

PROJECT	**KEY BENEFITS EXPECTED**
GradExpert system	Increase in planer efficiency, throughput and potential grade outturns Reduced manning costs Decreased trim loss Potential to broaden product range
Planer speed up projects	Reduce labour costs due to higher productivity Reduce labour costs by eliminating third shift Increased product value from “cut-in-two” capability
New sawmill debarkers	Increased log throughput at sawmill Reduced overtime expense Improved residual chip revenues due to improved quality Higher lumber recovery due to reduced fibre tear
New kiln and upgrade two kilns	Reduced drying defects Improved grade outturns Increased lumber drying capacity Reduced natural gas consumption

The budgeted cost and progress status of each project is summarized below.

PROJECT	**BUDGET**	**STATUS**
GradExpert system (Phase 1)	$6 million	Completed May 2010
Planer speed up projects (Phase 2)	$13 million	Major work completed in January 2011 Relocation of 1 line to be completed in March 2011
New sawmill debarker (Phase 2)	$4 million	To be completed March 2011
New kiln and upgrade two kilns (Phase 2)	$7 million	New kiln operating November 2010; Conversion of one kiln completed January 2011 Conversion of one kiln to be completed March 2011
Total	$30 million	

The installation of the GradExpert system required a planned three-week curtailment of planer operations in April and May of 2010. The other projects were completed without downtime at either the sawmill or planer operations although planer productivity was adversely impacted by the surrounding construction activity during the last two months of 2010 and will continue to be adversely affected in the first quarter of 2011. All projects are largely within budgeted costs.The

Cap-Ex Program is being funded by a combination of an $8.6 million Community Adjustment Fund (“CAF”) loan sponsored by the Northern Development Initiative Trust (“NDIT”), training and capital improvement grants from the NDIT, and cash reserves on hand.

The second shift of sawmill production is currently expected to commence late in the first quarter of 2011 and is expected to produce approximately 160 million board feet of finished lumber on an annual basis. The total output from this facility is expected to be approximately 310 million board feet of lumber on an annual basis.

Start-up of lumber production at Mackenzie

The Mackenzie Assets were generally not operated by its previous owner on a continuous basis since December 2007 due to market conditions although the sawmills and planer mills were kept in operating and start-up condition. Portions of the assets were operated on an interim basis in the late fall of 2009 and first quarter of 2010.

On November 1, 2010, the Company commenced lumber production on a one-shift basis at the Site II sawmill with lumber shipments following in early December. Start-up capital required for major maintenance work and several key improvements totalled $2.5 million. The mill is expected to produce approximately 110 million board feet of lumber annually on one shift. The Company is currently planning to add a second shift at this location during the second quarter of 2011.

Operating segments

The operating segments of the Company are differentiated by types of products manufactured, markets served, activities and strategic initiatives undertaken. The main activities of the lumber segment include timber harvesting, reforestation, forest management, manufacture of logs into finished lumber and residual products and distribution of its finished products. The main activities of the bioenergy segment will be to develop a project to increase its existing power generation capacity at its Mackenzie facility to generate renewable energy for commercial sale (the “Bioenergy Project”), to potentially produce heat to kiln dry lumber at Mackenzie, and to pursue additional investment opportunities in the bioenergy sector.

Other notable developments

Addition of management team and corporate office. During 2010, the Company added personnel in the key roles of Chief Operating Officer, Chief Financial Officer and Vice President of Corporate Development. Conifex also opened a corporate office in Vancouver and plans to add a regional office in Prince George in March of 2011.

Sale of redundant assets at Mackenzie. In September 2010, the Company sold a portion of the assets held for sale originating from the acquisition of the Mackenzie Assets. Due to the difficulty of assigning an appropriate cost to the items sold, as these items formed a part of a larger pool of assets, the entire proceeds of disposition of $2.3 million was credited to the carrying value of the assets with no income recognition during the period. In January of 2011, an additional asset from this pool was sold for net proceeds of $325,000.

Ratification of labour agreement with United Steel Workers. The United Steel Workers Union represents the Company’s unionized employees at the Fort St. James and Mackenzie operations. A new Collective Agreement was ratified at both locations in early September 2010 and will expire on June 30, 2013. The terms of the new agreement are similar to the previous agreement in place at Fort St. James and provides for a wage deferral program whereby the Company can defer a portion of the hourly wages payable when paying the full 15% export tax. The deferrals are repaid when the Company is not paying any export tax on US lumber shipments.

SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

The Company's 2009 operating results reflect ten months of production activity and nine months of shipping activity at the Fort St. James mill. The 2010 results reflect twelve months of production and shipping activity at the Fort St. James site and two months of production and one month of shipping activity at the Mackenzie site on a one-shift basis.

For the year ended December 31, 2010, the Company recorded a net loss of $10.8 million or $1.02 per share and negative EBITDA of $5.7 million on sales of $57.4 million. Negative EBITDA was comprised of $2.3 million from the lumber segment, $0.5 million from the bioenergy segment and $2.9 million from corporate costs and other items. EBITDA from the lumber segment for 2010 improved by $5.8 million over 2009 due largely to an increase of over 33% in lumber prices and an increase of 48% in production volume.

The Fort St. James operations ended the year with a slightly positive EBITDA despite absorbing higher unit manufacturing costs as a result of production inefficiencies from the ongoing Cap-Ex Program. The Mackenzie operations ended the year with a negative EBITDA largely attributable to facility idling costs and to low operating rates during its start-up phase.

Corporate costs increased by $0.8 million and other items increased by $3.4 million in 2010.

The Company ended 2010 with a strong balance sheet as a result of the completion of the Private Placement. The Company's net cash position improved by $20 million and net equity position by $77.5 million over the year ended December 26, 2009.

For the year ended December 26, 2009, the Company recorded a net loss of $10.3 million or $2.45 per share and negative EBITDA of $8.5 million on revenues of $31.3 million. The loss from operations in 2009 was largely attributable to historically low lumber prices, high unit manufacturing costs due to low operating rates, and facility idling costs of approximately $1.6 million. Costs of keeping a facility idled include the cost of retaining key staff, insurance premiums, property taxes, maintenance, administration and other expenses incurred to safeguard assets.

SELECTED ANNUAL INFORMATION

(millions of dollars except share and per share amounts)	**2010**	**2009**
Sales -Lumber	50.2	27.5
- By-products	7.2	3.8
Total Sales*	57.4	31.3
Operating loss	(8.0)	(10.9)
Net loss	(10.8)	(10.3)
Net loss per share - basic and diluted	(1.02)	(2.45)
EBITDA**	(5.7)	(8.5)
Shares outstanding - end of period (millions)	15.2	4.3
Shares outstanding - weighted average (millions)	10.6	4.2
Statistics		
Lumber shipments (MMfbm)	152.6	103.6
Lumber production (MMfbm)	169.2	114.3
Average exchange rate - US$/Cdn$ (1)	0.971	0.880
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 255	$ 181
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 263	$ 205
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$188 - $320	$134 - $232

* Sales for 2009 reflect shipments for the nine-month period commencing April 2009.

** EBITDA represents earnings before interest, taxes, depreciation and amortization, as well as before deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures and other investments. The company discloses EBITDA as it is a measure used by analysts and the Company's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

(1) Source: Bank of Canada website www.bankofcanada.ca

(2) Source: Random Lengths Publications Inc.

Reconciliation of EBITDA to Net Loss

(millions of dollars)	**2010**	**2009**
Net loss	(10.8)	(10.3)
Add: Interest income	0.1	-
Depreciation and amortization	2.5	1.0
Deferred union payroll liability	0.5	0.5
Share based compensation	0.5	0.3
Accretion of convertible debentures	1.0	-
Revaluation of Fourth shares to fair value	0.5	-
EBITDA*	(5.7)	(8.5)

*May not total exactly due to rounding.

The Company did not commence commercial operations until the first quarter of 2009 and did not deliver its first shipment of lumber until the second quarter of 2009. Accordingly, information for periods prior to 2009 has not been presented above as management believes it is of little assistance to readers.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Operating Results by Business Segment

(millions of dollars)	2010	2009
Revenue		
Lumber	57.4	31.3
Bioenergy	-	-
	57.4	31.3
Net Loss		
Lumber	(5.6)	(9.9)
Bioenergy	(0.5)	-
Corporate costs and other items	(4.7)	(0.4)
	(10.8)	(10.3)
EBITDA		
Lumber	(2.3)	(8.1)
Bioenergy	(0.5)	-
Corporate costs and other items	(2.9)	(0.4)
	(5.7)	(8.5)

Lumber Segment

Overview

Residential construction activity in the U.S. has traditionally been a key determinant of North American lumber prices. In early 2009, U.S. housing starts were at 50-year lows and lumber prices were at 30-year lows. In 2010, U.S. housing starts were up marginally at 587,600 starts compared to 554,000 starts for 2009. In spite of the modest increase of just over 6% in housing starts, average lumber prices increased by almost 41% over average 2009 prices. Prices for WSPF 2x4 #2 & Btr ("WSPF") averaged US$255 during 2010 and US$181 during 2009[1]. As the Company commenced its lumber shipments in April of 2009, the relevant comparable period for 2009 is the last nine months during which period WSPF averaged US$191. Significantly increased demand from China for lumber products is considered to be a major contributing factor to the higher average price levels achieved this year.

The advantage from the year over year improvement in lumber prices was partially offset by the strengthening of the Canadian dollar relative to its US counterpart. During 2010, the Canadian dollar averaged $0.97 US[2], a 7% appreciation over the average rate during the last nine months of 2009. The average WSPF price for 2010 converted into Canadian funds improved by 25% over the equivalent average price during the last nine months of 2009.

The export tax rate charged on shipments of softwood lumber to the U.S. from British Columbia fluctuates based upon prices published by the Random Lengths Framing Lumber Composite Price. As the tax is intended to be punitive at lower price ranges, the export tax rate is reduced when the composite price level increases to specified levels and the increase is sustained over a specified period. During 2010, sustained lumber price rallies during February, March and April

[1] Prices as quoted in Random Lengths Publications Inc.

[2] Bank of Canada website www.bankofcanada.ca

reduced export tax rates during the ensuing three months. Export tax rates averaged 12.9% during 2010 and 15% throughout 2009.

The lumber segment recorded a net loss of $5.6 million on sales of $57.4 million for the year ended December 31, 2010 compared to a net loss of $9.9 million on sales of $31.3 million for the year ended December 26, 2009. EBITDA was negative $2.3 million for 2010 and negative $8.1 million for 2009.

Operating results for both 2010 and 2009 were negatively impacted by the segment's low overall operating rates of approximately 23% in 2010 and 15% in 2009 if measured against the current available capacity of approximately 745 million board feet on an annualized two-shift basis. The segment is currently incurring fixed costs capable of supporting near capacity operations. The introduction of a second shift at Fort St. James and at Mackenzie by the end of the second quarter of 2011 is expected to increase operating rates to over 70% on an annualized basis. The increase in production volume is the key element required to reduce unit manufacturing costs and generate positive EBITDA in this segment.

Higher sales revenues and increased production volumes resulted in slightly positive cash flow generated by the Fort St. James operations during 2010 compared to a negative EBITDA of $8.1 million in 2009. However, overall EBITDA in this segment in 2010 was reduced by fixed costs related to the idled Mackenzie operations and lower efficiencies as the mill proceeded through its start-up phase. The net loss for 2009 includes $1.6 million of idle costs related to the first quarter of 2009 before the Fort St. James mill commenced operations.

Sales

Lumber shipments totalled 153 million board feet during 2010 and 104 million board feet representing nine months of shipments during 2009. Lumber revenues were $50.2 million for 2010 and $27.5 million for 2009. Of the $22.7 million increase in sales revenue in 2010, approximately $13.7 million is attributable to increased shipment volumes and approximately $12 million is attributable to increased sales prices, offset by $3 million attributable to the appreciation in the Canadian dollar.

The table below shows the percentage of net lumber revenue earned from and volume shipped to each geographic market.

	2010	2009
By Revenue (net of freight)		
Canada	22%	26%
USA	36%	52%
Export	42%	22%
	100%	100%
By Shipment Volume		
Canada	18%	26%
USA	36%	52%
Export	46%	22%
	100%	100%

Export shipments consisted primarily of sales of low grade and commodity grade products to China and premium quality products to Japan. Year over year, Conifex has significantly reduced its reliance on the U.S. market by almost doubling the proportion of lumber sales revenue derived from export sales. The proportion of total lumber sales derived from the Canadian market has also decreased slightly.

In 2009, the proportion of net revenue earned from each market equals the proportion of total volume shipped to each market. This indicates that the overall spread between prices paid for various grades of lumber and the actual product mix shipped were such that the net revenue earned per thousand board feet from each market was virtually the same. The slight change in this aspect in 2010 was the result of a substantial increase in volume of premium products shipped to Canada.

Revenue from by-products of $7.2 million in 2010 and $3.8 million in 2009 accounted for approximately 13% and 12% of total revenue respectively. Approximately 54% of the $3.4 million increase in 2010 was attributable to increased volume and 46% to increased prices for residual wood chips which typically increase as NBSK pulp prices increase.

Production and Operations

Lumber production totalled 169 million board feet in 2010 compared to 114 million board feet in 2009. The Cap-Ex Program at the Fort St. James mill reduced planer production and efficiency at this location during 2010. The installation of a GradExpert Automated Grading system required a planned three week shutdown of the main planer mill in late April and early May. Although no downtime was taken at either the sawmill or planer mill during Phase Two of the program, planer productivity was negatively affected by the surrounding construction activity during the last two months of 2010. . Production at the Mackenzie mill was lower than would be under normal conditions due to typical start-up issues and downtime taken during the holiday season.

Cost of goods sold were $45.4 million in 2010 and $29.7 million in 2009. Per unit manufacturing costs from year to year were virtually the same except for amortization costs, which increased by $1.5 million in 2010 over 2009. The higher amortization costs are attributable to the increased production volume and increase in depreciable assets related to the recent capital expenditures. Also included in cost of goods sold are costs related to idled assets of $1.8 million in 2010 and $1.6 million in 2009.

Freight and distribution costs on a per unit basis are 12% higher in 2010 than 2009. The higher unit costs are attributable to the notable increase in shipments to export markets which have a higher per unit freight cost component.

Export taxes incurred during 2010 were significantly lower than for the comparable period last year despite a 33% increase in the average “free on board” mill price on which the export tax liability is calculated. The decrease was due primarily to the substantially reduced shipment volumes to the U.S. in favour of export markets during the most recent year and less significantly to a slight reduction in the average export tax rate to 12.9% from 15%.

Selling, general and administrative expenses related to the lumber segment increased by $1.7 million in 2010 over 2009. Approximately one-half of this increase is attributable to higher selling and shipping costs related to increased shipment volumes and one-half is attributable to increased administrative and compensation costs.

Bioenergy Segment

The Company has initiated an approximately $45 million bioenergy generation project at its Mackenzie sawmill site, currently scheduled for commercial production of electricity in the summer of 2012 (the “Bioenergy Project”). In connection with the Bioenergy Project, Conifex has entered into arrangements with a manufacturer for the manufacture and purchase of a 36 MW steam turbine generation set (the “Turbine”). The total cost of the Turbine and ancillary equipment and services is currently estimated at approximately U.S. $10.5 million. The Bioenergy Project is expected to generate approximately 230 GWh of net energy per year.

Conifex is in discussions with BC Hydro in connection with a proposed energy purchase agreement and with respect to establishing energy savings arrangements at its Mills. Such agreements and arrangements, if completed, will be subject to regulatory approval.

The biomass power generation segment will complement Conifex’s existing woodland operations and lumber manufacturing business. Waste fibre from Conifex’s sawmilling and timber harvesting operations will be used to fuel the bioenergy plant, which in turn will supply power to its sawmills and for potential sale to BC Hydro. In addition, the extraction of the Turbine has been sized to accommodate future lumber drying requirements of the Mackenzie operations.

As no agreement has yet been reached, and as any such agreement would be subject to regulatory approval, there can be no assurance that the Bioenergy Project will proceed as currently described or at all. In order to provide the necessary flexibility, the Turbine acquisition agreement contains cancellation rights in favour of Conifex that may be exercised if the Bioenergy Project does not proceed.

The net loss of $0.5 million in 2010 arises from the costs related to holding idled facilities such as insurance and property tax and to professional fees related to activities undertaken in the bioenergy segment.

Income Tax

The Company has non-capital loss carry forwards totalling $18 million as at December 31, 2010 and $12.4 million as at December 26, 2009. The Company has not recognized certain future income tax assets arising from loss carry-forwards available to reduce future taxable income. The future income tax assets have been reduced by a valuation allowance each year.

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Company's financial position as at the end of the years 2010 and 2009:

(millions of dollars)	2010	2009
Cash	26.6	6.1
Operating working capital	13.7	5.4
Assets held for sale	1.6	-
Current portion of long-term debt	(1.2)	-
Net working capital	40.7	11.5
Long -term assets	74.6	12.2
Net assets	115.3	23.7
Non-interest bearing long-term liabilities	7.2	0.8
Long-term debt	11.3	3.5
Shareholders' equity	96.8	19.4
	115.3	28.0
Total assets	126.5	27.3
Total liabilities	29.7	8.0

The Company strengthened its balance sheet and improved liquidity during 2010 by increasing its cash position by $20.5 million over 2009. The increase in operating working capital of $8.3 million is attributable to higher accounts receivable due to increased revenues and the sale of redundant assets, higher log inventories to support the start-up of the Mackenzie mill and the increased production at Fort St. James, and higher finished inventories reflecting increased shipments to export markets which require transit inventory to facilitate shipments by container vessels. Assets held for sale represent redundant assets acquired with the purchase of the Mackenzie Assets. A further asset from this pool was sold in January of 2011 for net proceeds of US$0.3 million. The current portion of long-term debt reflects the quarterly repayments that are payable on the CAF loan commencing in June of 2011.

Additions to long-term assets included $23 million related to the Cap-Ex program, $37.9 million related to the acquisition of the Mackenzie assets and $2.5 million related to capital expenditures to facilitate the start-up of the Site II mill at Mackenzie. The increases were offset by amortization of assets and by proceeds from the sale of redundant assets.

Non-interest bearing long-term liabilities includes reforestation liabilities of $5.1 million and environmental liabilities of $2 million assumed as part of the Mackenzie Acquisition.

Long-Term Debt

Long-term debt is comprised of the long-term portion of the CAF loan in the amount of $5.7 million and convertible notes in the amount of $5.6 million.

In August 2009, the Company secured a credit facility of $8.5 million under the Community Adjustment Fund loan program sponsored by the Northern Development Initiative Trust. The facility was increased by $0.1 million in November 2010 for total availability of $8.6 million. The CAF loan carries a fixed interest rate of 3.75% and is repayable in equal quarterly instalments over a five year period commencing June 1, 2011. Funds are advanced as capital expenditures are incurred. The Company drew down $7 million of this credit facility during 2010 and expects to draw down the remaining $1.6 million during the first half of 2011. Principal and interest repayments totalling $1.5 million are payable during 2011.

In December 2009, the Company issued convertible notes in two tranches in the aggregate principal amount of $10 million. The notes have a five year term and carry an interest rate of 2.5% from issue to December 15, 2012 to be settled in common shares and 10.5% thereafter to be settled in cash. The convertible notes mature on December 15, 2014 and are convertible at $8.00 per share. The Company has the option to redeem the notes on or after December 15, 2013 at a redemption price equal to the principal amount plus accrued and unpaid interest.

The convertible notes contain two components: liability and equity elements. The equity element is presented on the balance sheet under the heading "conversion option on convertible notes". The effective interest rate of the liability element on initial recognition was 22.5% and represented the estimated rate of borrowings on equivalent unsecured financing at the time of issuance. The note discount equal to the value of the conversion option is accreted over the term of the note.

On December 15, 2010 the Company paid interest due on the convertible notes by issuing 31,151 common shares as payment in kind and cash payments for fractional shares.

During January and February of 2011, the Company issued a total of 4,133 common shares to convert notes with principal amounts totalling $33,000 and to pay accrued interest.

CASH FLOW

During 2010 the Company used cash of $7.4 million in operating activities before changes in working capital compared to $8.7 million in 2009. Operating working capital changes used cash of $6.8 million in 2010 compared to $2.0 million in 2009. The increase in the current year was due to an increase in working capital required for the Mackenzie operation, increase in various prepayments, and increase in log inventory levels in preparation for increased production levels.

Major expenditures related to investing activities during 2010 included $23 million on the Cap-Ex Program at Fort St. James, net amount of $34.5 million on the purchase of the Mackenzie Assets and $2.5 million on capital projects and major maintenance to support the start-up of the Mackenzie Site II operations. Of the total $30 million committed to the Cap-Ex Program, $1 million was spent during the fourth quarter of 2009 and $23 million during 2010. Most of the remaining estimated $6 million required to complete the program will be disbursed in early 2011, with approximately $1.6 million of this amount to be funded by further proceeds from the CAF loan.

Financing activities during 2010 included net proceeds from the private placement of $85.9 million and proceeds from the issue of convertible debentures of $2 million. Financing activities during 2009 consisted of $1 million proceeds from the issuance of common shares and $7.6 million from the issue of convertible debentures.

The net increase in cash for 2010 was $20.6 million compared to a decrease in cash of $4.1 million for 2009. At December 31, 2010, the Company had cash on hand of $26.6 million.

LIQUIDITY

The Company's current principal sources of funds are cash flow from operations, cash on hand and its available credit facility related to the Cap-Ex Program at the Fort St. James Mill. The Company is seeking to secure additional credit facilities in 2011. The Company's principal uses of funds consist of operating and capital expenditures.

As part of its overall strategy, the Company may acquire businesses or additional assets from time to time as such opportunities arise. As a result, the Company may require substantial additional capital resources. The Company expects such additional capital resources will be generated from debt financing and/or the sale of equity securities.

The Company's working capital levels fluctuate throughout the year and are affected by maintenance downtime, changes in operating rates, changing sales patterns, seasonality and the timing of receivables and the payment of payables and expenses. The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the winter months to ensure adequate supply of fibre to its mills during the spring months. Changes in sales volume and price can affect the level of receivables and influence overall working capital levels. The significant increase in shipments to export markets in 2010 has increased the level of finished goods inventory typically held by the Company. Shipments of product to North American markets are invoiced to the customer on the date of shipment from the mill. Shipments to export customers are invoiced to the customer on the date the product is loaded on to the container ship. The typical time lapse between the date the product leaves the mill and the date it is loaded onto the vessel and becomes an accounts receivable is approximately three to four weeks. The Company believes its management practices with respect to working capital conform to common industry practices.

2011 Projected Capital Spending and Debt Repayments

As at December 31, 2010 the Company had working capital of $13.7 million and cash of $26.6 million. The Company intends to disburse the remaining $6 million previously committed to the Cap-Ex Program during the first quarter of 2011. The Company expects to draw down the remaining $1.6 million available on the CAF loan during the second quarter. The Company has committed an additional $4 million to be spent at the Fort St. James and Mackenzie mills on selected improvement projects with high returns.

The Bioenergy Project at Mackenzie is expected to cost approximately $45 million of which approximately $28 million is currently expected to be disbursed during 2011.

Repayments of principal and interest payable on the CAF loan will commence on a quarterly basis from June 2011 and total approximately $1.5 million for 2011.

Conifex intends to finance its planned capital expenditures and scheduled debt repayments from existing cash reserves, cash flow from operations, existing credit availability from the CAF loan, and additional credit facilities the Company is seeking to secure in 2011.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(millions of dollars except share and per share amounts)	2010 Q4	2010 Q3	2010 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1
Sales -Lumber	16.0	12.8	10.6	10.8	9.6	10.7	7.3	-
- By-products	2.2	1.7	2.0	1.3	1.2	1.2	1.1	0.2
Total Sales	18.2	14.5	12.6	12.1	10.8	11.9	8.4	0.2
Operating loss	(2.7)	(2.4)	(1.8)	(1.0)	(2.5)	(1.1)	(1.9)	(5.4)
Net loss	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)	(1.0)	(1.7)	(5.4)
Net loss per share - basic and diluted	(0.26)	(0.19)	(0.31)	(0.39)	(0.52)	(0.24)	(0.40)	(1.31)
EBITDA	(2.2)	(1.8)	(0.8)	(0.9)	(1.7)	(0.4)	(1.1)	(5.3)
Shares outstanding - end of period (millions)	15.2	15.1	15.1	4.3	4.3	4.3	4.3	4.1
Shares outstanding - weighted average (millions)	15.1	15.1	7.6	4.3	4.3	4.3	4.2	4.1
Statistics								
Lumber shipments (MMfbm)	49.0	40.2	30.7	32.8	36.2	39.3	28.0	-
Lumber production (MMfbm)	49.1	39.3	41.3	39.5	32.8	36.5	36.0	9.0
Average exchange rate - US$/Cdn$ (1)	0.987	0.962	0.973	0.961	0.947	0.912	0.858	0.803
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 268	$ 222	$ 266	$ 268	$ 205	$ 191	$ 174	$ 155
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 272	$ 230	$ 273	$ 279	$ 216	$ 209	$ 203	$ 193

(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.

Reconciliation of EBITDA to Net Loss

(millions of dollars)	2010 Q4	2010 Q3	2010 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1
Net loss	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)	(1.0)	(1.7)	(5.4)
Add:								
Depreciation and amortization	1.0	0.5	0.5	0.5	0.3	0.3	0.3	0.1
Deferred union payroll liability	0.2	0.2	-	0.2	0.2	0.2	0.2	-
Share based compensation	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Accretion of convertible debentures	0.3	0.3	0.5	-	-	-	-	-
Revaluation of Fourth shares to fair value	-	-	0.5	-	-	-	-	-
EBITDA*	(2.2)	(1.8)	(0.8)	(0.9)	(1.7)	(0.4)	(1.1)	(5.3)

*May not total exactly due to rounding.

The Company's financial results are impacted by a variety of market related factors including fluctuation in lumber prices, price fluctuations in commodities associated with revenue derived from by-products and movements in foreign exchange rates. Quarterly trends are also impacted by the seasonal nature of activities such as logging operations and construction and remodelling activity. Other more company specific factors that influence quarterly trends include operating rates and transactions of a non-recurring nature.

The Fort St. James mill was acquired in August 2008 but remained idle until the Company commenced operations on a one-shift basis in March 2009 and shipments in April 2009. The net loss in first quarter of 2009 reflects the fixed costs associated with the idled facility and an inventory valuation adjustment of $2.9 million that was reflective of the historically low lumber prices during that period.

The Mackenzie Assets were acquired in June of 2010. Manufacturing operations started at the Site II sawmill and planer mill on a one-shift basis in November of 2010 and a small volume of lumber was shipped in December of 2010 from this location. Shutdown costs directly related to the non-operational assets are included in the results of the third and fourth quarter of 2010.

COMPARISON OF QUARTER ENDED DECEMBER 31, 2010 AND QUARTER ENDED DECEMBER 26, 2009

Summarized operating results and statistics for each of the comparison periods below are provided below.

(millions of dollars except share and per share amounts)	Q4 - 2010	Q4 - 2009
Sales -Lumber	16.0	9.6
- By-products	2.2	1.2
Total Sales	18.2	10.8
Operating loss	(2.7)	(2.5)
Net loss	(3.9)	(2.2)
Net loss per share - basic and diluted	(0.26)	(0.52)
EBITDA	(2.2)	(1.7)
Shares outstanding - end of period (millions)	15.2	4.3
Shares outstanding - weighted average (millions)	15.2	4.3
Statistics		
Lumber shipments (MMfbm)	49.0	36.2
Lumber production (MMfbm)	49.1	32.8
Average exchange rate - US$/Cdn$ (1)	0.987	0.947
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 268	$ 205
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 272	$ 216
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$233 - $308	$177 - $232

(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.

Reconciliation of EBITDA to Net Loss

(millions of dollars)	Q4 - 2010	Q4 - 2009
Net loss	(3.9)	(2.2)
Add:		
Depreciation and amortization	1.0	0.3
Deferred union payroll liability	0.2	0.2
Share based compensation	0.3	0.1
Accretion of convertible debentures	0.3	-
EBITDA*	(2.2)	(1.7)

* May not total exactly due to rounding.

Operating Results by Business Segment

(millions of dollars)	Q4 - 2010	Q4 - 2009
Net Loss		
Lumber	(1.7)	(2.0)
Bioenergy	(0.2)	-
Corporate costs and other items	(2.0)	(0.2)
	(3.9)	(2.2)
EBITDA		
Lumber	(0.4)	(1.5)
Bioenergy	(0.2)	-
Corporate costs and other items	(1.6)	(0.2)
	(2.2)	(1.7)

Lumber Segment

Overview

During the fourth quarter of 2010, the Company commenced harvesting operations in October, manufacturing operations in November and lumber shipment in December at its Site II mill in Mackenzie. This location contributed 25% of the total volume produced during this quarter and 10% of total lumber shipments. Production at the Fort St. James mill, operated on a one-shift basis throughout both comparative periods, increased by 12% over the same quarter last year despite disruptions from the construction activities of the Cap-Ex Program.

Despite continued weakness in the U.S. housing sector during the fourth quarter of 2010, WSPF prices improved steadily from US$236 at the end of the third quarter to US$308 by the end of the year. The average WSPF price for the quarter was US$268, an improvement of 31% over the fourth quarter of 2009. The strength in prices was largely attributed to the continuing increased demand from China which, in the absence of a corresponding supply side response, impacts the lumber available for domestic markets. Prices were further buoyed as purchasers in the U.S. replenished lean inventories.

During the fourth quarter of 2010, the Canadian dollar averaged $0.99 US compared to $0.95 US for the same quarter last year. The export tax rate remained steady at 15% throughout both periods.

Increases in product shipments and prices combined to improve fourth quarter 2010 revenues by 67% over the fourth quarter of 2009. Net loss was $1.7 million for the quarter ended December 31, 2010 compared to $2 million for the quarter ended December 26, 2009. EBITDA was negative $0.4 million for the fourth quarter of 2010, an improvement of $1.9 million over the same quarter last year.

Fourth quarter 2010 results were hampered by reduced efficiencies related to the Cap-Ex Program at the Fort St. James mill and idle costs and low operating rates during the start-up period at Mackenzie.

Sales

Fourth quarter of 2010 lumber shipments totalled 49 million board feet, an increase of 35% over the same quarter last year. Approximately 13% of the increased volume was attributable to the commencement of shipments from the Mackenzie mill. Revenues totalled $18.2 million, an increase of 65% over last year with 54% of the increase attributable to increased volumes and 46% to higher unit prices achieved.

Export sales accounted for 53% of total net lumber revenue in the fourth quarter of 2010 compared to 34% during the same quarter last year.

Revenues from by-products increased by $1 million during the fourth quarter of 2010. Approximately 37% of the increase was attributable to improved prices and 63% to increased volumes.

Production and Operations

Total production during the fourth quarter of 2010 was 49 million board feet compared to 33 million board feet during the same quarter last year. Approximately 75% of the additional volume was from the start-up of the Mackenzie mill.

Cost of goods sold totalled $14.7 million for the fourth quarter of 2010 compared to $9.2 million for the fourth quarter of 2009. Of the $5.5 million increase, approximately $3.3 million was due to increased production volumes, $0.6 million to increased depreciation, $0.6 million to an inventory valuation adjustment, and the balance of $1 million to idle costs, higher unit costs as a result of inefficiencies related to the Mackenzie start-up and the disruption of the Cap-Ex program at Fort St. James.

Freight and distribution costs on a per unit basis were 5% higher during the fourth quarter of 2010 than the fourth quarter of 2009. The higher unit costs are attributable to the notable increase in shipments to export markets which have a higher per unit freight cost component.

The export tax rate remained at 15% during both quarters. The smaller than expected variance in the export tax expense from quarter to quarter is due to the significant reduction in shipment volumes to the U.S. market.

Selling, general and administrative expenses related to this segment were higher by $0.6 million in the fourth quarter of 2010 over the same quarter last year. The increase is attributable to higher selling and shipping costs related to increased shipment volumes and increased administrative costs related to the Mackenzie operations.

Bioenergy Segment

The net loss of $0.2 million reported for the fourth quarter of 2010 is attributable to fixed costs such as property tax and insurance and to professional fees.

Corporate costs and other items

Corporate costs and other items increased by $1.8 million during the fourth quarter of 2010 compared to the same quarter last year. The increase is a result of a year over year change of $0.9 million in unrealized lumber price derivatives, $0.2 in foreign exchange loss, $0.4 million in management and administrative expense and $0.3 million in accretion of convertible notes.

Cash Flow

During the fourth quarter of 2010, cash of $3.8 million was used in operating activities including changes in working capital. Investing activities of $8.4 million was comprised of $5.9 million spent on the Cap-Ex Program and $2.5 on capital projects at Mackenzie. Financing activity consisted of proceeds from the CAF loan of $2.7 million. Net cash usage during the quarter was $9.5 million.

OUTLOOK AND STRATEGY

Lumber Segment

Conifex's key priority in the short term continues to be to achieve positive EBITDA from operations. Conifex believes that the two principal obstacles to generating positive EBITDA in its lumber segment has been the historic lack of capital invested in the Fort St. James manufacturing facilities and the low operating rates to date. During 2010, the Company made considerable progress towards removing these obstacles by investing in the modernization of the Fort St. James facility and by starting one of the Mackenzie facilities on a one-shift basis. By moving to two-shift operations at both locations by the end of the second quarter of 2011, the Company expects to improve operating rates from the current rate of approximately 23% to over 70% during the last six months of 2011. The improved operating rate and the benefits of the capital expenditure program about to be completed at Fort St. James are designed to significantly reduce unit manufacturing costs. Conifex also intends to finalize its strategy with regards to the potential operation of its second sawmill at Mackenzie which currently remains idled.

Concurrent with its focus on increased production volumes, the Company intends to pursue opportunities to stabilize and maximize revenues by broadening markets in terms of both geographic areas and product offerings and by taking measures to attract competitive prices for residual products. The Company will seek to maximize returns by optimizing product mix, retaining the flexibility to participate in the most advantageous markets while strengthening relationships with existing customers and further expanding export markets.

In terms of market outlook, lumber demand from China is expected to remain strong in 2011 although sensitivity to certain price points may restrict price ranges and impact sales and shipment patterns. The U.S. housing market is expected to continue to stage a slow recovery while demand from Japan and Canada is expected to remain steady. Lumber prices will continue to be influenced by changes in general demand, demand for specific products and supply side response. Prices achieved as measured by the Random Length Framing Lumber Composite Index will determine the export tax rate which in turn will influence the dynamics of which markets are favourable to producers.

Bioenergy Segment

Conifex intends to focus on the appropriate oversight and management of its Bioenergy Project at Mackenzie. The Company also intends to pursue additional high return investment opportunities in this sector which are complementary to its existing operating facilities and assets.

CHANGES IN ACCOUNTING POLICY

Amendment IAS 39, *Financial Instruments - Recognition and Measurement*, is effective for the year ended December 31, 2010. The application of this standard amends the principles that affect a hedged risk. The adoption of this standard had no impact on the financial statements.

Amendment IFRS 7, *Financial Instrument Disclosures*, is effective for the year ended December 31, 2010. The application of this revised standard impacts the presentation and format of the primary statements and notes and these disclosures have been revised accordingly in the 2010 financial statements.

The following standards have been issued but are not yet effective:

		Effective for annual periods beginning on or after
IAS 24	(Revisions) Related party disclosures – which clarifies the definition of a related party	January 1, 2011
IFRS 9	(New standard) Financial Instruments – which introduces certain new requirements for the classification and measurement of financial assets	January 1, 2013
IFRIC 19	New Interpretation Accounting for situations where financial liabilities are settled using equity instruments	July 1, 2010

The Company is currently evaluating the impact of the adoption of these standards on its consolidated financial statements.

RISKS AND UNCERTAINTIES

Fluctuations in Prices and Demand

Conifex's financial performance is principally dependent on the demand for and selling price of lumber, which is subject to significant fluctuations. The markets for lumber are highly volatile and are affected by factors such as North American economic conditions, including the strength of the U.S. housing market, the growing importance of the Asian market, changes in industry production capacity, changes in inventory levels and other factors beyond Conifex's control. In addition, interest rates have a significant effect on residential construction and renovation activity, which in turn influence the demand for and price of lumber.

On an annualized basis and based upon 2010 production volumes, Conifex estimates that a price increase/decrease of U.S.$10 per thousand board feet of lumber would increase/decrease operating earnings by approximately U.S.$1.7 million. Swings in price greater than U.S.$10 per thousand board feet of lumber would have a lesser impact on operating earnings due to offsetting changes in stumpage fees.

The selling price of Conifex's residual wood chips is tied by formula to the net pulp realizations obtained by its wood chip customers, in Canadian dollars. Fluctuations in pulp prices and foreign currencies will accordingly impact the selling price of Conifex's residual wood chips.

Currency Risk

Most of Conifex's lumber is sold at prices denominated in U.S. dollars or based on prevailing U.S. dollar prices, but nearly all operating costs and expenses are incurred in Canadian dollars. Therefore, an increase in the value of the Canadian dollar relative to the U.S. dollar reduces the revenue in Canadian dollar terms realized by Conifex from sales in U.S. dollars, which reduces operating margin and cash flow available to fund operations. Conifex is also exposed to the risk of exchange rate fluctuations in the period between sale and payment. This results in significant earnings sensitivity to changes in the Canadian/U.S. dollar exchange rate.

Conifex does not currently hedge its foreign exchange exposure with financial forward or open contracts. The Canadian/U.S. dollar exchange rate is affected by a broad range of factors which makes future rates difficult to predict.

Conifex estimates that an increase or decrease of 1% in the value of the Canadian dollar per US$1.00 would decrease or increase, respectively, operating earnings by approximately $0.4 million based upon the level of 2010 shipments denominated in U.S. dollars.

Softwood Lumber Agreement

Conifex cannot predict with any certainty the export tax rate applicable to future lumber shipments or the potential application and timing of the surge tax. The Softwood Lumber Agreement has a term of seven years, and may be extended by another two years by mutual agreement of the parties. However, at any time after April 12, 2008, either party may terminate the Softwood Lumber Agreement by providing not less than six months notice to the other. Conifex cannot predict if the Softwood Lumber Agreement will be terminated before the expiration of its term, or what actions might be taken by the United States or Canada following such expiration or termination. Because of low lumber prices, the Canadian softwood industry has been paying the highest export charges mandated by the agreement since enactment, though such export charges decreased for several months in 2010.

On January 18, 2011, the US triggered the arbitration provision of the 2006 Softwood Lumber Agreement “SLA 2006” by delivering a Request for Arbitration. The US claims that BC had not applied the timber pricing system grand parented in SLA 2006. The US also claims that, post 2006, BC made additional changes to the timber pricing system which contributed to the under pricing of timber. The claim focuses on the substantial increases in Grade 4 log volumes commencing in 2007. It is also alleged that the failure to apply the market pricing system wrongly reduced the prices of Grade 1 and Grade 2 sawlogs. As the arbitration is a state-to-state international dispute under the SLA 2006, Canada is preparing a defence to the claim with the assistance of BC and BC industry. It is not possible at this time to predict the outcome or the value of the claim.

Potential Surge Tax

Under the Softwood Lumber Agreement, if monthly shipments from British Columbia's interior region exceed a certain prescribed volume, the applicable export rate for that month is increased by 50%. This would currently mean an increase from 15% to 22.5%. The calculation of prescribed volumes is based on estimated trailing U.S. lumber consumption. For the first six months of 2009, shipments from the interior region of BC were at 60% of the levels permitted under the Softwood Lumber Agreement.

Availability of Fiber and Changes in Stumpage Fees

Substantially all of Conifex’s log requirements are harvested from Crown lands in British Columbia. The Province prescribes the methodologies that determine the amount of stumpage fees that are charged in respect of harvesting on Crown lands and changes to the methodologies or rates may adversely affect Conifex's results.

Currently, the timberlands in which Conifex operates are owned by the Province of British Columbia and administered by the Ministry of Forests and Range. The *Forest Act* empowers the Ministry of Forests and Range to grant timber tenures to producers. The Provincial Chief Forester must conduct a review of the allowable annual cut ("AAC") for each timber supply area on a periodic basis, which is usually once every five 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.

Competition

Markets for Conifex's lumber are highly competitive. Conifex's ability to maintain or improve the cost of producing and delivering products to those markets is crucial. Factors such as cost and availability of raw materials, energy and labor, the ability to maintain high operating rates and low per-unit manufacturing costs, and the quality of Conifex's final products and customer service all affect earnings. Additionally, Conifex's products are sold in markets where Conifex competes against many producers of larger capacity. Many of Conifex's competitors have existed for a longer period and have significantly greater financial resources.

Operational Curtailments

From time to time, Conifex may suspend operation of its sawmills or one of its logging operations in response to market conditions, environmental risks, workplace safety concerns or other operational issues, including power failure, equipment breakdown, dry forest conditions, adverse weather conditions, labor disruptions and fire hazards. These unscheduled operational suspensions could have a material adverse effect on Conifex's financial condition. Furthermore, pulp and paper mill production curtailments may require sawmills to find other ways to dispose of residual wood fiber and may result in curtailment or suspension of lumber production.

Transportation Limitations

Conifex relies primarily on third parties for the delivery of raw materials and the transportation of its products. From time to time, Conifex must also respond to rail car and truck shortages that limit raw material deliveries to it and/or product deliveries to customers, which may have a material adverse effect on Conifex's business.

Bioenergy Project

Conifex commissioned a feasibility study and conducted extensive due diligence prior to the Company's commitment to the Bioenergy Project at its Mackenzie sawmill site. Due diligence activities included extensive analysis of the Bioenergy Project plan by several independent industry experts. The Bioenergy Project is designed to employ dedicated in-house project managers, proven technology and equipment, experienced equipment manufacturers and installers, and experienced engineers and other professionals. The project plan and budget includes the commitment of considerable resources to the pre-production phase to ensure trained personnel and proven processes are in place and tested well before the commercial operation date. Despite these and other management practices, there are a variety of risks related to the Bioenergy Project. Risks include the failure to obtain the required regulatory approvals, cancellation penalty payable to a major equipment manufacturer if the project does not proceed, failure of the project to complete on time, on budget or at all, financial penalties if the project does not generate the contracted amount of energy, failure to attract required personnel and skills to operate the facilities, and failure of the equipment and technology to perform as expected. The realization of any of these risks could have a material adverse effect on Conifex's business, financial condition and operating results.

Capital Projects

Conifex undertakes ongoing maintenance activities and capital improvement projects at its manufacturing facilities. Capital projects require significant commitment of the Company's financial and other resources and the results of the project may not be immediately known or assessable. Conifex conducts extensive cost-benefit and other analysis prior to the commencement of each capital project to measure the feasibility and expected benefits of proposed projects against pre-established criteria. Each capital project is approved by the Company's Board of Directors. Conifex assigns experienced project managers to each project, employs proven technology, commits other resources as required and conducts post-project analysis to measure actual benefits to expected benefits. Conifex is subject to numerous risks related to the undertaking of capital projects, including extensive reliance on third party equipment manufacturers and installers, material cost and time overruns, equipment or technology failure, major unplanned disruptions to existing operations, and the failure of the completed project to deliver expected benefits. The realization of any of these risks could have a material adverse effect on Conifex's business, financial condition and operating results.

Labor Relations

Conifex employs a unionized work force in its sawmilling operations. While Conifex believes that its current labor relations are stable and does not anticipate any related disruptions to its operations in the foreseeable future, walkouts or strikes by employees could result in lost production and sales, higher costs and supply constraints that could have a material adverse impact on Conifex's business. Conifex also depends on a variety of third parties that employ unionized workers to provide critical services. Labor disputes experienced by these third parties could lead to disruptions at Conifex's facilities.

Natural Disasters

Conifex's operations are subject to adverse natural events such as forest fires, severe weather conditions, timber disease and insect infestation, and earthquake activity. These events could damage or destroy Conifex's physical facilities or its timber supply and similar events could also affect the facilities of its suppliers or customers. Any such damage or destruction could adversely affect Conifex's financial results. Although Conifex believes that it has reasonable insurance arrangements in place to cover certain of these incidents, there can be no assurance that these arrangements will be sufficient to fully protect Conifex against such losses. As is common in the industry, Conifex does not insure loss of standing timber for any cause.

Conifex's timber tenures are subject to the risks associated with standing forests, in particular forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to manage such risk through prevention and early detection. Most of the timber that Conifex harvests comes from Crown tenures, and insurance coverage is maintained only for loss of logs due to fire and other occurrences following harvesting. However, this coverage does not extend to standing timber, and there is no assurance that this coverage would be adequate to provide protection against all eventualities, including natural catastrophes.

In addition, Conifex's operations may be adversely affected by severe weather including wind, snow and rain that may result in Conifex's operations being unable to harvest or transport logs to Conifex's sawmills. Conifex is unable to predict the impact of all these factors on its tenures or its forest practices.

While Conifex maintains insurance coverage to the extent deemed prudent, Conifex cannot predict that all potential insurable risks have been foreseen or that adequate coverage is maintained against known risks.

Mountain Pine Beetle

The long-term effect of the MPB infestation on Conifex's operations is uncertain. The potential effects include a reduction in future AAC levels to below current and pre−MPB AAC levels, a diminished grade and volume of lumber recoverable from MPB−killed logs, decreased quality of wood chips produced from such logs, and increased production costs. The timing and extent of the effect on Conifex's timber supply, lumber grade and recovery, wood chip quality and production costs will depend on a variety of factors which cannot be determined at this time with any certainty.

Environment

Conifex's operations are subject to regulation by federal and provincial environmental authorities, including industry specific environmental regulations relating to air emissions and pollutants, wastewater discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Conifex's business, operations, financial condition and operational results.

Conifex may discover currently unknown environmental problems, contamination or conditions relating to its past or present operations. This may require site or other remediation costs to maintain compliance or correct violations or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Conifex's business, financial condition and operational results.

Conifex has in place internal programs under which all its forestry and manufacturing operations are audited for compliance with laws and accepted standards and with its management systems. Conifex's woodlands operations and the harvesting operations of its key suppliers are third-party certified to internationally-recognized sustainable forest management standards. Conifex's operations and its ability to sell products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, including responsible environmental and sustainable forestry standards.

Both the Fort St. James mill and the Mackenzie mills are currently in material compliance with all applicable environmental regulations.

First Nations Claims

Failure of the government of British Columbia to adequately discharge it obligations to First Nations groups may affect the validity of its actions in dealing with public rights, including the granting of Crown timber harvesting rights. Conifex cannot assure that First Nations claims will not in the future have a material adverse effect on its timber harvesting rights or its ability to exercise or renew them or secure other timber harvesting rights.

Regulatory Risks

Conifex's operations are subject to extensive general and industry-specific federal, provincial, municipal and other local laws and regulations, including those governing forestry, exports, taxes, employees, labor standards, occupational health and safety, waste disposal, environmental protection and remediation, protection of endangered and protected species and land use and expropriation. Conifex is required to obtain approvals, permits and licences for its operations, which may impose conditions that must be complied with. If Conifex is unable to extend or renew, or are delayed in extending or renewing, a material approval permit, or licence, Conifex's operations or financial condition could be adversely affected. There is no assurance that these laws, regulations or government policy, or the administrative interpretation or enforcement of existing laws and regulations, will not change in the future in a manner that may require Conifex to incur significant capital expenditures or could adversely affect its operations or financial condition. Failure to comply with applicable laws or regulations, including approvals, permits and licences, could result in fines, penalties or enforcement actions, including orders suspending or curtailing Conifex's operations or requiring corrective measures or remedial actions.

Liquidity Risk

Liquidity risk is the risk that Conifex will be unable to meet its financial obligations on a current basis. Conifex manages liquidity risk through regular cash-flow forecasting and undertaking appropriate financing activities as required. Conifex has forecasted financial results and cash flows for 2011 based upon management's best estimates of operating conditions. Based on these forecasts, the Company currently expects sufficient liquidity will be available to meet its obligations in 2011. The Company also intends to secure additional credit facilities in 2011. Although Conifex believes its actions will result in sufficient liquidity, there can be no assurance that it will be successful or that market forces or competition will not work to offset its actions.

OUTSTANDING SECURITIES

As at March 4, 2011, the Company had 15,172,142 issued and outstanding common shares, 100,000 options granted under the Company's stock option plan dated June 3, 2010, 335,364 long-term incentive plan awards issued under the Company's long-term incentive plan dated June 3, 2010, and stepped rate subordinated convertible promissory notes in the aggregate principal amount of $9,967,000, which notes are convertible into a maximum of 1,245,875 common shares of the Company, excluding any common shares issuable in payment of accrued interest thereon.

ADDITIONAL INFORMATION

Additional information about the Company is available on SEDAR at www.sedar.com.