CONIFEX

CONIFEX TIMBER INC.
SECOND QUARTER 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 1, 2014

*This interim Management's Discussion and Analysis ("**MD&A**") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the quarter ended June 30, 2014 relative to the quarters ended March 31, 2014 and June 30, 2013, the Company's financial condition and future prospects. This interim MD&A should be read in conjunction with Conifex's unaudited condensed consolidated interim financial statements and accompanying notes for the quarters ended June 30, 2014 and 2013, as well as the 2013 annual MD&A and the December 31, 2013 audited consolidated financial statements and notes thereon which are filed on SEDAR at www.sedar.com. The financial information contained herein has been prepared in accordance with International Financial Reporting Standards.*

In this interim MD&A, reference is made to "EBITDA". EBITDA represents earnings before interest, taxes, depreciation and amortization. The Company discloses EBITDA as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

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

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

FORWARD-LOOKING STATEMENTS

This interim MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industries and markets in which it operates. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include statements regarding: growth and future prospects of our business; our expectation for the export tax rate assessed on lumber shipments to the U.S.; our expectation for mill net realizations; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; benefits that may accrue to the Company as a result of certain capital expenditure programs, such as the lumber segment capital plan, equipment upgrades and *maintenance shutdowns; and the anticipated benefits, cost, timing and completion dates for projects, including the Power Generation Project.*

Assumptions underlying the Company's expectations regarding forward-looking information contained in this interim MD&A include, among others: that the Company will be able to effectively market its products; that the Company will conclude a new collective labour agreement on satisfactory terms; that the U.S. housing market will continue to improve; that there will be no unforeseen delays and disruptions affecting the completion of the Power Generation Project and that the Company will be able to commence timely delivery of power therefrom; that softwood lumber will experience improved and sustained demand in the marketplace at favourable prices; that the export tax rate on U.S. lumber shipments will be less than the maximum rate; that the Company will be able to dynamically respond to shifts in demand among its major markets; the general stability of the economic, political and regulatory environments within which the countries where the Company conducts operations; the ability of the Company to obtain financing (if necessary) on acceptable terms or at all; that interest and foreign exchange rates will not vary materially from current levels; and that our mills and equipment will operate at expected levels.

Persons reading this interim MD&A are cautioned that statements comprising forward-looking information are only predictions, and that the Company's actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials, including log costs; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments; availability of financing (as necessary); and other risk factors detailed in our Annual Information Form dated March 27, 2014 available on SEDAR at www.sedar.com and other filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to update any forward-looking information, except as required by applicable securities law.

SIGNIFICANT DEVELOPMENTS

Graduation to TSX

On May 13, 2014, the Company received final approval from the Toronto Stock Exchange ("TSX") for the listing of its common shares on the TSX. The Company's common shares began trading on the TSX effective May 20, 2014 and continued to trade under the stock symbol "CFF". Concurrent with the Company's graduation to the TSX, the Company delisted its common shares from trading on the TSX Venture Exchange.

Lumber segment capital budget

The Company recently approved a lumber segment capital plan totalling approximately $18 million planned to be largely implemented during the current year. Approximately two-thirds of the planned expenditures are intended to be allocated to safety, environmental and dust mitigation projects, with the balance intended to be invested in maintenance of business capital projects designed to improve mill uptime and reliability and other targeted upgrades at both of our mill locations. The Company intends to fund the capital upgrades primarily from internally generated cash flows.

SUMMARY OF CONSOLIDATED OPERATING RESULTS

Selected Financial Information

(millions of dollars, except share and per share amounts, unaudite	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Sales	99.6	67.2	166.8	64.4	130.7
Operating Income by Segment					
Lumber	5.4	4.4	9.8	4.7	13.4
Bioenergy	-	-	-	(0.2)	(0.3)
Corporate and other	(1.0)	(1.6)	(2.6)	(1.2)	(3.2)
	4.4	2.8	7.2	3.3	9.9
EBITDA by Segment					
Lumber	8.0	7.0	15.0	6.8	17.5
Bioenergy	-	-	-	(0.2)	(0.4)
Corporate and other	(2.1)	(1.5)	(3.6)	(1.6)	(3.3)
	5.9	5.5	11.4	5.0	13.8
Net income	2.0	1.6	3.6	2.4	8.6
Net income per share - basic and diluted (1)	0.10	0.08	0.17	0.12	0.42
Shares outstanding - weighted average (millions)	20.9	20.8	20.9	20.8	20.7
Average exchange rate - US$/Cdn$ (2)	0.917	0.906	0.912	0.977	0.984
Reconciliation of EBITDA to Net Income					
Net income	2.0	1.6	3.6	2.4	8.6
Add: Interest expense	1.2	1.3	2.5	0.5	1.1
Amortization	2.7	2.6	5.3	2.1	4.1
EBITDA (3)	5.9	5.5	11.4	5.0	13.8

(1) If the conversion of convertible notes and/or the inclusion of outstanding warrants and options is anti-dilutive, it is excluded from the calculation of diluted net income per share.
(2) Source: Bank of Canada website www.bankofcanada.ca
(3) The above EBITDA calculation represents earnings before interest, taxes, depreciation and amortization, and has been reported without reference to deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures as presented in previous quarters. EBITDA for all quarters presented has also been restated to exclude such items.

For the quarter ended June 30, 2014, the Company recorded net income of $2.0 million or $0.10 per diluted share on sales of $99.6 million compared to net income of $1.6 million or $0.08 per diluted share on sales of $67.2 million during the first quarter of 2014, and net income of $2.4 million or $0.12 per diluted share on sales of $64.4 million during the second quarter of 2013. Net income for the first six months of 2014 was $3.6 million or $0.17 per diluted share compared to net income of $8.6 million or $0.42 per diluted share over the same period last year.

The Company recorded consolidated operating income of $4.4 million for the second quarter of 2014 compared to $2.8 million in the previous quarter, and $3.3 million in the second quarter of 2013. Lumber segment operating income improved by $1.0 million over the previous quarter with the increase primarily attributable to higher shipments of Conifex produced lumber, increase in revenue from residuals and improvement in unit cash conversion costs, offset by lower average unit mill net realizations. Compared to the second quarter of 2013, the benefits of a weaker Canadian dollar, higher shipments of Conifex produced lumber, increase in revenue from residuals and slight improvement in unit mill net realizations were largely offset by increases in unit log costs and unit cash conversion costs. Unit mill net realizations refers to gross sales realizations on Conifex produced lumber, net of export taxes and freight and distribution costs, per thousand board feet of lumber shipments.

The Company recorded a foreign exchange translation loss of $0.8 million for the second quarter of 2014 and $0.2 million in the second quarter of 2013 compared to a translation gain of $0.2 million in the previous quarter. The foreign exchange translation gain or loss largely reflects the effect of the change in the value of the Canadian dollar relative to the value of the U.S. dollar on U.S. dollar denominated working capital balances and is discussed further under “Corporate costs and other items”.

Second quarter 2014 EBITDA of $5.9 million was comprised of lumber segment EBITDA of $8.0 million offset by corporate costs and other items of $2.1 million. Lumber segment EBITDA improved by $1.0 million over the previous quarter and $1.2 million over the second quarter of 2013.

At June 30, 2014, the Company had cash on hand of $15.4 million compared to $18.6 million at December 31, 2013. During the second quarter of 2014, net non-cash working capital was reduced by $17.6 million as the seasonal build of log inventories in the preceding quarters was drawn down and finished goods inventory was reduced as industry wide transportation challenges eased. The Company ended the second quarter of 2014 with consolidated net debt of $86.6 million (December 31, 2013 - $44.0 million) and net debt to capitalization ratio of 42% (December 31, 2013 – 27%). As at June 30, 2014, excluding borrowings under the project financing facility related to the Power Generation Project (as described below), which is largely structured on a non-recourse basis to the lumber segment assets and to the parent company, Conifex Timber Inc., net debt was $30.4 million (December 31, 2013 - $21.2 million) and the net debt to capitalization ratio was 20% (December 31, 2013 – 15%).

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, except share and per share amounts, unaudit	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Sales -Lumber - Conifex produced	63.6	44.9	108.5	49.4	101.3
- Lumber - wholesale	24.6	13.2	37.8	5.3	12.2
- By-products	8.0	5.7	13.7	5.7	10.0
- Logistics services	3.4	3.4	6.8	4.0	7.2
Total Sales	99.6	67.2	166.8	64.4	130.7
EBITDA (1)	8.0	7.0	15.0	6.8	17.5
Amortization	2.6	2.6	5.2	2.1	4.1
Operating income	5.4	4.4	9.8	4.7	13.4
Statistics					
Lumber shipments - Conifex produced (MMfbm)	146.4	95.9	242.3	119.2	239.0
Lumber shipments - Wholesale (MMfbm)	43.3	24.9	68.2	12.3	29.5
Lumber production (MMfbm)	134.9	128.3	263.2	135.8	260.0
Average exchange rate - US$/Cdn$ (2)	0.917	0.906	0.912	0.977	0.984
Average WSPF 2x4 #2&Btr lumber price (US$) (3)	$ 335	$ 367	$ 351	$ 334	$ 362
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (4)	$ 365	$ 405	$ 385	$ 342	$ 368

(1) The EBITDA calculation represents earnings before interest, taxes, depreciation and amortization, and has been reported without reference to deductions for non-cash charges related to employee compensation as presented in previous quarters. EBITDA for all quarters presented has also been restated to exclude such items.
(2) Source: Bank of Canada website www.bankofcanada.ca
(3) Source: Random Length Publications Inc.
(4) Average WSPF 2x4 #2&Btr lumber price (US$) divided by average exchange rate

Overview

WSPF #2 & Btr ("WSPF") prices averaged US$335 during the second quarter of 2014, a decline of US$32 per thousand board feet or 9% from the previous quarter.[1] The quarter over quarter decline was largely attributable to slower than expected pace of recovery in U.S. housing markets and a significant increase in shipment volumes to North American and export markets as the transportation disruptions which held back shipments during the previous quarter eased. Benchmark prices were largely flat compared to the second quarter of 2013. The Canadian currency strengthened by 1% over the previous quarter and weakened by 6% compared to the second quarter of 2013.

Shipments of Conifex produced lumber increased by 53% over the previous quarter, during which shipments were constrained by seasonal rail car shortages and a truckers' strike at the main container port in Vancouver, British Columbia, and by 23% over the second quarter of 2013.

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

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

to those of Conifex. The addition of Lignum contributed towards a quarter over quarter increase in wholesale lumber revenues of 86% and wholesale lumber shipments of 74%.

The Company continued to experience steady demand from its key markets, and the proportion of year-to-date shipment volumes of Conifex produced lumber that went to export markets was relatively consistent with volumes shipped during the first six months of 2013. The export tax rate on shipments to the U.S. was zero percent during the first six months of 2014 and 2013.

Lumber production volumes of approximately 135 million board feet reflected an increase of 5% over the previous quarter and were similar to volumes recorded in the second quarter of 2013.

The lumber segment recorded operating income of $5.4 million for the second quarter of 2014 compared to $4.4 million in the first quarter of 2014 and $4.7 million in the second quarter of 2013. Lumber segment EBITDA of $8.0 million improved by $1.0 million over the previous quarter and $1.2 million over the second quarter of 2013.

The improvement in lumber segment operating income of $1.0 million over the previous quarter was largely attributable to a 53% increase in shipments of Conifex produced lumber, 40% increase in revenue from residuals, and 10% improvement in unit cash conversion costs, offset by average unit mill net realizations that were lower by 9%. Compared to the second quarter of 2013, the benefits of a 6% weaker Canadian dollar, 23% increase in shipments of Conifex produced lumber, 40% increase in revenue from residuals and slight improvement in unit mill net realizations were largely offset by a 6% increase in unit log costs and 11% increase in unit cash conversion costs and resulted in a modest improvement of $0.7 million in lumber segment operating income.

Management expects steady demand from the North American market to continue during the third quarter of 2014 and a moderate seasonal tapering in the fourth quarter. Management views the recent improvement in WSPF lumber prices as sustainable, with demand and production now in alignment since the remaining excess inventory created by earlier transportation disruptions appears to have cleared. Demand from the Chinese market is expected to remain solid for the remainder of the year while Japanese market demand is expected to remain at the softer levels experienced during the first half of 2014. With production now reaching an annualized rate of close to 100% of current operating capacity of 525 million board feet, increased focus will be placed on initiatives to further improve unit cash conversion costs. These gains are expected to more than offset slightly higher log and labour costs and contribute to further growth in lumber segment profitability.

<u>Sales</u>

Lumber shipments of Conifex produced lumber totalled 146 million board feet during the second quarter of 2014 and represented an increase of approximately 53% over the previous quarter and 23% over the second quarter of 2013. Wholesale lumber shipments totalled 43 million board feet and reflected an increase of approximately 18 million board feet over the previous quarter and 31 million board feet over the second quarter of 2013. The increase in wholesale lumber shipments is substantially attributable to the addition of Lignum shipments from February 2014.

Compared to the previous quarter, gross revenues from shipments of Conifex produced lumber increased by 42% as a result of higher shipment volumes offset by a 7% decline in unit gross sales realizations. Quarter over quarter unit mill net realizations declined by 9% and largely mirrored the 10% downward movement in Canadian equivalent benchmark prices. Compared to the second quarter of 2013, gross revenues from shipments of Conifex produced lumber increased by 29% and reflected a 23% increase in shipment volumes and a 6% increase in unit gross sales realization. Unit mill net realizations, dampened by an increase in freight and distribution costs and less favourable product mix, increased by 1% and did not fully reflect the 7% improvement in Canadian equivalent benchmark prices. The balance of the increase in total gross revenues from lumber shipments of 52% over the previous quarter and 61% over the second quarter of 2013 was due to the growth in wholesale lumber revenues with the aforementioned addition of Lignum in February 2014. On a year-to-date basis, gross revenues from shipments of Conifex produced lumber increased by 7% over the same period last year with the improvement primarily attributable to higher average lumber prices.

The table below shows the percentage of net lumber revenue earned from and volume shipped to each geographic market (based on Conifex produced lumber).

	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
By Revenue (net of freight)					
Canada	12%	13%	13%	13%	11%
USA	46%	53%	49%	48%	52%
Japan	9%	10%	9%	13%	11%
China and other	33%	24%	29%	26%	26%
	100%	100%	100%	100%	100%
By Shipment Volume					
Canada	12%	13%	13%	14%	11%
USA	43%	51%	46%	47%	50%
Japan	6%	7%	6%	9%	9%
China and other	39%	29%	35%	30%	30%
	100%	100%	100%	100%	100%

The Company continued to experience steady demand from each of its major markets during the second quarter of 2014 and, with the easing of logistical challenges prevalent in the previous quarter, increased shipment volumes to each of its major markets. The largest quarter over quarter increases were to China and Japan, with shipment volumes improving by 109% and 31%, respectively, followed by a 30% increase in shipments to the North American market. On a year-to-date basis, shipment volumes to China have increased by 17% while shipment volumes to the North American and Japanese markets have declined by 2% and 26%, respectively, compared to the first six months of 2013. A portion of the premium products that would typically be destined for the Japanese market was diverted to alternative markets in the current year in response to the disruptions at the port in Vancouver, British Columbia. Year over year average unit mill net realizations from shipments to Japan and the North American markets have improved by 17% and 5%, respectively, and declined by 3% on shipments to China.

Revenue from chips and other residuals increased by 40% over the previous quarter with the increase primarily attributable to higher shipment volumes. Compared to the second quarter of 2013, an increase in revenue from by-products of approximately 40% was equally attributable to increases in shipment volumes and in unit chip prices, which are related to fluctuations in NBSK pulp prices.

Production and Operations

Lumber production totalled 135 million board feet during the second quarter of 2014, which represented an increase of 5% over the previous quarter and was relatively flat compared to the second quarter of 2013. Current year-to-date production of 263 million board feet reflected a modest increase over the same period last year and an annualized operating rate of approximately 100% (on a two-shift basis and excluding lumber capacity attributed to the idled sawmill). Productivity and sawmill uptime was somewhat hampered by unusually cold weather during the first quarter of 2014.

Costs of goods sold includes costs related to the raw materials and manufacturing of Conifex produced lumber, purchases of wholesale lumber and freight procurement costs related to third party revenue generated by the Company's logistics business. Wholesale lumber can be purchased on a free on board origin or other destination basis. As the entire third party purchase is recorded as cost of goods sold, this category typically includes freight costs embedded in the delivered price paid to the vendor. The increase in overall cost of goods sold of 49% over the first quarter of 2014 and 58% over the second quarter of 2013 is primarily attributable to the increase in wholesale lumber shipment volumes, due largely to the acquisition of Lignum in February 2014, and higher shipment volumes of Conifex produced lumber.

Unit log costs were relatively flat during the first two quarters of 2014 and increased by 6% over the second quarter of 2013. Year-to-date unit logs costs increased by 9% over last year with the increase substantially due to an increase in average delivered log costs as lumber recoveries were generally consistent. The increase in delivered log costs is mainly attributable to costs associated with increased stumpage rates, logging and hauling rates, and purchased log costs. The Company expects further modest increases in log costs over the second half of 2014.

An improvement in unit cash conversion costs of 10% over the first quarter of 2014 was primarily attributable to higher productivity and lower energy costs. An increase in unit cash conversion costs of 11% over the second quarter of 2013 was primarily attributable to higher labour and energy costs, greater use of contractor services and heightened safety related and maintenance practices.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were consistent in the first and second quarters of 2014 and increased by approximately 20% over the second quarter of 2013. Factors contributing to the increase included the weaker Canadian currency as freight costs outside of Canada are typically denominated in U.S. dollars, higher fuel costs, variations in shipping patterns, and higher costs associated with alternative freight movements and heightened competition for trucks as a result of the seasonal rail car shortages and shipment disruptions at the main container port in Vancouver, British Columbia during the first quarter of 2014.

Bioenergy Segment

The main activities planned for the bioenergy segment are to create power generation capacity at the Company's Mackenzie facility to generate renewable energy for commercial sale (the "Power Generation Project") and to pursue additional investment opportunities in bioenergy and bioproducts which are complementary to the Company's harvesting and manufacturing operations. The Company's wholly-owned subsidiary, Conifex Power Limited Partnership ("CP Partnership"), is developing the Power Generation Project adjacent to the idled Mackenzie Site I sawmill complex. The project involves upgrading the existing power island infrastructure, installing a new 36 MW turbine, supplying electricity to the Mackenzie operations under a Load

Displacement Agreement and selling electricity under an Electricity Purchase Agreement with BC Hydro. Both agreements have 20-year terms.

The Power Generation Project is currently on budget and proceeding as scheduled, with an expected commercial operation date late in the third quarter of 2014. Procurement and engineering activities are substantially completed. While construction activities on new components are ongoing, refurbishment of legacy equipment is substantially complete and is being transitioned to commissioning crews. Various testing, start-up and commissioning initiatives are underway. A majority of the operations and maintenance team have commenced employment, participated in the refurbishment work and are expected to play an integral role in the testing and commissioning phase.

Capital expenditures related to the Power Generation Project totaled $20.1 million during the second quarter of 2014 compared to $13.6 million during the first quarter of 2014 and $1.7 million during the first quarter of 2013. The current year-to-date spend of $33.7 million has been funded by drawings on the construction loan facility completed in November 2013.

Corporate costs and other items

(millions of dollars)	**Q2 2014**	**Q1 2014**	**YTD 2014**	**Q2 2013**	**YTD 2013**
Corporate costs	1.0	1.6	2.6	1.2	3.2
Borrowing costs and accretion	1.5	1.5	3.0	0.7	1.5
Foreign exchange (gain) loss	0.8	(0.2)	0.6	0.2	(0.2)
	3.3	2.9	6.2	2.1	4.5

The variability in corporate costs in the comparative quarters is primarily attributable to expenses related to the Company's performance based incentive plans. The Company provides a long-term share-based incentive plan for directors and key personnel and a short-term cash-based incentive plan. Year-to-date amounts accrued under the short-term incentive plan were considerably greater last year compared to the current year. Amounts accrued under the long-term incentive plan are impacted by the market value of the Company's common shares.

Borrowing costs and accretion are comprised of interest expense and amortization of costs related to debt issuance and accretion of convertible notes and senior secured notes. The increase in year-to-date borrowing costs of $1.5 million over the first six months of 2013 is primarily attributable to increased drawings under the revolving loan facilities and the issuance of promissory notes, bearing interest at a rate of 8% per annum, in the aggregate principal amount of $30 million in September 2013.

The foreign exchange translation gain or loss recorded for each quarter results from the revaluation of U.S. dollar-denominated working capital balances to reflect the change in the value of the Canadian dollar relative to the value of the U.S. dollar. U.S. dollar-denominated monetary assets and liabilities are translated using the rate of exchange prevailing at the reporting date whereas revenues and expenses are typically recorded at average rates during the period. The relative magnitude of the translation gain or loss is largely determined by the net amount of U.S. dollar-denominated monetary assets and liabilities and the change in the exchange rates at the end of each period. The largely unrealized foreign exchange loss of $0.8 million recorded in the second quarter of 2014 reflects the approximate 4% appreciation of the Canadian dollar at June 30, 2014 compared to March 31, 2014 and the increase in U.S. dollar denominated working capital balances subsequent to the Lignum acquisition. Although the Canadian dollar weakened by approximately 4% between December 31, 2013 and March 31, 2014, the impact on the translation gain of $0.2 million recorded in the first quarter of 2014 was much less pronounced as the currency movement occurred during January 2014 before the Company had completed the Lignum acquisition.

The Company utilizes derivative financial instruments to manage its commodity lumber price exposures in the ordinary course of business and interest rate variability. Realized and unrealized gains or losses from the revaluation of lumber derivative instruments to fair values at period end are recognized as other income or expense each period and allocated to lumber segment operating results. The Company recorded gains from lumber derivative instruments of $0.1 million in the first six months of 2014 compared to $0.3 million in the first six months of 2013. The construction loan provided under the Company's project finance facility (discussed further below) consists of a floating rate tranche and a fixed rate tranche. Concurrent with the completion of the project finance facility in November 2013, CP Partnership entered into interest rate swap transactions with the lead arranger to swap the interest rates on the floating rate tranche of the construction loan and the subsequent term loan to fixed interest rates. The realized and unrealized gains or losses on the interest rate swap instruments are capitalized during the construction period and will be recorded as interest expense once the Power Generation Project commences commercial operations. The loss under the interest rate swap instruments in the first six months of 2014 was *de minimus*.

Income tax

The Company had unused non-capital tax loss carry forwards totalling approximately $30.7 million as at December 31, 2013. Although the Company expects to realize the full benefit of the loss carry forwards and other deferred tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefits of its deferred tax assets available to reduce any future taxable income.

LIQUIDITY AND CAPITAL RESOURCES

The following table is a summary of selected financial information as at the end of the second quarters of 2014 and 2013 and the year ended December 31, 2013**:**

(millions of dollars, unaudited)	**Q2 2014**	**Q4 2013**	**Q2 2013**
Cash	12.4	17.4	10.3
Cash - restricted	3.0	1.2	-
Operating working capital	38.4	25.1	16.7
Operating loan	(6.1)	-	-
Senior secured notes payable	-	-	(5.0)
Convertible notes	(9.3)	(8.8)	-
Current portion of long-term debt	(2.1)	(2.1)	(2.1)
Net current assets	36.3	32.8	19.9
Long-term assets related to power project	102.2	68.6	42.6
Long-term assets - lumber segment and corporate	80.6	79.5	71.4
Net assets	219.1	180.9	133.9
Non-interest bearing long-term liabilities	14.0	12.9	10.8
Long-term debt - power project construction loan	56.2	22.8	-
Long-term debt - other	28.3	28.9	3.5
Convertible notes	-	-	8.3
Shareholders' equity	120.6	116.3	111.3
	219.1	180.9	133.9
Ratio of current assets to current liabilities	1.7	1.7	1.5
Net debt to capitalization, non-recourse borrowings excluded	20%	15%	7%
Net debt to capitalization, non-recourse borrowings included	42%	27%	7%

The Company's current principal sources of funds are cash flow from operations, cash on hand and borrowing availability under its revolving credit facilities and project finance facility related to the Power Generation Project. The revolving credit facilities are provided by leading Canadian chartered banks and are used primarily to support working capital requirements in the lumber segment. The revolving credit facilities total $32.5 million and consist of a $25.0 million asset backed credit facility and a $7.5 million demand loan which was assumed in connection with the acquisition of Lignum. Borrowings under the revolving credit facilities totaled $6.1 million at June 30, 2014. The project finance facility is provided to CP Partnership and includes up to $82.0 million as a development and construction loan, an $18.95 million letter of credit facility and a $1.75 million revolving operating facility. The project finance facility is primarily secured by a first priority security interest on the Power Generation Project assets and recourse to affiliates is largely limited to a $5 million contingent equity letter of credit issued by the Company which can be drawn if the general contingency provided within the project budget is exhausted. At June 30, 2014, CP Partnership had drawn $56.2 million of the construction loan and issued letters of credit totaling $6.8 million.

The Company's working capital levels fluctuate throughout the year and are affected by a variety of factors, including changes in sales volume and price, shipment patterns, operating rates, seasonality and the timing of receivables and the payment of payables and expenses. The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the winter months to ensure adequate supply of fibre to its mills during the spring months. Factors such as disruption of transportation services by third party providers and increases in export shipments can impact the level of finished goods inventory. The increase in operating working capital in the comparative periods is primarily attributable to higher levels of transit finished goods inventory as the Company has increased direct shipments to export markets and the incremental working capital required with the addition of Lignum in February 2014.

The Company's long-term debt consists primarily of senior secured promissory notes in the aggregate principal amount of $30 million. The promissory notes mature in September 2017, bear interest at a rate of 8% per annum, and can be partially or fully repaid by the Company at any time without penalty.

The improvement of the ratio of current assets to liabilities during the first six months of 2014 to 1.7:1 from 1.5:1 at June 30, 2013 reflects the positive impact of cash flow generated from operations and the completion, during the second half of 2013, of various financing initiatives with longer maturity dates. The reclassification from long-term debt to current debt of the convertible notes which mature in December 2014 detracted from the ratio. Excluding the effects of the borrowings under the construction loan, the Company ended the second quarter of 2014 with a net debt to capitalization ratio of 20% compared to 15% at December 31, 2013.

As part of its overall strategy, the Company may acquire businesses or additional assets from time to time as such opportunities arise. As a result, the Company may require substantial additional capital resources. The Company expects such additional capital resources will be generated from debt financing and/or the sale of equity securities, but no assurance may be given that such additional capital resources will be available on satisfactory terms, or at all.

The Company monitors expected liquidity levels by regularly preparing rolling cash flow forecasts to ensure sufficient resources are available to meet operational requirements, debt service commitments and to sustain future business development. The Company recently approved a lumber segment capital plan totalling $18.0 million to be largely implemented during the current year. The Company intends to fund the capital upgrades primarily from internally generated cash flows. The Company expects the project finance facility will provide the remainder of the funding required to complete the Power Generation Project. Based on its current forecasts, the Company expects sufficient liquidity will be available to meet its obligations in 2014.

Selected Cash Flow Items

(millions of dollars, unaudited)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Operating Activities					
Cash provided before working capital changes	5.4	7.5	12.9	4.5	15.3
Cash provided (used) in non cash working capital	14.9	(18.8)	(3.9)	8.9	1.4
Cash provided from (used in) operating activities	20.3	(11.3)	9.0	13.4	16.7
Investing Activities					
Additions to:					
Capital assets - power project	(16.4)	(15.7)	(32.1)	(3.5)	(7.2)
Capital assets - lumber and corporate	(1.7)	(3.0)	(4.7)	(2.2)	(3.2)
Other long-term investments	(0.6)	-	(0.6)	-	-
Acquistion of subsidiary	-	(4.8)	(4.8)	-	-
Cash used in investing activities	(18.7)	(23.5)	(42.2)	(5.7)	(10.4)
Financing Activities					
Proceeds from issuance of secured notes	-	-	-	-	5.0
Proceeds from construction loan - power project	17.4	16.1	33.4	-	-
Proceeds from (repayment of) operating loan	(10.2)	9.5	(0.7)	-	-
Repayment of senior secured notes	-	-	-	(12.0)	(12.0)
Repayment of long-term debt	(0.5)	(0.4)	(0.9)	(0.4)	(0.9)
Finance expenses and fees paid	(0.7)	(1.2)	(1.8)	(1.4)	(2.2)
Cash provided from (used in) financing activity	6.0	24.0	30.0	(13.8)	(10.1)
Change in cash	7.6	(10.8)	(3.2)	(6.1)	(3.8)

Cash provided from (used in) non-cash working capital items

(millions of dollars)	Q2 2014	Q1 2014	YTD 2014	Q2 2013	YTD 2013
Trade and other receivables	(4.5)	3.9	(0.6)	5.4	1.9
Inventories	25.0	(20.4)	4.6	7.0	(3.3)
Accounts payable and accrued liabilities	0.1	(3.1)	(3.0)	(1.4)	4.6
Other	(5.7)	0.8	(4.9)	(2.1)	(1.8)
Cash provided from (used in) non cash working capital	14.9	(18.8)	(3.9)	8.9	1.4

Operating activities provided cash of $20.3 million in the second quarter of 2014 and $13.4 million in the second quarter of 2013 and consumed cash of $11.3 million in the first quarter of 2014. The fluctuation between quarters was due primarily to the net change in non-cash working capital levels and, to a lesser extent, the variation in lumber segment profitability. The level of log and finished goods inventories and the incremental working capital required by Lignum had the most significant impact on the change in non-cash working capital. During the second quarter of 2014, log inventories were drawn down by $19.8 million due to the seasonal curtailment of harvesting and delivery activities and finished goods inventories were reduced by $5.4 million as industry wide challenging shipping conditions improved.

Investing activities during the second quarter of 2014 totalled $18.7 million on a cash basis and were comprised primarily of $16.4 million of expenditures on the construction of the Power

Generation Project and $1.7 million on lumber segment capital expenditures. In the previous quarter, the Company invested $15.7 million in the Power Generation Project, $3.0 million in capital improvements in the lumber segment and $4.8 million in the acquisition of Lignum. Lumber segment capital expenditures during the first half of 2014 were weighted towards the replacement and upgrade of aging equipment and safety related and asset protection projects, with the balance focused on targeted higher return projects including improvements to recovery of residuals. During the first six month of 2013, the Company invested $3.2 million in the lumber segment, primarily on mobile equipment and items related to major maintenance, safety and asset protection and $7.2 million in the Power Generation Project.

Financing activities during the second quarter of 2014, consisting primarily of proceeds from the construction loan of $17.4 million, and repayment of revolving credit facilities of $10.2 million, provided net cash of $6.0 million. Net cash provided from financing activities during the first quarter of 2014 totalled $24.0 million and included proceeds from the construction loan of $16.1 million and net proceeds from revolving credit facilities of $9.5 million. During the first half of 2013, material financing activities included gross proceeds of $5.0 million from the issuance of senior secured promissory notes by CP Partnership, the repayment in full of previously issued senior secured notes of $12.0 million and payment of finance expenses and fees of $2.2 million.

Overall cash balances increased by $7.6 million during the second quarter of 2014. The Company had unrestricted cash of $12.4 million at June 30, 2014 compared to $17.4 million at December 31, 2013.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(millions of dollars, except share and per share amounts, unaudited)	2014		2013				2012	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales	99.6	67.2	63.7	65.3	64.5	66.1	60.0	54.4
Operating income (loss)	4.4	2.8	2.2	0.7	3.3	6.6	(2.4)	(2.8)
Net income (loss)	2.0	1.6	1.1	(0.1)	2.4	6.2	(3.5)	(3.7)
Net income (loss) per share - basic	0.10	0.08	0.05	(0.01)	0.12	0.30	(0.18)	(0.19)
Net income (loss) per share - diluted (1)	0.10	0.08	0.05	(0.01)	0.12	0.29	(0.18)	(0.19)
EBITDA (2)	5.9	5.5	4.5	2.5	5.0	8.8	(1.1)	(1.2)
Shares outstanding - weighted average (millions)	20.9	20.8	20.8	20.8	20.8	20.7	19.6	19.4
Statistics								
Lumber shipments - Conifex produced (MMfbm)	146.4	95.9	118.6	129.3	119.2	119.8	110.2	107.5
Lumber production (MMfbm)	134.9	128.3	116.3	123.0	135.8	124.2	108.4	102.8
Average exchange rate - US$/Cdn$ (3)	0.917	0.906	0.953	0.963	0.977	0.991	1.009	1.005
Average WSPF 2x4 #2&Btr lumber price (US$) (4)	$ 335	$ 367	$ 370	$ 328	$ 334	$ 390	$ 335	$ 301
Average WSPF 2x4 #2&Btr lumber price (Cdn$)(5)	$ 365	$ 405	$ 388	$ 341	$ 342	$ 393	$ 332	$ 299
Reconciliation of EBITDA to Net Income (Loss)								
Net income (loss)	2.0	1.6	1.1	(0.1)	2.4	6.2	(3.5)	(3.7)
Add: Interest expense	1.2	1.3	1.2	0.4	0.5	0.6	0.5	0.5
Amortization	2.7	2.6	2.2	2.2	2.1	2.0	1.9	2.0
EBITDA (6)	5.9	5.5	4.5	2.5	5.0	8.8	(1.1)	(1.2)

(1) If the conversion of convertible notes and/or the inclusion of outstanding warrants is anti-dilutive, it is excluded from the calculation of diluted net income per share.

(2) The EBITDA calculation represents earnings before interest, taxes, depreciation and amortization, and has been reported without reference to deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures as it was presented in previous quarters. EBITDA for all quarters presented has also been restated to exclude such items.
(3) Source: Bank of Canada website www.bankofcanada.ca.
(4) Source: Random Lengths Publications Inc.
(5) Average WSPF 2x4 #2&Btr lumber price (US$) divided by average exchange rate.
(6) May not total exactly due to rounding.

The financial data summarized in the preceding table for each of the eight most recently completed quarters has been prepared in accordance with International Financial Reporting Standards.

The Company's financial results are impacted by a variety of market related factors, including fluctuations in lumber prices, fluctuation in prices of certain commodities related to by-product revenue and manufacturing inputs, and changes in foreign exchange rates. Quarterly trends are also impacted by the seasonal nature of activities such as logging operations and construction and remodelling activity. The Company primarily relies on third parties for transportation of its products, as well as delivery of raw materials, and any significant or prolonged disruption of services provided by third party carriers may adversely impact operations or cost structure. Other more company specific factors that influence quarterly trends include operating rates and transactions of a non-recurring nature. 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 unstable road conditions. The Company completed the acquisition of Lignum, a lumber marketing and distribution business, in February 2014.
Due to the cyclical nature of the forest products industry and the economic conditions over the last several years, the Company has not recognized certain future income tax assets arising from loss carry-forwards that should otherwise be available to reduce any future taxable income.

OUTLOOK AND STRATEGY

The Company is executing a strategy to grow and add value to its business. Management has been executing against this plan since the Company's management restructuring late in 2012. The momentum established in 2013 in terms of increasing production volumes and expanding profit margins is expected to continue through the balance of 2014.

Through the balance of the year, the Company expects to complete its Power Generation Project on budget, and to commence deliveries of electricity late in the third quarter of 2014. The Company also expects to establish a long-term plan for its idled and operating Mackenzie mills following the release of information regarding future sawlog harvest levels in the Mackenzie Timber Supply Area by the Ministry of Forests, Lands and Natural Resources Operations.

OUTSTANDING SECURITIES

As at August 1, 2014, the Company had 20,897,064 issued and outstanding common shares, 100,000 options granted, 1,157,836 long-term incentive plan awards, 2,210,200 warrants, and stepped rate subordinated convertible promissory notes in the aggregate principal amount of $9,732,000, which notes are convertible into a maximum of 1,216,500 common shares of the Company, excluding any common shares issuable in payment of accrued interest thereon.

SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

Management has made certain estimates and judgements that affect the reported amounts and other disclosures in our financial statements. These estimates and judgments are described bellows.

Valuation of Inventory
We closely monitor conditions that could impact valuation of inventories or otherwise impair our assets. Inventories of logs and lumber products are valued at the lower of average cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs for completion and applicable variable selling expenses. Our estimated selling price is based on sales order that exist at balance sheet reporting dates and management's estimate for forecasted sales prices based on supply, demand and industry trends. Prices fluctuate over time and it is probable that market values at the time of eventual sale will differ from our estimates.

Valuation of Long-Lived 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. Assessing the valuation of the affected assets requires us to make judgments, assumptions and estimates. An impairment loss is generally recognized when the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the greater of an asset's fair value less costs to sell and value in use.

We review the amortization periods for our manufacturing equipment and machinery to ensure that the periods appropriately reflect anticipated obsolescence and technological change. Current amortization periods for manufacturing equipment range from 3 to 20 years. Timber licences are amortized over 60 years.

Management currently believes that Conifex has adequate support for the carrying value of its long-lived assets based on analysis including anticipated cash flows that result from our estimates of future demand, pricing and production costs, and assuming certain levels of planned capital expenditures. However, should the markets for Conifex's products deteriorate to levels significantly below current forecasts or should capital not be available to fund operations or expenditures, it is possible that we will be required to record further impairment charges.

Reforestation Obligation
Timber is harvested under various licenses issued by the Province of British Columbia, which include future requirements for reforestation. The future estimated reforestation obligation is accrued and charged to earning on the basis of the volume of timber cut. The estimates of reforestation obligation are based upon various judgments and assumptions. Both the precision and reliability of such estimates are subject to uncertainties and, as additional information becomes known, these estimates are subject to change.

Environmental Remediation Costs
Costs associated with environmental remediation obligations are accrued and expensed when there exists a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Such accruals are adjusted as further information develops or circumstances change. Estimated costs

of future expenditures for environmental remediation obligations are discounted to their present value when the amount and timing of expected cash payments are reliably determinable.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors is included in the Company's 2013 annual information form dated March 27, 2014, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

On June 26, 2014, the Supreme Court of Canada (the ″**SCC**″) released its decision in *Tsilhqot'in Nation v. British Columbia* (the "**William Decision**"), upholding the First Nations' claim to Aboriginal title and rights over a large area of land in about central British Columbia. The SCC also held that Provincial laws of general application apply to land held under Aboriginal title if the laws are not unreasonable, impose no undue hardship and do not deny the Aboriginal title holders of their preferred means of exercising their rights.

Conifex does not currently have any Crown-granted timber harvesting rights in the area involved in the William Decision, and Aboriginal title hasn't been established in areas overlapping with the Company's forest tenures. Although this has created uncertainty, Conifex does not currently expect that the SCC decision will lead to any fundamental changes in how Conifex conducts its lumber and sawlog operations.

The Company believes that its dealings with First Nations, since Conifex purchased its first sawmill in 2008, have been largely consistent with the principles set out in the William Decision. The Company has been, and remains, committed to fostering long-term relations with First Nations, including in an environmentally sound manner to minimally impact the communities in which Conifex operates. The Company has and will continue to operate on the basis that resource companies must consult, and where possible, accommodate Aboriginal rights and foster positive long-term relations with First Nations communities.

ADDITIONAL INFORMATION

Additional information about the Company, including its 2013 Annual Information Form, is available on SEDAR at www.sedar.com.