



CONIFEX

LETTER TO SHAREHOLDERS

The past 12 months have been extremely active. We completed the acquisition of Mackenzie to position us to benefit even more from the strong lumber markets we anticipate in 2011 and beyond. We successfully completed our public offering, and expect to add added significant value upon the completion of our Energy Purchase Agreement with B. C. Hydro.

Now that our leadership team is in place and our capital expenditure program at the Fort St. James mill is largely complete, our key priority for the current year is to demonstrate the cash flow generating capability of our asset base. We are going to improve margins by getting more value out of every tree we harvest and process, by reducing cash conversion costs, and by increasing by-product revenues. The fourth quarter of 2011 is the target date we have set to demonstrate to shareholders that our profit margins are fully competitive with the major public forest products companies operating in the Interior region of B. C.

March 8, 2011

Fellow Shareholders

We thank you for your investment and confidence in our company.

On behalf of the board of directors, I am pleased to provide this review of activities for 2010, our plans for 2011, and outline of how we are positioning our company for future success.

Pleased with our Fiber and Financial Base

In August, 2008 we completed the purchase of the forestry and sawmilling assets at Fort St. James B. C. previously owned by Pope & Talbot. Lumber production started on a one-shift basis in March, 2009.

In June, 2010, we completed the purchase of the forestry and sawmilling assets at Mackenzie B. C. previously owned by AbitibiBowater. Funding for the purchase and improvement of these assets was obtained through a concurrent \$89 million public equity offering we successfully completed. Lumber production at one of the two Mackenzie mills started safely on a one-shift basis in November, 2010.

We now have two-shift lumber capacity of 745 million board feet per annum, supported by annual harvest rights to over 1.5 million cubic meters of sawlogs. We are presently moving to a two-shift operation in Fort St. James and at one of our two mills at Mackenzie. This implies a capacity utilization rate of over 70% for the closing six months of 2011, versus 20% for the closing six months of 2010.

We are pleased with our acquisitions for these reasons:

- We have a world-class softwood fiber base. Our sawlog supply is plentiful and reasonably-priced in an environment where many B. C. sawmillers face harvest reductions due to the Mountain Pine Beetle ("MPB") infestation.
- Our converting facilities are substantial, and well matched with the available fiber supply. The facility we operate currently at Mackenzie is reasonably cost-competitive as presently constituted. Our Fort St. James facility will be fully cost-competitive following the second quarter 2011 tie-in and ramp up of the new machine centers available to us now that our \$30 million capital expenditure program is nearing completion at this mill; and
- The work forces at the mills are performing satisfactorily and have the potential to be even more productive once we fine-tune our operating formats.

The expectations we had when we committed to purchase the assets have been met and exceeded -- we have an excellent base from which we can build a high-performing and financially rewarding forest products company. We are completely satisfied that our opportunity to purchase these fiber and converting assets arose because of financial issues at the parent company level, and not because of mill level or fiber supply concerns.

Investment Thesis is Validated

We launched our company because we believed North American lumber producers were going to benefit from higher and more stable lumber prices on a secular basis. This is the reason why we purchased harvest rights and converting facilities when others were reluctant to do so. We believe that the mid-term effect of the MPB epidemic, the single most important factor underpinning our investment thesis, is to:

- create a supply/demand balance in lumber which favors producers, and
- contribute to record high lumber prices in North America when housing starts return to demographic trend levels which are generally placed around 1.5 million units.

We are encouraged that benchmark (Spruce, Pine, Fir #2 & Better, 2x4) lumber prices averaged US\$ 256 per thousand board feet in 2010 when US housing starts totaled 587,600 units. The benchmark price averaged US\$ 250 per thousand board feet in 2007, but US housing starts totaled 1.36 million units that year. Clearly, supply constraints in B. C. and other regions in Canada are putting upward pressure on lumber prices, and so too is the growth in shipments to China which is diverting supply from the North American market. These factors support our view that lumber prices will be materially higher in the future than they were at any given level of U. S. housing starts historically. And while we acknowledge that the acquired mills have been a drag on our financial results since the



time of acquisition, in the pricing environment we envisage, we believe we will generate extremely attractive financial rewards from the investments we have made.

Acquisition Strategy and Size Considerations

We are prepared to consider other acquisition opportunities in an effort to grow and strengthen our business in furtherance of our stated objective to reach one billion board feet of annual lumber capacity. Although we continue to evaluate potential targets, no assurance can be given that we will ever consummate any further transactions.

We do not believe that we must complete further acquisitions for Conifex to have sufficient size and scale to be a high-performing lumber producer. We believe that competitiveness in the industry is largely based on the availability of competitively priced sawlogs on a facility-by-facility basis, and on individual mill efficiency, rather than the number of mills operated. This is due to the fact that it is generally not economical to transfer wood between or among facilities, which might permit a greater degree of specialization and operating efficiencies. Instead, each facility must utilize the raw materials that are available to it in a relatively limited geographic area. The extensive fiber base available to our mills at Fort St. James and Mackenzie supports our belief that, as presently constituted, we are able to compete effectively with companies that have a larger number of mills.

Business Plan Refinements

To date, our team at Fort St. James has worked to operate this mill similar to how other successful mills have operated in the interior region of B. C. over the past two decades or so. Sourcing logs at the lowest possible cost and converting them into construction grade lumber products at the lowest possible cash cost were the key determinants of financial performance for commodity lumber producers. This accounts for the interior region of B. C. being consistently ranked as having the lowest log and conversion costs of any supply region servicing the North American softwood lumber market.

However, dramatic changes are now occurring in fiber quality and availability brought on by the MPB epidemic, and in lumber demand patterns reflecting the emergence of a market for B. C. lumber in China. Furthermore, a host of bio-energy opportunities are now available which did not exist a decade earlier. Given these fundamental changes in fiber availability and revenue generation opportunities, it is not clear to us that our sawmilling complexes will achieve optimal financial results if we continue to adopt a traditional approach to log procurement and lumber production. Our fiber basket differs from most of our competitors. The sawlog supply available to our converting facilities is generally more abundant and of higher quality than what is available to a typical operator in the interior region of B. C.

Under the direction of our Chief Operating Officer, we are recalibrating our approach to setting log quality specifications, re-defining cutting protocols in our primary log breakdown units, and improving our lumber drying, planing and finishing. He has laid out a clearly defined process, and allocated tasks and accountabilities with clear and explicit goals to revise the operating formats at our manufacturing facilities. Our objective is to produce a greater portion of higher-valued lumber products, and although our cash costs per thousand board feet will not be at the lowest possible levels, our revenues per thousand board feet are expected to be considerably higher than those achieved at the typical mill operating in the interior region of B. C. Our objective is to get more



value out of every tree we harvest and process, and improve the cash flows we generate at the mills we own.

We believe that the production of high quality lumber products will decline in B. C. given the degradation occurring in fiber supply, and this will lead to expanded price premiums for quality lumber products, such as those targeted for the Japanese market. We also believe it will be difficult for MPB focused producers to make inroads into these higher-valued markets we have chosen to emphasize. This is the reason we see an opportunity to move our lumber production profile up market. We will divert the low-valued fiber we handle towards bio-energy, rather than produce low-valued lumber.

Safety and the Environment

Despite taking initiatives to modify our business plan, there is one part of our business plan we will never change. We remain committed to ensuring that financial returns do not come at the expense of safety and environmental performance. We have established performance measure for these variables that are continually monitored to ensure initiatives aimed at improving our performance are carried out by employees and contractors in a safe, environmentally responsible and sustainable manner.

Bio-Energy Initiatives

Conifex has been studying the opportunities available to produce a range of bio-energy products from its available wood fiber, and how best to develop new revenue streams to augment our existing lumber and residual chip revenue streams. The former owners of our mills viewed the 20% or so of each tree which does not end up as lumber or chips as waste. We view it as a revenue stream, and intend to unlock the value of the solar energy captured in this currently underutilized resource. Exploiting our bio-energy potential is the best way we know to:

- provide continuity of operations and employment for our hard working, safety-minded employees in the forest dependent communities of Mackenzie and Fort St. James;
- broaden and deepen the healthy working relationships we enjoy with First Nations in our local operating areas;
- move Conifex into the lowest quartile on the industry cost curve, enabling us to compete head on with the best companies the North American softwood lumber industry has to offer;
- enhance and stabilize our return on shareholders' equity; and
- distinguish our company from the other well-financed and efficient lumber producers operating in the Interior region of B. C.

Bio-Energy Project at Mackenzie

Our intention is to use our sawmill and harvest waste as feedstock to produce dependable, cost-effective and environmentally responsible electricity utilizing infrastructure and technology with proven past performance. We have therefore:



- initiated an approximately \$45 million bio-energy generation project at our Mackenzie site with commercial production scheduled for mid-2012; and
- entered into agreements with an equipment supplier to purchase a 36 MW steam turbine facility at a cost of approximately US\$10.5 million, which includes ancillary equipment.

We are in discussions with BC Hydro in connection with a proposed energy purchase agreement and with respect to establishing energy savings arrangements at our Mills.

Upon achieving commercial production, we expect to generate approximately 230 GWh of net energy per year.

This bio-electricity project provides important ancillary benefits to us, such as:

- a reliable market at a full, fair price for the sawmill and logging waste produced at our Mackenzie site;
- efficient utilization and value optimization for the power boiler, transmission and other energy assets included in our purchase from AbitibiBowater of the idled pulp and paper complex;
- a reliable source of heat to fuel our adjacent lumber drying kilns;
- a Canadian dollar denominated revenue stream which is independent of foreign currency fluctuations and cross-border trade challenges; and
- further progress in our goal to be a global leader in the production of sustainable products and in environmental performance.

Our target is for this project to add over \$25 million of revenue and approximately \$10 million of EBITDA on an annual basis upon the commencement of commercial production and sale of "green" electricity in July, 2012.

Other Potential Bio-Energy Investments

We intend to pursue additional high return investment opportunities in the bio-energy sector over the next few years. We believe the large volumes of presently uncommitted sawmill residues and unutilized wood waste materials we have under our control, and the site infrastructures we have in place, are sources of competitive advantage that will propel, not impede the success of Conifex. Our Fort St. James site has the infrastructure and availability of economically sourced biomass to support both an independent power facility and a pellet plant in the proximate region. Studies by the Forest Products Association of Canada concluded that the investment returns in the bio-energy sector are highest when large volumes of reasonably-priced biomass feedstock are available and when the new facilities can be integrated into the traditional businesses. This is the precise opportunity we intend to exploit at each of our locations.

Financial Results



We reported sales of \$57.4 million for the year ending December 31, 2010 versus \$31.3 million for the year ending December 31, 2009. Our EBITDA was negative \$5.7 million in the most recent year, an improvement from negative \$8.5 million in the previous year.

Although higher shipments and improved lumber prices led to a break even EBITDA result at our Fort St. James facility in 2010 versus negative EBITDA of \$8.1 million in 2009, our results were adversely impacted by the \$30 million capital expenditure program underway at the mill for the closing nine months of the most recent fiscal year. We expect our operations at Fort St. James to show considerable improvement in the second quarter of 2011, after the existing mill upgrades have been completed, the construction crews are no longer on site, and we have completed one other quick payback expenditure to debottleneck the plant.

We incurred negative EBITDA of \$2.6 million at our Mackenzie facility. We incurred the costs of maintaining the idled facilities for the five months we owned the facility prior to commencing production in November. Our cash losses after start up were substantial because we operated at only 50% of our one-shift capacity. Under the direction of a new and experienced site manager who joined Conifex early in 2011, we expect our operations at Mackenzie to show improvement in 2011 because mill reliability and efficiency have reached more acceptable levels, and because we will implement operations on a two-shift basis in the second quarter of 2011.

Improved Competitiveness is the Top Priority

We analyzed the 2010 financial results to two large public lumber producers with substantial operations in the Interior region of B. C. which account for just under 20% of North American softwood lumber shipments. While we generated negative EBITDA per thousand board feet of lumber shipped in the most recent year, these two competitors generated EBITDA of \$30 to \$48 per thousand board feet. We have set a goal in Conifex to generate an EBITDA per thousand board feet by the fourth quarter of 2011 which is fully competitive with the results achieved by these two producers. The key swing factors in our year-over-year results will be the benefits of moving to a higher rate of capacity utilization, the benefits of the capital expenditure program about to be completed at Fort St. James, and the benefits of the initiative underway to emphasize higher-valued lumber products.

In the closing six months of 2011, we expect to be producing and shipping lumber at an annual rate of more than 500 million board feet, three times the volume we achieved in 2010. Because of the relatively high fixed costs per unit of production associated with maintaining idled facilities or operating facilities on a one-shift basis, ramping up our production along the lines we have indicated will have a materially positive impact on our unit costs and EBITDA.

Employee Contribution

Before concluding, we wish to make special mention of the contribution that our employees and our contactors' employees have made to the success of Conifex. Our employees are well aware of the challenges this downturn presented while operations at Fort St. James and Mackenzie were idled by their former owners in 2007. We share the pain our employees experienced during the downturn, and we share their passion for working together to make us a world-class producer with a more diversified revenue stream so we never have to revisit the merits of taking downtime at a facility in



the future. We thank all our employees for their effort and commitment to our company and their local communities.

Concluding Comment

We trust you find these comments helpful in terms of outlining the steps we are taking to make Conifex a leader in the forestry, sawmilling and woody biomass sectors. It is clear to us that we made considerable progress in 2010 positioning Conifex to benefit from strong lumber markets, and transforming Conifex into a company that is optimizing its bio-energy potential to improve its bottom line in furtherance of our objective to become a high performing forest products company. However, more work needs to be done to deliver more value from each tree we process at our converting facilities, and thereby strengthen our core manufacturing activities. Now that we have our leadership team in place and the significant capital expenditures are almost behind us, we will work on this aspect of our business on a priority basis in 2011.

On behalf of the Board of Directors of Conifex Timber Inc.,

A handwritten signature in black ink that reads "Ken Shields". The signature is written in a cursive, flowing style.

Ken Shields
Chairman and CEO

