Consolidated financial statements of

Conifex Timber Inc.

December 31, 2013 and 2012

Conifex Timber Inc.
December 31, 2013 and 2012

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February 21, 2014

Independent Auditor's Report

To the Shareholders of Conifex Timber Inc.

We have audited the accompanying consolidated financial statements of Conifex Timber Inc., which comprise the consolidated balance sheets as at December 31, 2013 and December 31, 2012 and the consolidated statements of net income (loss) and comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Conifex Timber Inc. as at December 31, 2013 and December 31, 2012 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

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Conifex Timber Inc.

Consolidated statements of net income (loss) and comprehensive income (loss)
Years ended December 31, 2013 and 2012

		Year ended December 31,	
(thousands of Canadian dollars)	Notes	**2013**	2012
		$	$
Revenue	7	**259,599**	217,590
Costs and expenses			
Cost of goods sold		**194,051**	179,513
Freight and distribution costs		**39,948**	35,602
Export taxes		**617**	4,647
Selling, general and adminstrative	8	**12,165**	10,744
		246,781	230,506
Operating income (loss)		**12,818**	(12,916)
Loss on disposal of assets		**(23)**	(271)
Interest expense and accretion	9	**(3,963)**	(3,537)
Other income		**428**	1,021
Foreign exchange gain (loss)		**286**	(473)
		(3,272)	(3,260)
Income (loss) before tax		**9,546**	(16,176)
Current tax	10	**-**	9
Net income (loss) and comprehensive income (loss) for the year		**9,546**	(16,185)
Net income (loss) per share, basic and diluted (in dollars)	11	**0.46**	(0.86)

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated balance sheets
as at December 31, 2013 and 2012

(thousands of Canadian dollars)	Notes	As at December 31, 2013	As at December 31, 2012
		$	$
Assets			
Current assets			
Cash	12	**17,416**	12,061
Cash equivalents - restricted	12	**1,193**	2,002
Trade and other receivables	13	**16,243**	16,802
Prepaid expenses and deposits		**6,063**	5,541
Inventories	14	**37,767**	20,395
Assets held for sale	15	**-**	515
Current assets		**78,682**	**57,316**
Goodwill	16	**2,066**	2,066
Intangible assets	16	**8,069**	8,272
Property, plant and equipment	17	**137,549**	100,688
Deposits		**415**	335
Total assets		**226,781**	**168,677**
Liabilities			
Current liabilities			
Trade payables, accrued liabilities and other payables	18	**28,763**	24,385
Current portion of reforestation obligations	19	**4,043**	3,995
Employee liabilities	21	**2,226**	3,334
Notes payable	23	**-**	12,000
Current portion of convertible notes	23	**8,825**	-
Current portion of long-term debt	23	**2,076**	1,873
Current liabilities		**45,933**	**45,587**
Reforestation obligations	19	**3,196**	3,376
Environmental liabilities	20	**1,688**	1,797
Other long-term liabilities	22	**7,960**	3,865
Convertible notes	23	**-**	7,772
Long-term debt	23	**51,677**	4,060
Non-current liabilities		**64,521**	**20,870**
Total liabilities		**110,454**	**66,457**
Equity			
Share capital	24	**155,493**	154,896
Conversion option on convertible notes	23	**5,125**	5,170
Contributed surplus		**6,322**	2,313
Deficit		**(50,613)**	(60,159)
Total equity		**116,327**	**102,220**
Total liabilities and equity		**226,781**	**168,677**

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated statements of changes in equity
Years ended December 31, 2013 and 2012

(thousands of Canadian dollars)	Share capital	Conversion option on convertible notes	Contributed surplus	Deficit	Total equity
	$	$	$	$	$
Balance at December 31, 2011	**118,582**	**5,170**	**1,670**	**(43,974)**	**81,448**
Net loss for the year ended December 31, 2012	-	-	-	(16,185)	(16,185)
Private placement of common shares, net of issue costs	35,613	-	-	-	35,613
Issue of common shares upon vesting of share-based payments	453	-	(311)	-	142
Issue of common shares for payment in kind of interest on convertible notes	248	-	-	-	248
Recognition of share-based payments	-	-	954	-	954
Balance at December 31, 2012	**154,896**	**5,170**	**2,313**	**(60,159)**	**102,220**
Net income for the year ended December 31, 2013	-	-	-	9,546	9,546
Issue of common shares upon conversion of notes	85	(45)	-	-	40
Recovery of costs for private placement of common shares	4	-	-	-	4
Issue of common shares upon vesting of share-based payments	508	-	(423)	-	85
Cash settlement of stock options	-	-	(417)	-	(417)
Issue of warrants on secured notes	-	-	320	-	320
Issue of warrants on senior secured notes	-	-	3,611	-	3,611
Recognition of share-based payments	-	-	918	-	918
Balance at December 31, 2013	**155,493**	**5,125**	**6,322**	**(50,613)**	**116,327**

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated statements of cash flows
Years ended December 31, 2013 and 2012

(thousands of Canadian dollars)	Year Ended December 31, 2013	2012
	$	$
Cash flows from operating activities		
Net income (loss)	**9,546**	(16,185)
Items not affecting cash:		
Depreciation and amortization	**8,637**	7,560
Change in mark-to-market value of lumber price derivatives	**28**	(81)
Change in reforestation obligations	**(132)**	(578)
Interest expense and accretion	**3,963**	3,537
Share-based compensation	**574**	1,019
Other	**53**	560
	22,669	(4,168)
Change in:		
Trade and other receivables	**543**	(7,271)
Prepaid expenses and deposits	**(530)**	(2,505)
Inventories	**(17,372)**	(207)
Trade payables, accrued liabilities and other payables	**8,152**	6,890
Employee liabilities	**(1,119)**	858
Environmental liabilities	**(109)**	(243)
Net cash provided from (used in) operating activities	**12,234**	(6,646)
Cash flows from investing activities		
Additions to property, plant and equipment	**(46,985)**	(28,838)
Proceeds on disposal of assets held for sale	**-**	414
Net cash used in investing activities	**(46,985)**	(28,424)
Cash flows from financing activities		
Private placement of common shares, net of issue costs	**4**	35,613
Incentive funding received	**3,313**	3,312
Finance fees for senior secured notes and senior secured revolving asset backed credit facility	**(561)**	-
Proceeds of secured notes	**5,000**	-
Proceeds of senior secured notes	**30,000**	-
Proceeds from construction loan	**22,760**	-
Repayment of short-term debt	**(17,000)**	-
Repayment of long-term debt	**(1,759)**	(1,694)
Interest expense paid	**(2,460)**	(817)
Net cash provided from financing activities	**39,297**	36,414
Net increase in cash and cash equivalents	**4,546**	1,344
Cash and cash equivalents, beginning of year	**14,063**	12,719
Cash and cash equivalents, end of year	**18,609**	14,063

The accompanying notes are an integral part of these consolidated financial statements.

In these notes, “Conifex” or the “Company” means Conifex Timber Inc. and its subsidiaries.

1. GENERAL INFORMATION

The primary business of Conifex in its lumber segment includes timber harvesting, reforestation, forest management, sawmilling logs into lumber and wood chips, and value added lumber finishing. Conifex's lumber products are sold in the United States, Chinese, Canadian and Japanese markets. The primary activity in its bioenergy segment is the development of a power generation plant at Mackenzie, BC.

Conifex is a publicly traded company listed on the TSX Venture Exchange under the symbol CFF. The Company is incorporated under the *Canada Business Corporations Act* and is headquartered in Vancouver, BC, Canada.

The address of its registered office is 1000 Cathedral Place, 925 West Georgia Street, Vancouver, BC V6C 3L2.

These consolidated financial statements were approved by the Board of Directors on February 21, 2014.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of Conifex have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of consolidated financial statements in conformity with IFRS requires the use of critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company’s accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in note 4.

2.2 Changes in accounting policy and disclosures

(a) New and amended standards adopted by the Company

The Company has adopted the following new and amended standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

IFRS 10, “Consolidated Financial Statements”; IFRS 11, “Joint Arrangements”; and IFRS 12, “Disclosure of Interests in Other Entities”, were issued by the IASB in May 2011. These new standards provide more guidance on the identification of entities and joint arrangements that should be included in the consolidated statements of a parent company and also require additional disclosure of all forms of interests that an entity holds. The Company has assessed its consolidation conclusion and determined that the adoption of these standards did not result in any change in the consolidation status of any of its subsidiaries.

IFRS 13, “Fair Value Measurement”, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used to measure fair value and did not result in any measurement adjustments.

International Accounting Standards ("IAS") 1, "Presentation of Financial Statements", was amended to require the grouping together of other comprehensive income items that may be reclassified in the future to the statement of earnings within other comprehensive income. The adoption of the amendments to IAS 1 did not result in any adjustments to other comprehensive income.

(b) New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2013 and not early adopted

IFRS 9, "Financial Instruments", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and further amended in October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. IFRS 9 also provides for new measurement guidance for financial liabilities designated at fair value through profit or loss. In December 2011, the IASB deferred the mandatory effective date of IFRS 9 to annual periods beginning on or after January 1, 2015. The Company has not yet determined the impact of this standard on its consolidated financial statements.

2.3 Consolidation

Subsidiaries are all entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

The Company applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary includes the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree, the fair value of any asset or liability resulting from a contingent consideration arrangement, and any cash consideration paid. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

Acquisition-related costs are expensed as incurred.

Any contingent consideration to be transferred by the Company is recognized at fair value upon the acquisition date. Subsequent changes to the fair value of the contingent consideration are recognized either in profit or loss or as a change to other comprehensive income.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

Inter-company transactions, balances, income and expenses are eliminated on consolidation, where appropriate. Profits and losses resulting from inter-company transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

2.4 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions.

2.5 Foreign currency translation

The Canadian dollar is the functional and presentation currency of the Company. Foreign currency-denominated monetary assets and liabilities of the Company are translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Gains or losses on translation of these items are included in earnings.

2.6 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditures that are directly attributable to the acquisition of the assets.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land and assets classified as held for sale are not depreciated. Buildings and fixtures and computer hardware are depreciated on a straight-line basis over their estimated useful life. Machinery, mobile and other production equipment are depreciated using the units of production basis. This method amortizes the cost of equipment over the estimated units that will be produced during its estimated useful life. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Estimated useful lives of non-manufacturing property, plant and equipment are reflected with the following rates:

Buildings and fixtures	2% - 5%
Machinery and equipment	5% - 33%
Mobile equipment	20% - 50%
Computer hardware	10% - 33%

The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over their useful lives. These periods are assessed at least annually to ensure that they continue to approximate the useful lives of the related assets. The carrying amount of an asset is written down immediately to its recoverable amount if it is determined to be greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the income statement.

2.7 Goodwill and intangible assets

(a) Goodwill

Goodwill arises on the acquisition of subsidiaries and associates and represents the excess of the consideration transferred over the fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. Goodwill impairment is assessed by comparing the fair value of the cash generating unit ("CGU") to the underlying carrying amount of the CGU's net assets, including goodwill. When the carrying amount of the CGU exceeds its fair value, the fair value of the CGU's goodwill is compared with its carrying amount to measure the amount of impairment loss, if any.

(b) Other intangible assets

Other intangible assets, comprising forestry licences and software licences, are stated at cost less accumulated amortization.

The forestry licences are amortized on a straight-line basis over 60 years. Software licences are amortized on a straight-line basis over 3 years.

2.8 Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.9 Assets held for sale

Assets are classified as held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell. Assets held for sale are not depreciated once they are classified as held for sale, but are tested for impairment.

2.10 Financial assets – loans and receivables

The Company classifies non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. Loans and receivables are recorded at amortized cost using the effective interest method, less any impairment.

Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial. Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated future cash flows of the asset have been impacted.

2.11 Derivative financial instruments and hedging activities

The Company utilizes derivative financial instruments to manage its commodity lumber price exposures in the ordinary course of business and interest rate variability. Lumber derivatives are initially recognized at fair value on the date a lumber derivative contract is entered into and are subsequently re-measured at their fair value. The fair values are determined by using observable market inputs for identical assets and liabilities and thus reflect the estimated amount that the Company would have paid or received if required to settle all outstanding contracts at period end. The resulting gain or loss is recognized as a gain (loss) on lumber derivative instruments each period unless the lumber derivative is designated as a hedging instrument under IFRS. If the lumber derivative is designated as a hedging instrument, any unrealized gains or losses are deferred and recognized in earnings when the related hedge transaction occurs.

2.12 Inventories

Logs and lumber inventories are valued at the lower of average cost and net realizable value. The cost of logs and lumber comprises all costs that relate to purchasing, harvesting and delivery of the logs to their present location, plus costs of production, including labour, overhead and amortization. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost for completion and applicable variable selling expenses.

Operating and maintenance supplies are valued at the lower of average cost and replacement cost.

2.13 Trade receivables

Trade receivables are amounts due from customers for products sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

2.14 Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents include cash in hand, deposits held with banks, other short-term highly liquid investments, and bank overdrafts.

2.15 Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares or options are shown in equity as a deduction from the proceeds.

2.16 Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

2.17 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Fees paid on establishment of loan facilities are capitalized and amortized over the term of the facility to which they relate.

2.18 Borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.19 Compound financial instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition.

The liability component is classified as current liability if the maturity date is within 12 months of the end of the reporting period. If not, it is classified as a non-current liability.

2.20 Current and deferred income tax

The tax expense for the period comprises current and deferred tax.

Current income tax is the expected tax payable on the taxable income for the period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

2.21 Employee benefits

(a) Retirement benefit costs

Contributions to defined contribution retirement benefit plans are recognized as an expense when employees have rendered service entitling them to the contributions.

(b) Share-based payments

The Company operates a share compensation plan and a stock option plan under which the Company grants equity instruments as consideration for services from directors, employees and consultants. The fair value of the equity instrument and the employee services received in exchange for the grant of the options or share awards is measured at the grant date.

The share awards and stock options vest over multiple periods. The fair value of each tranche is considered to be a separate grant based on its vesting period. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period based on the Company's estimate of equity instruments that will eventually vest.

2.22 Warrants

The Company measures warrants at the issue date using the Black-Scholes pricing model.

2.23 Provisions

Provisions for reforestation, environmental restoration, restructuring costs and legal claims are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is charged to the income statement in the same expense category as the original expense related to the obligation.

2.24 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods supplied, stated net of returns and value added taxes. The Company recognizes revenue when the amount of revenue can be reliably measured, the significant risks and rewards of ownership are passed to the customer, and collectability is reasonably assured.

2.25 Interest income

Interest income is recognized using the effective interest method. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

2.26 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

2.27 Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to property, plant and equipment are recorded as a reduction to the cost base of the related asset and are credited to the income statement through the recognition of a lower depreciation expense than would be recognized in the absence of the grant.

Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, commodity price risk and interest rate risk), credit risk and liquidity risk. The Company's overall financial risk management activities focus on the unpredictability of financial markets and seek to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

The Company's financial risk management activities are governed by Board-approved financial policies that cover risk identification, tolerance, measurement, hedging limits, hedging products, and authorization levels.

(a) Market risk

(i) Foreign exchange risk

The Company is exposed to currency risk, primarily with respect to the US dollar, as its products are sold principally in US dollars and its costs of production are incurred principally in Canadian dollars. Foreign exchange risk arises from future commercial transactions and recognized assets and liabilities. The Company does not currently use financial derivative instruments for its foreign exchange risk management program.

As at December 31, 2013, the Company's US dollar denominated accounts receivable totaled US $7,697,774 (2012 – US $4,835,466) and accounts payable totaled US $1,627,193 (2012 – US $3,795,020). The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US $1.00 during 2013 would have decreased or increased, respectively, annual operating earnings by approximately $1,240,000.

(ii) Commodity price risk

The Company is exposed to commodity price risk related to the sale of lumber and residual products and purchase of certain manufacturing inputs which are purchased primarily on the open market. From time to time, the Company enters into futures contracts on the Chicago Mercantile Exchange to reduce its exposure to risks associated with fluctuations in lumber prices. At December 31, 2013, the fair value of non-covered outstanding commodity financial instruments was $573,527 (2012 – $672,896). The fair value of these instruments was determined based on market rates for instruments with similar characteristics. An increase (decrease) in the futures market price of lumber of US $10 per thousand board feet would result in a pre-tax gain (loss) of approximately US $145,200 in relation to the lumber futures held at year end.

(iii) Interest rate risk

Exposure to interest risk arises primarily when financial assets and financial obligations bear variable interest rates. At December 31, 2013, the Company's financial obligations bearing variable interest rates totaled $16,400,000 (2012 – nil). The Company utilizes interest rate swaps to reduce its interest rate risk associated with its financial obligations that bear variable interest rates. At December 31, 2013, the Company had $19,067,614 in fixed interest rate swaps with a maturity date of September 30, 2014. The Company had no interest rate swaps at December 31, 2012.

(b) Credit risk

Credit risk is the risk of financial loss to the Company in the event a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily related to its accounts receivable balances. The Company's credit department is responsible for managing and analyzing the credit risk for each new client before standard payment and delivery terms and conditions are offered. The Company utilizes a combination of credit insurance, letters of credit and self-insurance to manage risks associated with its accounts receivable. Management regularly reviews the collectability of accounts receivable and makes provisions where the collectability is uncertain. The Company does not have significant credit risk related to its cash and cash equivalent balances as deposits are held with a major Canadian bank.

(Tabular amounts expressed in thousands except per share amounts)

(c) Liquidity risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations on a current basis. The Company manages liquidity risk by regularly performing rolling cash flow forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs and commitments. Management uses cash flow forecasts to identify financing requirements, which are then addressed through a combination of committed credit facilities and access to capital markets.

Repayment of amounts due within one year is typically funded by cash on hand, cash flow from operations and normal collection of current trade accounts receivable.

3.2 Capital management

The Company's objective when managing capital is to maintain a strong balance sheet that ensures adequate capital resources to support operations and to sustain future business development.

The Company monitors capital on the basis of the net debt to total capitalization ratio. Net debt is calculated as current and non-current borrowings including the present value of convertible notes (note 23) less cash and cash equivalents. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

The Company's capital structure at year end consisted of the following:

	2013	2012
	$	$
Borrowings, current	**10,901**	13,873
Borrowings, non-current	**51,677**	11,832
Less: Cash and cash equivalents	**(18,609)**	(14,063)
Net debt	**43,969**	11,642
Shareholders' equity	**116,327**	102,220
Total capitalization	**160,296**	113,862
Net debt to capitalization	**27%**	10%

The Company's capital structure, excluding non-recourse borrowings, at year end consisted of the following:

	2013	2012
	$	$
Borrowings, current	**10,901**	13,873
Borrowings, non-current (excluding non-recourse borrowings)	**28,917**	11,832
Less: Cash and cash equivalents	**(18,609)**	(14,063)
Net debt	**21,209**	11,642
Shareholders' equity	**116,327**	102,220
Total capitalization	**137,536**	113,862
Net debt to capitalization	**15%**	10%

Non-recourse borrowings refer to the Construction Facility described in note 23. There were no changes in the Company's approach to capital management during the year.

(Tabular amounts expressed in thousands except per share amounts)

3.3 Fair value estimation

The Company's accounts receivable, other deposits and advances, notes payable, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition.

Cash and cash equivalents and derivative instruments are measured at fair value.

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are classified within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The following table summarizes the Company's financial instruments at December 31, 2013 and 2012, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

	Fair value hierarchy Level	**2013**	2012
		$	$
Financial assets			
Held for trading			
Derivative financial instruments	Level 2	**574**	673
		574	673

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of consolidated financial statements in conformity with IFRS requires management to make critical judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could materially differ from those estimates.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and judgments have been applied in a manner consistent with prior periods. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include valuation of inventory, income taxes, provision for accrued liabilities, environmental and reforestation obligations, share-based compensation, impairment and contingencies.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(Tabular amounts expressed in thousands except per share amounts)

5. SEASONALITY OF OPERATIONS

The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the winter months, primarily December to March, to ensure adequate supply of fibre to its mills during the spring months when logging operations are largely curtailed due to road conditions.

6. SEGMENT INFORMATION

The Company is organized into business units based on its products and services and has two reportable segments as follows:

- Lumber - The main activities of the lumber segment include timber harvesting, reforestation, forest management, and the manufacture, sale and distribution of dimension lumber. The Company markets and distributes its lumber products through its wholly-owned subsidiaries, Conifex Fibre Marketing Inc. ("CFMI") and Navcor Transportation Services Inc. ("Navcor"). Both CFMI and Navcor generate additional revenue from third party transactions.

- Bioenergy - The primary activities of the bioenergy segment are the development of a power generation project at Mackenzie, BC and the development of other opportunities in bioenergy and bioproducts which are complementary to the Company's harvesting and manufacturing operations.

Summary by segment:

	Lumber	Bioenergy	Corporate & other	Consolidated
	$	$	$	$
Year ended December 31, 2013				
Sales to external customers	259,599	-	-	259,599
Operating income (loss)	18,239	(489)	(4,932)	12,818
Loss on disposal of assets	(23)	-	-	(23)
Interest expense	-	-	(2,940)	(2,940)
Other income	428	-	-	428
Foreign exchange gain	-	-	286	286
Accretion of convertible debenture	-	-	(1,023)	(1,023)
Income tax	-	-	-	-
Net income (loss)	18,644	(489)	(8,609)	9,546
Depreciation and amortization	8,589	-	47	8,636
Capital expenditures	15,791	29,055	-	44,846
Identifiable assets	134,864	69,000	22,917	226,781

(Tabular amounts expressed in thousands except per share amounts)

	Lumber	Bioenergy	Corporate & other	Consolidated
Year ended December 31, 2012				
Sales to external customers	217,590	-	-	217,590
Operating loss	(8,494)	(1,016)	(3,406)	(12,916)
Loss on disposal of assets	(271)	-	-	(271)
Interest expense	-	-	(2,508)	(2,508)
Other income	1,021	-	-	1,021
Foreign exchange loss	-	-	(473)	(473)
Accretion of convertible debenture	-	-	(1,029)	(1,029)
Income tax	-	-	(9)	(9)
Net loss	(7,744)	(1,016)	(7,425)	(16,185)
Depreciation and amortization	7,528	-	32	7,560
Capital expenditures	9,472	22,603	-	32,075
Identifiable assets	112,561	40,590	15,526	168,677

Revenues by geographic area were as follows:

	2013	2012
	$	$
United States	**92,146**	75,912
China and other	**82,001**	66,169
Canada	**55,837**	65,618
Japan	**29,615**	9,891
	259,599	217,590

All of the Company's harvesting and manufacturing operations are located in the interior region of British Columbia.

7. REVENUE

	2013	2012
	$	$
Lumber	**224,773**	184,365
By-product *	**20,269**	19,611
Transportation services	**14,557**	13,614
	259,599	217,590

* By-product revenue in the prior period has been restated to include certain items previously included in Lumber revenue. The reclassification totals $2,582,819, with no impact to total revenue.

(Tabular amounts expressed in thousands except per share amounts)

8. SELLING, GENERAL AND ADMINISTRATIVE

	2013	2012
	$	$
Selling and logistics services	**5,235**	4,381
Salaries and benefits	**2,532**	2,717
Legal, professional and organizational	**2,087**	2,077
Other administrative expenses	**2,015**	1,395
Depreciation and amortization	**296**	174
	12,165	10,744

9. INTEREST EXPENSE AND ACCRETION

	2013	2012
	$	$
Interest expense	**2,061**	1,747
Accretion	**1,586**	1,407
Financing expense	**316**	383
	3,963	3,537

10. INCOME TAX

10.1 Current income taxes

	2013	2012
	$	$
Recognized in income statement		
Tax expense comprises		
Current tax expense	**-**	9
Reconciliation of effective tax rate		
Income (loss) before tax	**9,546**	(16,176)
Income tax expense (recovery) at corporation rate of 25.75% (2012 - 25.00%)	**2,458**	(4,044)
Expenses not deductible for tax purposes	**512**	556
Effect of unused tax losses and tax offsets not recognized as deferred assets	**(2,843)**	3,485
Effect of items flowing through equity	**(168)**	(59)
Other	**41**	71
Total income tax expense	**-**	9

(Tabular amounts expressed in thousands except per share amounts)

10.2 Unrecognized deferred income taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts used for income tax purposes.

The source of unrecognized deferred income taxes is as follows:

	2012	Change		**2013**
	Opening balance	Related to earnings	Related to equity	**Closing balance**
	$	$	$	**$**
Deferred tax assets related to non-capital losses	7,898	170	-	**8,068**
Deferred tax assets related to temporary differences in tax and book basis	5,747	(3,013)	(168)	**2,566**
Net deferred tax assets	13,645	(2,843)	(168)	**10,634**

	2011	Change		2012
	Opening balance	Related to earnings	Related to equity	Closing balance
	$	$	$	$
Deferred tax assets related to non-capital losses	6,343	1,555	-	7,898
Deferred tax assets related to temporary differences in tax and book basis	4,150	1,656	(59)	5,747
Net deferred tax assets	10,493	3,211	(59)	13,645

No deferred tax assets have been recognized in these consolidated financial statements due to the uncertainty as to realization.

(Tabular amounts expressed in thousands except per share amounts)

10.3 Non-capital loss carry forwards

As at December 31, 2013, the Company has non-capital losses from the following years:

Year of loss	Non-capital loss amount
	$
2006	174
2007	-
2008	2,993
2009	8,862
2010	4,862
2011	5,543
2012	5,835
2013	2,466
	30,735

The non-capital losses can be carried forward for 20 years from the year the loss was incurred.

11. NET INCOME (LOSS) PER SHARE

	Year ended December 31, 2013			Year ended December 31, 2012		
	Net income	**Weighted average number of shares**	**Per share**	Net loss	Weighted average number of shares	Per share
	$		**$**	$		$
Basic income (loss) per share	**9,546**	**20,776**	**0.46**	(16,185)	18,904	(0.86)
Convertible notes	**-**	**1,235 ***	**-**	-	1,246*	-
Diluted income (loss) per share	**9,546**	**20,776**	**0.46**	(16,185)	18,904	(0.86)

* The conversion of convertible notes is anti-dilutive and is therefore excluded from the weighted average number of ordinary shares for the purposes of calculating diluted earnings (loss) per share.

12. CASH AND CASH EQUIVALENTS

	2013	2012
	$	$
Cash at bank and in hand	**17,416**	12,061
Cash at bank and in hand - restricted	**1,193**	-
Short-term deposits - restricted	**-**	2,002
	18,609	14,063

The $1,193,055 of restricted cash at bank and in hand at December 31, 2013 is held in restricted accounts pursuant to the *Builders Lien Act* (2012 – nil). The short-term deposits of $2,002,064 held at December 31, 2012 secured a standby letter of credit issued in the same amount by the Company to BC Hydro pursuant to the terms of the Electricity Purchase Agreement. The Company had no short-term deposits at December 31, 2013.

(Tabular amounts expressed in thousands except per share amounts)

13. TRADE AND OTHER RECEIVABLES

	2013	2012
	$	$
Trade receivables	**15,056**	14,583
Other receivables	**603**	1,000
GST / HST receivable	**584**	1,219
	16,243	16,802

All receivable balances are due within one year and do not require provision.

14. INVENTORIES

	2013	2012
	$	$
Logs	**21,649**	8,048
Lumber	**11,721**	8,086
By-products	**138**	43
Supplies	**4,259**	4,218
	37,767	20,395

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has not been written down at December 31, 2013 (2012 – nil). Write-downs are included in cost of goods sold when incurred.

15. ASSETS HELD FOR SALE

The Company classified as “assets held for sale” certain redundant assets acquired with the purchase of the Mackenzie Assets in June 2010. Transactions within this asset category were as follows:

	2013	2012
	$	$
Balance at beginning of year	**515**	929
Proceeds of disposition from sale of assets	**-**	(414)
Transfer of assets held for sale to property, plant and equipment	**(515)**	-
	-	515

Proceeds of disposition from the sale of assets were credited towards the carrying value of the asset class and there were no profits or losses recognized from the transactions.

The consolidated statement of cash flows reports proceeds on disposal of assets held for sale in the period the proceeds are received.

(Tabular amounts expressed in thousands except per share amounts)

16. GOODWILL AND INTANGIBLE ASSETS

(a) Goodwill

	2013	2012
	$	$
Cost and carrying amount	**2,066**	2,066
	2,066	2,066

(b) Intangible assets

	Forestry licences	Software licences	**Total**
	$	$	**$**
Cost			
At December 31, 2011	8,550	372	**8,922**
Additions	-	-	**-**
At December 31, 2012	8,550	372	**8,922**
Additions	-	-	**-**
At December 31, 2013	8,550	372	**8,922**
Accumulated amortization			
At December 31, 2011	(205)	(234)	**(439)**
Amortization charge for the period	(142)	(69)	**(211)**
At December 31, 2012	(347)	(303)	**(650)**
Amortization charge for the period	(172)	(31)	**(203)**
At December 31, 2013	(519)	(334)	**(853)**
Carrying amount			
At December 31, 2012	8,203	69	**8,272**
At December 31, 2013	**8,031**	**38**	**8,069**

(Tabular amounts expressed in thousands except per share amounts)

17. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings / equipment	Capital work in progress	Power assets	Power Capital work in progress	Total
	$	$	$	$	$	**$**
Cost						
At December 31, 2011	2,844	66,028	147	9,875	7,034	**85,928**
Net additions	19	8,563	890	-	22,603	**32,075**
Disposals	(7)	(818)	-	-	-	**(825)**
At December 31, 2012	2,856	73,773	1,037	9,875	29,637	**117,178**
Net additions	-	15,298	493	-	29,055	**44,846**
Assests available for sale						**-**
reclassification	-	515	-	-	-	**515**
Disposals	-	(284)	-	(1)	-	**(285)**
At December 31, 2013	2,856	89,302	1,530	9,874	58,692	**162,254**
Accumulated depreciation						
At December 31, 2011	-	(9,404)	-	-	-	**(9,404)**
Depreciation charge for the year	-	(7,349)	-	-	-	**(7,349)**
Disposals	-	263	-	-	-	**263**
At December 31, 2012	-	(16,490)	-	-	-	**(16,490)**
Depreciation charge for the year	-	(8,434)	-	-	-	**(8,434)**
Disposals	-	219	-	-	-	**219**
At December 31, 2013	-	(24,705)	-	-	-	**(24,705)**
Carrying amount						
At December 31, 2012	2,856	57,283	1,037	9,875	29,637	**100,688**
At December 31, 2013	**2,856**	**64,597**	**1,530**	**9,874**	**58,692**	**137,549**

The power assets are not being depreciated as the assets are not being operated and are not in a form suitable for management's intended uses.

18. TRADE PAYABLES, ACCRUED LIABILITIES AND OTHER PAYABLES

	2013	2012
	$	$
Trade payables	**27,016**	23,783
Accruals	**982**	511
Deferred revenue	**680**	-
Other payables	**85**	91
	28,763	24,385

(Tabular amounts expressed in thousands except per share amounts)

19. REFORESTATION OBLIGATIONS

	2013	2012
	$	$
Silviculture liability		
Current	**4,043**	3,995
Non-current	**3,196**	3,376
	7,239	7,371

	2013	2012
	$	$
Balance at beginning of year	**7,371**	7,949
Additional provisions recognized	**3,225**	2,964
Reductions arising from payment	**(3,482)**	(2,990)
Change arising from re-measurement or settlement without cost	**125**	(552)
	7,239	7,371

20. ENVIRONMENTAL LIABILITIES

	2013	2012
	$	$
Balance at beginning of year	**1,797**	2,040
Reductions arising from payment	**(43)**	(114)
Change arising from re-measurement or settlement without cost	**(66)**	(129)
	1,688	1,797

21. EMPLOYEE LIABILITIES

	2013	2012
	$	$
Current		
Payroll	**1,486**	1,601
Deferred union payroll liability	**740**	1,733
	2,226	3,334

The deferred union payroll liability relates to deferred payroll costs for unionized employees. Under the terms of the agreement, a portion of employee wages are deferred, as long as lumber selling prices are below a specified value. Deferred employee wages will be paid out once lumber selling prices increase above a specified value or upon employee retirement.

(Tabular amounts expressed in thousands except per share amounts)

22. OTHER LONG-TERM LIABILITIES

	2013	2012
	$	$
Other liabilities	**655**	553
Deferred revenue (a)	**7,305**	3,312
	7,960	3,865

(a) Deferred revenue

During 2013, the Company drew down $3,312,500 of the Load Displacement Agreement (“LDA”) incentive funds available under the BC Hydro LDA contract (2012 – $3,312,500). The incentive funding will be recognized in profit or loss on a systematic basis over the 20 year term of the LDA upon commencement of delivery of electrical energy.

23. BORROWINGS

	2013	2012
	$	$
Non-current		
Long term debt (a)	**2,451**	4,060
Convertible notes (b)	**-**	7,772
Senior secured notes (c)	**26,466**	-
Construction loan (d)	**22,760**	-
	51,677	11,832
Current		
Current portion of convertible notes (b)	**8,825**	-
Current portion of long term debt (a)	**2,076**	1,873
Notes payable (e)	**-**	12,000
	10,901	13,873
Total borrowings	**62,578**	25,705

The aggregate amount of contractual cash outflows for borrowings, which reflects payments in full before accretion, are as follows:

	2013
	$
2014	**11,959**
2015	**3,979**
2016	**2,166**
2017	**32,015**
2018	**2,965**
Thereafter	**14,085**
	67,169

(Tabular amounts expressed in thousands except per share amounts)

(a) Long-term debt

Long-term debt includes a secured loan facility provided under the Community Adjustment Fund ("CAF") loan program sponsored by the Northern Development Initiative Trust. The CAF loan carries a fixed interest rate of 3.75% and is repayable by 20 quarterly repayments of $485,700 commencing June 2011. The loan is secured by a General Security Agreement (excluding inventory and receivables) and a mortgage against certain properties. The Company repaid $1,758,735 of the CAF loan during the year ended December 31, 2013 (2012 – $1,694,300). The CAF loan facility is fully drawn with principal outstanding of $3,803,969 at December 31, 2013 (2012 – $5,562,703).

Long-term debt also includes two capital leases for mobile equipment. The capital leases expire in 2016 and 2017 and the principal outstanding at December 31, 2013 was $723,103 (2012 – $369,572).

(b) Convertible notes

The Company issued $10,000,000 in unsecured convertible notes in two tranches in December 2009.

The key terms of the convertible notes are summarized below.

Term	5 years
Maturity date	December 15, 2014
Interest rate	2.5% from date of issuance to December 15, 2012 to be settled in common shares and 10.5% thereafter to be settled in cash
Holders' option	Convertible at the option of the holder into common shares at a conversion price of $8 per share
Company's option	Redeemable by the Company on or after December 15, 2013 at a redemption price equal to the principal amount plus accrued and unpaid interest.

The values of the liability component and the equity conversion component were determined at issuance of the notes. The fair value of the liability component, included in non-current liabilities, was calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the value of the equity conversion option, is included in equity. The note discount equal to the value of the option and issuance costs is accreted over the term of the note.

During the year ended December 31, 2013, the Company paid $1,043,910 for interest due on the convertible notes. In 2012, the Company paid $249,175 for interest due on the convertible notes by issuing 31,138 common shares as payment in kind and cash payments for fractional shares.

(Tabular amounts expressed in thousands except per share amounts)

The convertible notes recognized in the consolidated balance sheet are calculated as follows:

	Convertible notes	Issuance costs	Equity component	Liability component
	$	$	$	$
At December 31, 2011	9,967	204	5,170	6,675
Conversion of notes	-	-	-	-
Accretion of convertible notes	-	-	-	1,029
Accretion of issuance cost	-	(68)	-	68
At December 31, 2012	9,967	136	5,170	7,772
Conversion of notes	(85)	-	(45)	(40)
Accretion of convertible notes	-	-	-	1,023
Accretion of issuance cost	-	(70)	-	70
At December 31, 2013	**9,882**	**66**	**5,125**	**8,825**

(c) $30 Million senior secured notes

On September 18, 2013, the Company completed a senior secured financing agreement under the terms of which the Company issued promissory notes (the "Notes") in the aggregate principal amount of $30 million. The Notes mature on September 18, 2017 and bear interest at a rate of 8% per annum. The Company may redeem the Notes, in whole or in part, at any time on or after four months from the issue date of the Notes upon 15 days' notice and payment of interest accrued on the amount redeemed to the date of redemption, but otherwise at par.

As additional consideration for the loan, the Company issued share purchase warrants entitling the holder to purchase up to an aggregate of 1,060,000 common shares of the unissued capital stock of the Company at a price of $8.25 per share until September 18, 2017.

The fair market value of each share purchase warrant is calculated using the Black-Scholes option pricing model at $3.41. The related issuance costs will be amortized over the term of the Notes. For the year ended December 31, 2013, the Company recorded expenses that comprised accretion of $243,081, amortization of issuance costs of $11,034 and accrued interest expense of $650,959 (2012 – nil).

The Notes are primarily secured by a first priority security interest in certain long-term lumber assets.

The Notes recognized in the consolidated balance sheet are calculated as follows:

	Promissory notes	Issuance costs	Warrants	Accretion	Total
	$	$	$		$
Issuance of promissory notes	30,000	(177)	(3,611)	-	26,212
Amortization of issuance costs and accretion	-	11	-	243	254
At December 31, 2013	**30,000**	**(166)**	**(3,611)**	**243**	**26,466**

(d) Construction loan

On November 27, 2013, Conifex Power Limited Partnership ("CP Partnership"), a wholly-owned subsidiary of the Company, completed secured project financing (the "Project Financing") for its Power Generation Project with a syndicate of four institutional lenders led by a Canadian chartered bank. The Project Financing is for an aggregate up to $102.7 million and includes a development and construction loan facility of up to $82 million (the "Construction Facility"). The Construction Facility is comprised of floating rate and fixed rate tranches, both of which mature in December 2014 and convert into an amortized term loan having a term of five years once the conditions to conversion are satisfied, including substantial completion of the Power Generation Project. The balance of the Project Financing is in the form of a $18.95 million letter of credit facility primarily to secure certain obligations of CP Partnership under its Load Displacement Agreement and a $1.75 million revolving operating facility.

Interest rates on the floating rate tranche borrowings are based on either banker's acceptances or the Canadian chartered bank prime rate, at CP Partnership's option, plus an applicable margin. The fixed rate tranche bears an interest rate largely consistent with the floating rate tranche.

The undrawn portion of the floating rate tranche is subject to a standby fee and CP Partnership is required to pay a closing fee upon completion of the Project Financing. The Project Financing is primarily secured by a first priority security interest on existing and after acquired assets of the CP Partnership.

As at December 31, 2013, CP Partnership had drawn $22,760,204 of the Construction Facility and issued letters of credit totaling $6,825,000 under the letter of credit facility provided under the Project Financing.

(e) Notes payable

In December 2011, the Company issued senior secured promissory notes in the aggregate principal amount of $12 million. The promissory notes had a maturity date of December 31, 2012, subject to early redemption by the Company as provided in the notes, and bore interest rates of 10% for the first six months and 12% for the remaining term of the loan. The notes were secured by a General Security Agreement. As additional consideration for the loan, the Company issued share purchase warrants to the holders under the terms described in note 26.

On December 10, 2012, the Company extended the maturity date of the $12 million senior secured notes to December 31, 2013. The interest rate remained unchanged at 12%, there was a one percent extension fee and the notes were subject to a premium of 3.5% on any balance repaid after June 30, 2013.

In April 2013, the 12% senior secured notes of the Company were repaid in full.

(f) $5 Million senior secured notes

On February 21, 2013, CP Partnership completed a senior secured financing agreement under the terms of which CP Partnership issued promissory notes (the "CP Notes") in the aggregate principal amount of $5 million. The CP Notes had an expiry date of February 21, 2014 and bore interest at a rate of 12% per annum. The CP Notes were redeemable, in whole or in part, at any time on or after four months from the issue date upon 15 days' notice and payment of interest accrued on the amount redeemed to the date of redemption, but otherwise at par.

As additional consideration for the loan, the Company issued non-transferrable share purchase warrants entitling the holder to purchase up to an aggregate of 160,417 common shares of the unissued capital stock of the Company at a price of $9.50 per share until February 21, 2016 (note 26).

The fair market value of each share purchase warrant was calculated using the Black-Scholes option pricing model at $1.99. As the CP Notes were issued primarily to partially fund further development of CP Partnership's Power Generation Project at Mackenzie, related issuance costs were amortized over the term of the CP Notes and capitalized. For the year ended December 31, 2013, the Company capitalized expenses that comprised accretion of $319,862, amortization of $65,120 issuance costs and interest expense of $352,476 (2012 – nil).

(Tabular amounts expressed in thousands except per share amounts)

On September 18, 2013, the CP Notes were repaid in full by the Company.

(g) $25 Million senior secured revolving asset based credit facility

On April 2, 2013, the Company entered into a three-year $25 million senior secured revolving asset based credit facility (the “Facility”) with a Canadian chartered bank. Under the terms of the Facility, amounts drawn and to be repaid are determined by a borrowing base calculation that fluctuates with eligible accounts receivable and inventory balances, net of specific reserves. Borrowings can be in Canadian or US dollars. Interest rates on Canadian dollar borrowings are based on either banker’s acceptances or the Canadian chartered bank prime rate, at the Company’s option, plus an applicable margin.

The portion of the $25 million commitment that is not drawn is subject to a standby fee and the Company was required to pay a closing fee upon completion of the Facility agreement. The Facility is primarily secured by a first priority security interest on certain existing and after acquired lumber assets. The Company is subject to customary covenants, including a fixed charge coverage ratio if the amount available for borrowing falls below a certain threshold. Conifex uses the Facility primarily for working capital in its lumber segment and for other permitted general corporate purposes.

The Facility was undrawn as at December 31, 2013.

24. SHARE CAPITAL

Authorized

Unlimited number of common voting shares without par value.

Common share activity of the Company is as follows:

	Number of common shares	Amount
		$
Balance at December 31, 2011	15,247	118,582
Shares issued in February 2012 private placements (a)	4,075	26,943
Shares vested under share-based compensation plan (note 25)	55	453
Shares and warrants issued in December 2012 private placements (b)	1,330	8,670
Shares issued as payment of interest on convertible notes	31	248
Balance at December 31, 2012	20,738	154,896
Shares vested under share-based compensation plan (note 25)	**62**	**508**
Shares issued on conversion of convertible notes	**11**	**85**
Recovery of costs on December 2012 private placements	**-**	**4**
Balance at December 31, 2013	**20,811**	**155,493**

(a) February 2012 private placements of common shares

On February 16, 2012, the Company completed a brokered private placement (the “Brokered Placement”) of 3,860,700 common shares at a price of $7.00 per share for gross cash proceeds of $27,024,900. In connection with the Brokered Placement, the Company paid the underwriters a cash fee in the amount of $1,351,245.

On the same date, the Company also completed a non-brokered private placement of 214,286 common shares at a price of $7.00 per share for net proceeds of $1,500,002.

In connection with the Brokered Placement and the non-brokered placement, the Company incurred issuance costs of $230,891. The costs associated with the private placements have been accounted for as a reduction of capital stock. The net aggregate proceeds have been used to fund capital expenditures and for general corporate purposes.

(b) December 2012 private placement of common shares and common share purchase warrants

On December 18, 2012, the Company completed a brokered private placement of 1,329,566 units of the Company (the "Units") resulting in aggregate gross proceeds of $9,306,962. Each Unit consists of one common share of the Company (each, a "Common Share") and one-half one common share purchase warrant (each whole common share purchase warrant, a "Warrant") at a subscription price of $7.00 per Unit. Each Warrant will entitle the holder thereof to acquire a Common Share at an exercise price of $9.00 at any time before December 17, 2014 (note 26).

In connection with the private placement, the Company incurred total issuance costs of $636,866 including the payment of a cash fee in the amount of $465,348 to the underwriters. The costs associated with the private placement have been accounted for as a reduction of capital stock.

The net proceeds from the private placements have been used primarily for working capital purposes.

25. STOCK OPTION PLAN AND SHARE-BASED COMPENSATION

25.1 Stock option plan

The Company has a stock option plan applicable to directors, officers and consultants. The total outstanding stock options are limited to 10% of the outstanding common shares of the Company at any one time. Options granted to consultants will be based upon equivalent fair value of services provided and invoiced to the Company. There have not been any options granted to consultants to date. Under the plan, each option granted shall be for a term not exceeding 10 years from the grant date and the vesting period is determined based on the discretion of the Board of Directors. The option exercise price is set at the date of the grant and cannot be less than the closing trading price of the Company's common shares on the day immediately preceding the day of the grant of the option.

There were 100,000 options outstanding at December 31, 2013 with an exercise price of $8.25 per share. The options were granted on August 20, 2010 and expire on August 20, 2020. The options are exercisable only to the extent that they have vested. The options vest as follows: approximately 33% on the date of grant; approximately 33% on August 20, 2013 and the remaining approximately 34% on August 20, 2015.

The fair value of the options granted is estimated at the time of the grant using the Black-Scholes option pricing model. Based on a share price of $6.50 on the day of the grant, expected life of 10 years, risk-free interest rate of 3.05% and annualized volatility of 33%, the fair value of the options granted on August 20, 2010 is estimated at $265,000 or $2.65 per option. Expense related to the stock option plan of $36,303 was recognized in the year ended December 31, 2013 (2012 – $47,122).

25.2 Share award plan

The Company operates a share compensation program for executives and salaried employees under which it grants long-term incentive plan awards, restricted share units and performance share units. The Company measures the fair value of the services received as consideration for equity instruments indirectly by reference to the fair value of the equity instruments granted. The fair value is measured on the basis of an observable market price subject to a minimum price.

(Tabular amounts expressed in thousands except per share amounts)

(a) Long-term incentive plan awards and restricted share units

The following table illustrates the number and weighted average fair value ("WAFV") of, and movements in, long-term incentive plan awards and restricted share units granted during the year:

	2013 Number	**2013 WAFV**	2012 Number	2012 WAFV
		$		**$**
Outstanding at January 1	**623,053**	**8.00**	373,309	8.56
Granted during the year	**102,757**	**8.06**	456,347	7.66
Forfeited during the year	**(300,746)**	**7.42**	(151,033)	8.37
Vested during the year	**(62,532)**	**8.11**	(55,570)	8.00
Outstanding at December 31	**362,532**	**8.48**	623,053	8.00

The awards vest in three, four, and five year tranches. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period.

Expense related to the grant of long-term incentive plan awards and restricted share units of $386,432 was recognized in the year ended December 31, 2013 (2012 – $1,029,288). The compensation expense is allocated between cost of goods sold and selling, general and administrative expense.

(b) Performance share units

The Company grants Performance Share Units ("PSUs") from time to time under the terms of its share compensation plan for officers and employees. The PSUs vests on the third anniversary of the issuance date with the number of vesting shares determined by the 10-day volume-weighted average share price at vesting relative to the share price at issuance. Payments for vested units can be made in cash at the discretion of the Company's Board of Directors. The Company records an expense based on the 10-day volume-weighted average share price at each balance sheet date. Expense related to the grant of PSUs of $151,308 was recognized in the year ended December 31, 2013 (2012 – nil). Payments in cash related to vested PSUs for the year ended December 31, 2013 totaled $249,665 (2012 – nil).

26. WARRANTS

	Number of Warrants	Amount
		$
Balance at December 31, 2011	325,000	406,537
Warrants issued under private placement (note 24) (a)	664,783	664,783
Balance at December 31, 2012	989,783	1,071,320
Warrants issued with $5 million promissory notes (note 23) (b)	160,417	319,861
Warrants issued with $30 million promissory notes (note 23) (c)	1,060,000	3,611,492
Balance at December 31, 2013	**2,210,200**	**5,002,673**

(Tabular amounts expressed in thousands except per share amounts)

(a) Warrants issued in connection with December 2012 private placement

In connection with the private placement of 1,329,566 Units of the Company completed on December 18, 2012 (note 24), the Company issued 664,783 common share purchase warrants. Each common share purchase warrant is valued at $1.00. Each common share purchase warrant will entitle the holder thereof to acquire one common share of the Company at an exercise price of $9.00 at any time prior to December 17, 2014.

(b) Warrants issued in connection with $5 million senior secured promissory notes

In connection with the February 2013 issuance of senior secured promissory notes (note 23) by CP Partnership, the Company issued share purchase warrants entitling the holders of the promissory notes to purchase up to an aggregate of 160,417 common shares of the unissued capital stock of the Company at a price of $9.50 per share until February 21, 2016.

The fair market value of the warrants was recorded against and amortized over the term of the promissory notes. During the year ended December 31, 2013, the Company capitalized $319,862 related to the common share purchase warrants (2012 – nil) to the Power Generation Project.

(c) Warrants issued in connection with $30 million senior secured promissory notes

In connection with the September 2013 issuance of senior secured promissory notes (note 23), the Company issued share purchase warrants entitling the holders of the promissory notes to purchase up to an aggregate of 1,060,000 common shares of the unissued capital stock of the Company at a price of $8.25 per share until September 18, 2017.

The fair market value of the warrants is recorded against the carrying value of the borrowing and amortized over the term of the promissory notes. During the year ended December 31, 2013, the Company recorded interest expense of $243,081 related to the common share purchase warrants (2012 – nil).

27. COMMITMENTS

Lease payments

The amount of operating lease payments charged to the statement of net income (loss) and comprehensive income (loss) during the year comprised:

	2013	2012
	$	$
Equipment	**770**	1,118
Office and office equipment	**677**	444
Vehicles	**40**	29
	1,487	1,591

(Tabular amounts expressed in thousands except per share amounts)

Lease commitments

The future aggregate minimum lease payments under non-cancellable leases are as follows:

	2013	2012
	$	$
Not later than 1 year	**2,168**	1,330
Later than 1 year and not later than 5 years	**5,176**	3,055
Later than 5 years	**3,160**	63
	10,504	4,448

28. KEY MANAGEMENT COMPENSATION

Compensation of key management (directors and officers)

	2013	2012
	$	$
Short-term benefits	**1,371**	1,508
Share-based payments	**304**	302
	1,675	1,810

29. RELATED PARTY TRANSACTIONS

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

During the year, the Company received payment in full for an interest free short-term loan to an officer of the Company in the principal amount of $346,500. The loan, provided in 2012, was repayable upon demand and secured by a mortgage over certain property. At December 31, 2013, the outstanding balance included in trade and other receivables was $nil (2012 – $346,500).

30. RECLASSIFICATION OF COMPARATIVE AMOUNTS

Certain comparative amounts for the prior year have been reclassified to conform to the current year's presentation.

31. EVENTS AFTER THE REPORTING PERIOD

Acquisition of Lignum Forest Products LLP

On February 3, 2014, the Company completed the acquisition of Lignum Forest Products LLP ("Lignum"), a private partnership which operates a lumber marketing and distribution business. Lignum serves customers and distributes products that are complementary to those of Conifex.

Conifex will pay an aggregate purchase price of approximately US$ 4 million for Lignum, subject to certain post-closing adjustments, which it is funding from its existing available cash.