CONIFEX

# CONIFEX TIMBER INC.
**SECOND QUARTER 2011**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

**Dated as of August 16, 2011**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the three and six months ended June 30, 2011 relative to 2010, the Company's financial condition and future prospects. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements of Conifex and accompanying notes for the three and six months ended June 30, 2011 and 2010 and for the three months ended March 31, 2011 and 2010, as well as the 2010 annual MD&A and the 2010 audited consolidated financial statements and notes thereon which are filed on SEDAR at www.sedar.com. The financial information contained in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") and in accordance with International Accounting Standard 34 Interim Financial Reporting.*

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

*Unless otherwise noted, all monetary references in this 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

*Certain statements in this interim MD&A may constitute "forward-looking statements". Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. When used in this interim MD&A, words such as "estimates", "expects", "plans", "anticipates", "projects", "will", "intends", "believes", "should", "could", "may" and other similar terminology are intended to identify such forward-looking statements. Forward-looking statements reflect the current expectations and beliefs of the Company's management. Because forward-looking statements involve known and unknown risks, uncertainties and other factors, actual results, performance or achievements of the Company or industry may be materially different from those implied by such forward-looking statements. Forward-looking statements involve significant uncertainties, should not be read as a guarantee of future performance or results, and will not necessarily be an accurate* *indication of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including those matters described under "Risks and Uncertainties". Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstances, except as required by law.*

**SIGNIFICANT DEVELOPMENTS**

Significant developments during the second quarter of 2011 included the completion of an Electricity Purchase Agreement ("EPA") and Load Displacement Agreement ("LDA") with BC Hydro, the addition of a second shift at Fort St. James and Mackenzie, and record shipments during the quarter to export markets.

**Completion of EPA and LDA with BC Hydro**

In June 2011, the Company announced the completion of an EPA and a LDA with BC Hydro in connection with the Company's planned bioenergy facility (the "Bioenergy Facility") at Mackenzie, British Columbia. With the agreements finalized, the Company is set to proceed with more extensive detailed project engineering work which will enable refinement of expected capital costs. Planned capital expenditures will include the upgrade of the existing power island infrastructure and the purchase of a 36 megawatt steam turbine generator set. The Bioenergy Facility is currently expected to generate approximately 230 gigawatt hours ("GWh") of net energy per year.

Under the EPA, the Company will supply a minimum of approximately 200 GWh of electrical energy annually to BC Hydro over a 20-year term with deliveries currently estimated to commence in late 2012. The EPA provides for a fixed price for energy delivered to BC Hydro. Revenues from the project to the Company's bioenergy segment are expected to exceed $20 million annually when the Bioenergy Facility is operating at design capacity.

Under the LDA, the Company is required to deliver 30 GWh of electrical energy annually to BC Hydro over a 20-year term paralleling that of the EPA. The energy delivered to BC Hydro under the LDA shall offset and supply the energy requirements of the Company's sawmills located in Mackenzie over the term of the LDA. In exchange for the Company agreeing to supply such energy for the sawmills, BC Hydro shall provide incentive funding to be utilized towards the completion of the Bioenergy Facility.

The feedstock for the Bioenergy Facility will be sourced from a portion of the residuals and former waste products produced at Conifex's lumber manufacturing and log harvesting operations.

The transaction contemplated by the EPA and LDA are subject to the EPA being accepted by the British Columbia Utilities Commission as an energy supply contract.

**Addition of second shift at Fort St. James and Mackenzie**

The addition of a second shift at Fort St. James and Mackenzie in late March 2011 improved operating rates during the second quarter of 2011 to approximately 55% of total annualized production potential. Operating rates were approximately 34% in the previous quarter and 22% in the same quarter last year.

Unit conversion costs during the second quarter of 2011 improved by approximately 23% over the previous quarter and by approximately 8% over the same quarter last year. Unit conversion costs during first quarter of 2011 were higher than trend due to disruptions from the major construction activity at Fort St. James and the incremental costs incurred as both operating sites prepared for additional shifts.

Management and operations personnel remain focused on continuous process improvements and employee development to capture further efficiencies and increase output from the manufacturing and finishing operations. Increased production has provided the opportunity to add talented operations personnel in key supervisory roles. Management expects unit conversion costs to decline further as operating rates improve to the targeted 70% on an annualized basis.

The addition of the second shifts brings the total annual production potential at Fort St. James and the Site II sawmill at Mackenzie to approximately 310 million board feet and 220 million board feet respectively. The production potential of the currently idled Site I sawmill complex as it is presently constituted is approximately 215 million board feet per year. Estimated total annual production capacity on a two-shift basis is 745 million board feet.

**Record second quarter shipments to export markets**

The provincial government of British Columbia recently published a press release noting that, for the first time ever, the value of lumber destined for China in May 2011 surpassed that shipped to the U.S. Conifex's geographical shipment profile reflected this larger pattern as the Company shipped a record 83% of total second quarter shipments to export markets compared to 44% in the previous quarter and 41% in the same quarter last year. The Company's primary export markets are China and Japan. Shipments to export markets for the first half of 2011 represented 66% of total shipments compared to 36% for the first half of 2010.

## SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

### CONSOLIDATED OPERATING RESULTS

| (millions of dollars except share and per share amounts) | Q2 2011 | Q1 2011 | YTD 2011 | Q2 2010 | YTD 2010 |
|---|---|---|---|---|---|
| Sales -Lumber | 21.9 | 18.6 | 40.5 | 10.7 | 21.6 |
| - Co-products | 5.0 | 2.6 | 7.6 | 1.9 | 3.1 |
| Total Sales | 26.9 | 21.2 | 48.1 | 12.6 | 24.7 |
| Operating loss | (4.1) | (3.8) | (7.9) | (1.8) | (2.9) |
| Net loss | (3.6) | (3.6) | (7.2) | (2.4) | (4.0) |
| Net loss per share - basic and diluted | (0.24) | (0.24) | (0.48) | (0.31) | (0.67) |
| EBITDA* | (0.8) | (1.3) | (2.2) | (0.9) | (1.8) |
| Shares outstanding - end of period (millions) | 15.2 | 15.2 | 15.2 | 15.1 | 15.1 |
| Shares outstanding - weighted average (millions) | 15.2 | 15.2 | 15.2 | 7.6 | 5.9 |
| **Statistics** | | | | | |
| Lumber shipments (MMfbm)** | 81.5 | 62.5 | 144.0 | 34.2 | 71.6 |
| Lumber production (MMfbm) | 102.4 | 63.5 | 165.9 | 41.3 | 80.8 |
| Average exchange rate - US$/Cdn$ (1) | 1.0335 | 1.0142 | 1.0238 | 0.973 | 0.967 |
| Average WSPF 2x4 #2&Btr lumber price (US$) (2) | $ 240 | $ 297 | $ 268 | $ 264 | $ 266 |
| Average WSPF 2x4 #2&Btr lumber price (Cdn$) | $ 232 | $ 293 | $ 262 | $ 271 | $ 275 |

* EBITDA represents earnings before interest, taxes, depreciation and amortization, as well as before deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures and other investments. The company discloses EBITDA as it is a measure used by analysts and the Company's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.
**Shipment volumes from prior periods have been adjusted for consistency with current product classifications.
(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.

### Reconciliation of EBITDA to Net Loss

| (millions of dollars) | Q2 2011 | Q1 2011 | YTD 2011 | Q2 2010 | YTD 2010 |
|---|---|---|---|---|---|
| Net loss | (3.6) | (3.6) | (7.2) | (2.4) | (4.0) |
| Add: | | | | | |
| Net interest expense | 0.1 | - | 0.1 | - | - |
| Depreciation and amortization | 1.7 | 1.4 | 3.1 | 0.5 | 1.0 |
| Deferred union payroll liability | 0.5 | 0.3 | 0.8 | - | 0.2 |
| Share based compensation | 0.2 | 0.3 | 0.5 | 0.1 | 0.2 |
| Share revaluation related to qualifying transaction | - | - | - | 0.4 | 0.4 |
| Accretion of convertible debentures | 0.3 | 0.3 | 0.6 | 0.5 | 0.5 |
| EBITDA* | (0.8) | (1.3) | (2.2) | (0.9) | (1.7) |

* May not total exactly due to rounding.

The Fort St. James and Mackenzie Site II sawmill complexes operated on a one-shift basis throughout the first quarter and on a two-shift basis throughout the second quarter of 2011.

Results for the first six months of 2010 reflect the operation of the Fort St. James sawmill complex on a one-shift basis and the purchase of the idled Mackenzie Assets in June 2010.

For the quarter ended June 30, 2011 the Company recorded a net loss of $3.6 million or $0.24 per share and negative EBITDA of $0.8 million on sales of $26.9 million. Negative EBITDA was comprised of $0.8 million from the lumber segment and $0.2 million from the bioenergy segment offset by positive EBITDA of $0.2 million from corporate costs and other items. Corporate costs and other items included income from lumber price derivatives of $1 million for the second quarter of 2011. Overall EBITDA improved by $0.5 million compared to the previous quarter and $0.1 million compared to the same quarter last year.

Benchmark WSPF 2X4 #2 & Btr ("WSPF") lumber prices during the current quarter were 19% lower than the previous quarter and 9% lower than the same quarter last year. Lumber revenues were further challenged by the strengthening of the Canadian dollar by 2% compared to the U.S. dollar over the previous quarter and 6% over the second quarter of 2010. Current quarter mill nets did not decline as steeply as benchmark prices would indicate due to improved product and grade mix, the price lag on export orders, and shallower price declines in export markets compared to North American markets. Unit manufacturing costs improved by 23% compared to the previous quarter and 8% compared to the same quarter last year although corresponding improvements were not realized on year-to-date costs.

At June 30, 2011, the Company had $7.8 million cash on hand and cash equivalents, a decrease of $1.7 million during the quarter and $18.9 million from December 31, 2010. Approximately $9.4 million of the year-to-date decrease in cash is attributable to a net increase in non-cash working capital to support higher production volumes coupled with a shift in sales mix to overseas markets and $8.5 million to additions of capital assets.

## REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

### Operating Results by Business Segment

| (millions of dollars) | **Q2 2011** | **Q1 2011** | **YTD 2011** | **Q2 2010** | **YTD 2010** |
|---|---|---|---|---|---|
| **Revenue** | | | | | |
| Lumber | 26.9 | 21.2 | 48.1 | 12.6 | 24.7 |
| Bioenergy | - | - | - | - | - |
| | 26.9 | 21.2 | 48.1 | 12.6 | 24.7 |
| **Net Loss** | | | | | |
| Lumber | (3.1) | (2.9) | (6.0) | (1.5) | (2.4) |
| Bioenergy | (0.3) | (0.2) | (0.5) | (0.1) | - |
| Corporate costs and other items | (0.2) | (0.5) | (0.7) | (0.8) | (1.6) |
| | (3.6) | (3.6) | (7.2) | (2.4) | (4.0) |
| **EBITDA** | | | | | |
| Lumber | (0.8) | (1.0) | (1.8) | (1.0) | (1.3) |
| Bioenergy | (0.2) | (0.2) | (0.5) | (0.1) | - |
| Corporate costs and other items | 0.2 | (0.1) | 0.1 | 0.2 | (0.4) |
| | (0.8) | (1.3) | (2.2) | (0.9) | (1.7) |

**Lumber Segment**

Overview
Benchmark WSPF prices declined by 25% during the first half of the second quarter of 2011 before staging a modest recovery to end the period near the quarterly average of US$240[1]. WSPF prices averaged US$297 during the first quarter of 2011 and US$264 during the second quarter of 2010. The price decline in the current quarter was largely attributable to production increases without a corresponding demand side response as the anticipated seasonal activity in the U.S. construction market failed to materialize. During the first quarter of 2011, strong demand specific to the 2x4 #2 & Btr product bid up the benchmark price which was not necessarily indicative of corresponding strength in other dimensions.

The Canadian dollar averaged approximately $1.03 for each U.S. dollar during the second quarter of 2011, an increase of 2% over the previous quarter and 6% over the second quarter of 2010. The Company's mill nets on lumber shipments during the second quarter of 2011 were 6% lower than mill nets achieved during the previous quarter and 10% lower than the same quarter last year although average WSPF prices in Canadian dollars were 21% and 14% lower in the respective periods. Actual mill net realizations in the current quarter were higher than would be indicated by the quarter over quarter decline in benchmark prices because:

- An improved product and grade mix was produced and shipped in the current quarter due to the recent improvements in manufacturing processes
- Export orders are typically contracted on a monthly or quarterly basis and the Company had a robust order file entering the quarter
- Generally speaking, prices in export markets are more stable than prices in the North American market.

For the six months ended June 30, 2011, WSPF price averaged US$268 and the Canadian dollar averaged $1.02 compared to average WSPF price of US$266 and exchange rate of $0.97 for the first six months of 2010.

The export tax remained at 15% throughout the first six months of 2011 and averaged 8.3% during the second quarter of 2010.

The Company recorded a net loss of $3.1 million in its lumber segment on sales of $26.9 million for the second quarter of 2011 compared to a net loss of $2.9 million on sales of $21.2 million for the previous quarter and a net loss of $1.5 million on sales of $12.6 million for the same quarter last year. EBITDA in this segment was negative $0.8 million for the second quarter of 2011 compared to negative $1 million for the first quarter of 2011 and the second quarter of 2010.

Sales
Revenue from lumber shipments increased by $3.3 million or 18% during the second quarter of 2011 compared to the previous quarter. The net increase of 18% was comprised of a 30% increase attributable to higher shipment volumes offset by a 12% decrease due to the decline in unit prices. Lumber revenue during the current quarter increased by $11.2 million or 105% compared to the same quarter last year. The net increase was comprised of higher shipment volumes which represented a 138% increase in revenue offset by the decline in unit prices which reduced revenue by 33%. For the six months ended June 30, 2011, lumber revenue

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

increased by 87% over the first six months of 2010. Revenue increase of 101% from higher shipments was offset by a decrease of 14% from the decline in unit prices.

Lumber shipments of 81.5 million board feet during the current quarter represented an increase of 30% over the previous quarter and 138% over the same quarter last year. The increase is primarily attributable to higher production levels from the addition of second shifts at Fort St. James and Mackenzie. Current year-to-date shipment volume totalled 144 million board feet and was double the volume shipped during the first six months of last year.

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

| | Q2 2011 | Q1 2011 | YTD 2011 | Q2 2010 | YTD 2010 |
|---|---|---|---|---|---|
| **By Revenue (net of freight)** | | | | | |
| Canada | 11% | 23% | 17% | 23% | 25% |
| USA | 4% | 34% | 18% | 40% | 44% |
| Export | 85% | 43% | 65% | 37% | 31% |
| | 100% | 100% | 100% | 100% | 100% |
| **By Shipment Volume** | | | | | |
| Canada | 13% | 23% | 17% | 18% | 19% |
| USA | 4% | 33% | 17% | 41% | 45% |
| Export | 83% | 44% | 66% | 41% | 36% |
| | 100% | 100% | 100% | 100% | 100% |

The Company shipped 83% of total second quarter 2011 shipment volume to export markets compared to 44% in the previous quarter and 41% in the same quarter last year. Current year-to-date export shipments represented 66% of total shipment volume compared to 36% during the first six months of 2010. Conifex's primary export markets are China and Japan.

The significant increase of shipments to export markets during the current quarter was a reflection of a larger than usual order file carried over from the previous quarter due to temporary logistical constraints, increased production of premium products that have a traditional Japanese market, and diversion of products to capture higher mill returns attainable in export markets relative to the North American market. Shipments to the U.S. and Canadian markets in the first quarter of 2011 accounted for an above normal portion of volume due to seasonal slowdowns in the Asian markets and relatively strong prices in the domestic market.

Shipments lagged production during the second quarter of 2011 by approximately 21 million board feet because the increased commitment of sales orders to overseas markets requires an increased investment in finished goods in transit inventory. The average time lag between shipments of finished product from the mill sites to delivery on board the ocean going vessel at which time the shipment is recognized as accounts receivable is approximately 35 days. In contrast, shipments to North American customers are invoiced on the same day the product is shipped from the mill sites.

Revenue from co-products (primarily chips, sawdust and shavings, hog fuel, and trim blocks) totalled $5 million in the second quarter of 2011, an increase of $2.4 million or 92% over the previous quarter. Approximately 61% of the increase was due to increased volume and 31% was due to the effect of retroactive price adjustments on certain items. Current quarter co-products revenue increased by $3.1 million compared to the same quarter last year with most of the increase attributable to increased volumes.

For the six months ended June 30, 2011, revenue from co-products totalled $7.6 million and represented approximately 16% of total revenue compared to $3.1 million, representing 13% of total revenue, for the first half of 2010.

Production and Operations

With the addition of a second shift at Fort St James and Mackenzie in late March 2011, lumber production during the second quarter of 2011 increased by 61% over the previous quarter and 148% over the second quarter of 2010. Production for the first half of 2011 totalled 166 million board feet and was more than double production volume for the first six months of 2010 when the Company operated only the Fort St. James sawmill on a one shift basis. Operating rates during the current quarter improved to approximately 55% of overall annual production capacity on a two-shift basis compared to approximately 34% for the previous quarter and 22% for the same quarter last year.

During the second quarter of 2011, management and operations personnel focused on ramp up activities including the training and development of personnel in key supervisory and operating roles, increased maintenance, and ongoing recalibration of specific manufacturing and finishing processes to adjust to increased volumes and the recently completed major capital improvements at Fort St. James.

Unit conversion costs for the second quarter of 2011 declined by approximately 23% compared to the previous quarter and 8% compared to the same quarter last year. The improvement was attributable to increased operating rates during the current quarter. In addition, higher than trend conversion costs were recorded in the previous quarter as a result of construction related production inefficiencies at Fort St. James and incremental costs incurred to prepare for the second shifts.

There was no significant change in unit conversion costs for the first six months of 2011 compared to the same period last year. Current year-to-date unit conversion costs do not reflect the benefit of the higher operating rates due to the unusually higher unit costs incurred during the first quarter. Management expects unit costs to improve during subsequent periods as further production gains are realized and targeted operating rates of approximately 70% are achieved. Per unit amortization costs increased 44% year over year due to a higher depreciable asset base associated with the purchase and commencement of production at Mackenzie and completion of the capital expenditure program at Fort St. James.

There were no significant changes in log costs throughout the comparative periods.

Freight and distribution costs on a per unit basis were 6% higher in the current quarter compared to the previous quarter due primarily to increased export shipments. Compared to the second quarter of 2010, per unit freight and distribution costs were 11% lower in the current quarter due to a stronger Canadian dollar and an increase in the volume of sales transacted on free on board ("FOB") mill terms. Freight movements to geographical areas outside of Canada are typically priced in U.S. dollars.

Export taxes were significantly lower during the second quarter of 2011 as shipments to the U.S. represented only 4% of total lumber shipments.

Selling, general and administrative expenses ("SG&A") related to the lumber segment increased by 19% over the previous quarter with the increase attributable to variable costs related to increased shipment volumes and the addition of a regional office in March 2011. The increase of 130% in SG&A expenses compared to the second quarter last year was attributable primarily to increased shipment volumes and the acquisition of the Mackenzie Assets in June 2010.

**Bioenergy Segment**

The completion of the EPA and LDA agreements with BC Hydro in June 2011 allows for the undertaking of further project development activities. The Company has finalized a project oversight structure and selected a project manager. Prioritized project development activities include detailed engineering work and the consideration of agreements related to major project components in order to comprehensively define scope and to refine total project costs. Once the scope and expected cost of the project is sufficiently defined, the Company intends to secure related financing.

The Company is concurrently exploring a variety of other opportunities in the bioenergy sector with a focus on those that will allow the Company to capitalize on its existing infrastructure and residual fibre suitable for use as bioenergy feedstock.

The net loss in this segment for the reporting periods mainly arises from costs related to holding idled facilities such as insurance and property tax.

**Corporate costs and other items**

Corporate costs for the first half of 2011 increased by $0.9 million compared to the first half of 2010. The increase results from the addition of a corporate office and personnel and costs related to the provision of corporate services to operations.

The Company recorded income from lumber price derivatives of $1 million for the second quarter of 2011 compared to $0.7 million for the previous quarter and $0.5 million for the same quarter last year. Income from lumber price derivatives for the first six months of 2011 totalled $1.7 million compared to nil for the first six months of 2010.

## FINANCIAL POSITION AND LIQUIDITY

### SELECTED CASH FLOW ITEMS

| (millions of dollars) | Q2 2011 | Q1 2011 | YTD 2011 | Q2 2010 | YTD 2010 |
|---|---|---|---|---|---|
| **Operating Activities** | | | | | |
| Cash used before working capital changes | **(1.6)** | **(2.2)** | **(3.8)** | (1.1) | (1.8) |
| Non - cash working capital change | **2.8** | **(12.1)** | **(9.3)** | 0.1 | (3.2) |
| Cash provided from (used in) operating activities | **1.2** | **(14.3)** | **(13.1)** | (1.0) | (5.0) |
| **Investing Activities** | | | | | |
| Additions to property, plant, equipment | **(4.8)** | **(3.6)** | **(8.4)** | (2.4) | (4.8) |
| Acquisiton of Mackenzie Assets | **-** | **-** | **-** | (34.5) | (34.5) |
| Proceeds on disposal of assets held for sale | **0.8** | **0.8** | **1.6** | - | - |
| Cash used in investing activities | **(4.0)** | **(2.8)** | **(6.8)** | (36.9) | (39.3) |
| **Financing Activities** | | | | | |
| Net proceeds from private placement | **-** | **-** | **-** | 85.9 | 85.9 |
| Net proceeds from loans | **1.1** | **-** | **1.1** | 2.3 | 2.3 |
| Proceeds from convertible notes | **-** | **-** | **-** | - | 2.0 |
| Cash provided from financing activity | **1.1** | **-** | **1.1** | 88.2 | 90.2 |
| **Change in cash and cash equivalents** | **(1.7)** | **(17.1)** | **(18.8)** | 50.3 | 45.9 |

Cash provided from operating activities totalled $1.2 million during the second quarter of 2011 compared to cash used of $14.3 million in the previous quarter and $1 million in the second quarter of 2010. The most substantial change in non-cash working capital in the previous quarter was a $12.5 million increase in inventories with the build-up primarily represented in log inventories. During the current quarter, log inventories were reduced by $11 million while finished lumber inventories increased by $6.5 million. The increase in finished goods inventories was attributable primarily to higher in transit inventories required to facilitate commitments to export orders. The $6.1 million increase in cash used in non-cash working capital during the first six months of 2011 compared to the first six months of the prior year reflects the higher overall levels of working capital required to support two shift operations at both locations.

Investment activities of $4.8 million during the second quarter of 2011 consisted of additions to capital assets of $1.4 million and payment of $3.4 million of expenditures capitalized in the prior period which remained in accounts payable at period end. Investment activities for the second quarter of 2010 included additions to capital assets of $2.4 million and acquisition of the Mackenzie Assets for $34.5 million. During the first six months of 2011, the Company also collected proceeds from assets sold in a prior period.

Related to its capital expenditures, in April 2011 the Company drew down the remaining $1.5 million available from its previously approved credit facility under the Community Adjustment Fund (“CAF”) loan program sponsored by Northern Development Initiative Trust. The loan carries a fixed interest rate of 3.75% and is to be repaid in twenty quarterly instalments beginning June 2011. The Company repaid $0.4 million during the current quarter.

Financing activities during the second quarter of 2010 consisted of proceeds from the CAF loan of $2.3 million and net proceeds from a private placement of $85.9 million.

The net decrease in cash for the second quarter of 2011 was $1.7 million compared to net decrease of $17.1 million in the previous quarter and net increase of $50.3 million for the second quarter of 2010.

During the second quarter of 2011, the Company issued a standby letter of credit to BC Hydro in the amount of $1.66 million pursuant to the terms of the EPA. Concurrently, the Company transferred an equivalent amount from cash on hand to a short term deposit account to secure the letter of credit. At June 30, 2011, the Company had cash on hand and cash equivalents totalling $7.8 million.

**LIQUIDITY**

The Company's current principal sources of funds are cash flow from operations and cash on hand. In July 2011, the Company executed a letter of intent to undertake a financing agreement with a major Canadian financial institution. The Company will be provided a line of credit for general working capital purposes pending the successful completion of the financing agreement. The Company intends to secure additional financing specific to the development of its Bioenergy Facility once regulatory approval is granted and certain other agreements near completion. The Company's principal uses of funds consist of operating and capital expenditures.

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

The Company's working capital levels fluctuate throughout the year and are affected by changes in operating rates, changing sales patterns, seasonality and the timing of receivables and the payment of payables and expenses. The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the winter months to ensure adequate supply of fibre to its mills during the spring months. Changes in sales volume and price can affect the level of receivables and influence overall working capital levels. The significant increase in shipments to export markets has increased the level of in transit finished goods inventory typically held by the Company. The Company believes its management practices with respect to working capital conform to common industry practices.

## SELECTED QUARTERLY FINANCIAL INFORMATION

| Quarterly Earnings Summary | 2011 | | 2010 | | | | 2009 | |
|---|---|---|---|---|---|---|---|---|
| (millions of dollars except share and per share amounts) | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Sales -Lumber | 21.9 | 18.6 | 16.2 | 12.9 | 10.7 | 10.9 | 9.8 | 10.8 |
| - Co-products | 5.0 | 2.6 | 2.0 | 1.6 | 1.9 | 1.2 | 1.0 | 1.1 |
| Total Sales | 26.9 | 21.2 | 18.2 | 14.5 | 12.6 | 12.1 | 10.8 | 11.9 |
| Operating loss | (4.1) | (3.8) | (2.7) | (2.4) | (1.8) | (1.0) | (2.5) | (1.1) |
| Net loss | (3.6) | (3.6) | (3.9) | (2.9) | (2.4) | (1.6) | (2.2) | (1.0) |
| Net loss per share - basic and diluted | (0.24) | (0.24) | (0.26) | (0.19) | (0.31) | (0.39) | (0.52) | (0.24) |
| EBITDA | (0.8) | (1.3) | (2.2) | (1.8) | (0.9) | (0.8) | (1.7) | (0.4) |
| Shares outstanding - end of period (millions) | 15.2 | 15.2 | 15.2 | 15.1 | 15.1 | 4.3 | 4.3 | 4.3 |
| Shares outstanding - weighted average (millions) | 15.2 | 15.2 | 15.1 | 15.1 | 7.6 | 4.3 | 4.3 | 4.3 |
| **Statistics** | | | | | | | | |
| Lumber shipments (MMfbm)* | 81.5 | 62.5 | 53.5 | 44.4 | 34.3 | 37.4 | 39.9 | 43.3 |
| Lumber production (MMfbm) | 102.4 | 63.5 | 49.1 | 39.3 | 41.3 | 39.5 | 32.8 | 36.5 |
| Average exchange rate - US$/Cdn$ (1) | 1.0335 | 1.0142 | 0.987 | 0.962 | 0.973 | 0.961 | 0.947 | 0.912 |
| Average WSPF 2x4 #2&Btr lumber price (US$) (2) | $ 240 | $ 297 | $ 268 | $ 222 | $ 264 | $ 268 | $ 205 | $ 191 |
| Average WSPF 2x4 #2&Btr lumber price (Cdn$) | $ 232 | $ 293 | $ 272 | $ 230 | $ 271 | $ 279 | $ 216 | $ 209 |

* Shipment volumes from prior periods have been adjusted for consistency with current product classifications.
(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.

| Reconciliation of EBITDA to Net Loss | 2011 | | 2010 | | | | 2009 | |
|---|---|---|---|---|---|---|---|---|
| (millions of dollars) | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 |
| Net loss | (3.6) | (3.6) | (3.9) | (2.9) | (2.4) | (1.6) | (2.2) | (1.0) |
| Add: | | | | | | | | |
| Net interest expense | 0.1 | - | - | - | - | - | - | - |
| Depreciation and amortization | 1.7 | 1.4 | 1.0 | 0.5 | 0.5 | 0.5 | 0.3 | 0.3 |
| Deferred union payroll liability | 0.5 | 0.3 | 0.2 | 0.2 | - | 0.2 | 0.2 | 0.2 |
| Share based compensation | 0.2 | 0.3 | 0.3 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Accretion of convertible debentures | 0.3 | 0.3 | 0.3 | 0.3 | 0.5 | - | - | - |
| Revaluation of Fourth shares to fair value | - | - | - | - | 0.5 | - | - | - |
| EBITDA* | (0.8) | (1.3) | (2.2) | (1.8) | (0.9) | (0.8) | (1.7) | (0.4) |

*May not total exactly due to rounding.

The Company's financial results are impacted by a variety of market related factors including fluctuation in lumber prices, price fluctuations in commodities associated with revenue derived from co-products 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. Other more company specific factors that influence quarterly trends include operating rates and transactions of a non-recurring nature.

The Fort St. James mill commenced operations on a one-shift basis in March 2009 and added a second shift in the second quarter of 2011.

The Mackenzie Assets were acquired in June of 2010. Manufacturing operations started at the Site II sawmill complex on a one-shift basis in November of 2010 and a small volume of lumber was shipped in December of 2010 from this location. A second shift was added in the second quarter of 2011. Shutdown costs directly related to the non-operational assets are included in the results of the third and fourth quarter of 2010.

## SOFTWOOD LUMBER AGREEMENT

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement ("SLA") by delivering a Request for Arbitration. The U.S. claims that BC has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on the substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. The U.S. filed a Statement of Case with the arbitration panel on August 9, 2011. It is not possible at this time to predict the outcome or the value of the claim, and accordingly no provision has been recorded by the Company.

## OUTLOOK AND STRATEGY

### Lumber segment

Conifex's key priority in the short term continues to be to achieve positive EBITDA from its core forestry and sawmilling operations. Management remains focused on improving margins by optimizing value from the fibre harvested and reducing cash conversion costs. Management expects to achieve better than industry average sales realizations as a result of an improvement in product mix and will continue to pursue optimal markets for its products in a challenging price environment. Operations personnel continue to work towards gaining further production efficiencies which are integral to the achievement of targeted operating rates of 70% and lower unit conversion costs.

The Company has targeted the end of the calendar year to achieve operating margins comparable to top-quartile performers in the interior BC forestry and sawmilling sector.

### Bioenergy segment

The Company will focus on engineering and design work related to the Bioenergy Facility and intends to secure project related financing once key agreements are solidified and regulatory approval is granted. The Company intends to concurrently pursue additional high return investment opportunities in this sector which are complementary to its existing operating facilities and assets and co-product fibre suitable for use as bioenergy feedstock.

## OUTSTANDING SECURITIES

As at August 16, 2011, the Company had 15,187,068 issued and outstanding common shares, 100,000 options granted under the Company's stock option plan dated June 3, 2010, 393,426 long-term incentive plan awards issued under the Company's long-term incentive plan dated June 3, 2010 and amended June 21, 2011 and stepped rate subordinated convertible promissory notes in the aggregate principal amount of $9,967,000, which notes are convertible into a maximum of 1,245,875 common shares of the Company, excluding any common shares issuable in payment of accrued interest thereon.

**CHANGES IN ACCOUNTING POLICY**

Effective January 1, 2011, the Company adopted an amendment to IAS 24, *Related Party Transactions,* that was issued by the International Accounting Standards Board ("IASB"). The amendment clarifies the definitions of a related party. The adoption of the amendment had no impact on the condensed consolidated financial statements.

In addition to the above, the IASB has issued a number of new and revised accounting standards which are effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. These standards include the following:

- IFRS 9, *Financial Instruments;*
- IFRS 10, *Consolidated Financial Statements;*
- IFRS 11, *Joint Arrangements;*
- IFRS 12, *Disclosure of Interests in Other Entities;* and
- IFRS 13, *Fair Value Measurement.*

The Company has not yet adopted these new and revised accounting standards and has not yet completed the process of evaluating the impact that they will have on its financial statements or whether to early adopt any of the new requirements.

**RISKS AND UNCERTAINTIES**

A discussion of the risks and uncertainties to which the Company is subject is included in the 2010 annual MD&A which is available on www.sedar.com or www.conifex.com.

**ADDITIONAL INFORMATION**

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