



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

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Dated as of November 18, 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 nine months ended September 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 nine months ended September 30, 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](http://www.sedar.com).*

*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**

During the third quarter of 2011, the Company announced its intention to internalize its marketing, sales and logistics function through the acquisition of certain businesses of its current service providers. The Company also entered into an agreement to dispose redundant assets at its Mackenzie B.C. site.

### **Letter of Intent to Acquire Lumber Distribution and Transportation Businesses**

In September 2011, the Company entered into a non-binding letter of intent ("LOI") to acquire ("the Transaction") the commodity lumber distribution business owned and operated by Welco Lumber Corp. ("Welco") and the transportation and logistics business owned and operated by Navcor Transportation Inc. ("Navcor"). Welco and Navcor are both B.C. private companies that have provided lumber marketing and logistics services to Conifex under a three-year lumber sales agreement which expires in November 2011.

Pursuant to the terms of the LOI, the proposed Transaction includes the purchase of all of Welco's assets related to its commodity dimensional lumber distribution business, other than certain current assets. Conifex also intends to assume Welco's existing office lease and enter into employment agreements with certain of Welco's key employees in the commodity lumber distribution business prior to closing. Conifex intends to operate its lumber distribution business under a newly formed company to be named Conifex Fibre Marketing Inc. and maintain trading relationships previously established by its commodity lumber sales group. Additionally, the LOI provides that Conifex will acquire all of the issued and outstanding shares of Navcor upon closing.

Under the terms of the proposed Transaction, Conifex shall pay an aggregate of approximately \$1.6 million to Welco, as well as payment of certain commissions to Welco for a three-year period following closing.

The Company believes that as a result of the Transaction, including the expected retention of the key employees, it will be able to seamlessly continue to serve its customers in the United States, China, Japan and Canada and to further develop new markets.

In November 2011, the Company entered into a definitive agreement, which includes customary closing conditions, to acquire the businesses under substantially the same terms as outlined in the LOI. The transaction is expected to close on or before December 31, 2011.

### **Demolition, Purchase and Removal of Equipment Agreement**

The Company entered into an agreement in September 2011 under the terms of which certain redundant assets at its Mackenzie B.C. facilities, currently classified as assets held for sale, will be demolished and removed. The Company will be paid for all material salvaged in the demolition. As it is difficult to estimate the expected proceeds of disposition, any gain or loss on the transaction will be recorded upon the completion of the removal. The removal is expected to be completed by August 2012.

## SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

### CONSOLIDATED OPERATING RESULTS

	Q3	Q2	YTD	Q3	YTD
(millions of dollars except share and per share amounts)	2011	2011	2011	2010	2010
Sales -Lumber	33.8	21.9	74.9	12.9	34.6
- Co-products	4.4	5.0	11.4	1.5	4.5
<b>Total Sales</b>	<b>38.2</b>	<b>26.9</b>	<b>86.3</b>	<b>14.4</b>	<b>39.1</b>
Operating loss	(3.3)	(4.1)	(11.3)	(2.4)	(5.3)
Net loss	(2.2)	(3.6)	(9.4)	(2.9)	(6.9)
Net loss per share - basic and diluted	(0.14)	(0.24)	(0.62)	(0.19)	(0.76)
EBITDA	0.6	(0.8)	(1.6)	(1.8)	(3.5)
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	15.1	9.0

#### Statistics

Lumber shipments (MMfbm)*	115.4	81.5	259.4	44.4	116.1
Lumber production (MMfbm)	101.6	102.4	267.6	39.3	120.1
Average exchange rate - US\$/Cdn\$ (1)	1.0202	1.0335	1.0226	0.962	0.965
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$ 246	\$ 240	\$ 261	\$ 222	\$ 251
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)	\$ 241	\$ 232	\$ 255	\$ 230	\$ 260

\* Shipment volumes from prior periods have been adjusted for consistency with current product classifications.

(1) Source: Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

(2) Source: Random Lengths Publications Inc.

### Reconciliation of EBITDA to Net Loss

	Q3	Q2	YTD	Q3	YTD
(millions of dollars)	2011	2011	2011	2010	2010
Net loss	(2.2)	(3.6)	(9.4)	(2.9)	(6.9)
Add:					
Net interest expense	0.1	0.1	0.3	-	-
Depreciation and amortization	1.8	1.7	4.9	0.5	1.5
Deferred union payroll liability	0.3	0.5	1.0	0.2	0.4
Share based compensation	0.3	0.2	0.8	0.1	0.2
Share revaluation related to qualifying transaction	-	-	-	-	0.5
Accretion of convertible debentures	0.3	0.3	0.8	0.3	0.8
<b>EBITDA*</b>	<b>0.6</b>	<b>(0.8)</b>	<b>(1.6)</b>	<b>(1.8)</b>	<b>(3.5)</b>

\* May not total exactly due to rounding.

The Fort St. James and Mackenzie Site II sawmill complexes operated on a two-shift basis throughout the third quarter of 2011 with the second shifts at both sawmills added in late March 2011. Results for the first nine months of 2010 reflect the operation of the Fort St. James sawmill complex on a one-shift basis. The Mackenzie Assets were purchased in June 2010 and the Site II mill commenced operations on a one-shift basis in November 2010. Operating rates for the current year, based on a total production capacity of approximately 745 million board feet, were 55% during the third quarter and 48% during the first nine months. The operating rate for 2010 was 21% for both the third quarter and the year-to-date period.

Average benchmark lumber prices expressed in Canadian dollar equivalent were 5% higher during the current quarter compared to the same quarter last year and 2% lower during the first nine months of 2011 compared to the same period last year. Current quarter shipment volume of 115 million board feet outpaced production by 14%. Approximately 72% of the total shipment volume went to export markets compared to 49% for the same quarter last year.

For the quarter ended September 30, 2011 the Company recorded a net loss of \$2.2 million or \$0.14 per share and EBITDA of \$0.6 million on sales of \$38.2 million. EBITDA was comprised of negative \$0.1 million from the lumber segment and negative \$0.2 million from the bioenergy segment offset by positive EBITDA of \$0.9 million from corporate costs and other items. Corporate costs and other items included income from lumber price derivatives of \$1.1 million for the third quarter of 2011. The Company adheres to a defensive strategy with respect to hedging lumber prices, limits its hedging activities to a portion of its expected production of commodity lumber, and does not enter into hedging contracts for speculative purposes. Overall EBITDA improvement of \$2.4 million compared to the same quarter last year was attributable primarily to the increase in income from lumber price derivatives and the cost benefits derived from higher operating rates and shipment volumes.

Net loss for the first nine months of 2011 was \$9.4 million or \$0.62 per share on sales of \$86.3 million compared to net loss of \$6.9 million or \$0.76 per share on sales of \$39.1 million for the same period last year. Year over year EBITDA in the lumber segment was flat at negative \$1.9 million while overall current year-to-date EBITDA was negative \$1.6 million, an improvement of \$1.9 million over the same period last year.

At September 30, 2011, the Company had \$8.9 million cash on hand and cash equivalents, an increase of \$1.2 million during the quarter and a decrease of \$17.7 million from December 31, 2010. Approximately \$7 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 \$9.9 million to additions of capital assets.

## REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

### Operating Results by Business Segment

(millions of dollars)	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
<b>Revenue</b>					
Lumber	38.2	26.9	86.3	14.4	39.1
Bioenergy	-	-	-	-	-
	38.2	26.9	86.3	14.4	39.1
<b>Net Loss</b>					
Lumber	(2.5)	(3.1)	(8.5)	(1.5)	(3.9)
Bioenergy	(0.2)	(0.3)	(0.7)	(0.3)	(0.3)
Corporate costs and other items	0.5	(0.2)	(0.2)	(1.1)	(2.7)
	(2.2)	(3.6)	(9.4)	(2.9)	(6.9)
<b>EBITDA</b>					
Lumber	(0.1)	(0.8)	(1.9)	(0.7)	(1.9)
Bioenergy	(0.2)	(0.2)	(0.7)	(0.3)	(0.3)
Corporate costs and other items	0.9	0.2	1.0	(0.8)	(1.3)
	0.6	(0.8)	(1.6)	(1.8)	(3.5)

## Lumber Segment

### Overview

WSPF #2 & Btr ("WSPF") prices<sup>1</sup> averaged \$246 US during the third quarter of 2011 and represented an increase of \$24 or 11% over the same quarter last year. Year-to-date WSPF prices for the first nine months of 2011 averaged \$261 US compared to \$251 US during the same period last year. Current period price gains were largely offset or reversed as the Canadian dollar strengthened over the U.S. dollar. The Canadian dollar appreciated by six cents quarter over quarter and year over year moving from an average of \$0.96<sup>2</sup> for each U.S. dollar to \$1.02. Benchmark average lumber prices in Canadian dollar equivalent was 5% higher during the current quarter compared to the same quarter last year but declined by 2% in the first nine months of 2011 compared to the same period last year.

Against the backdrop of continued weakness in the U.S. housing market, price movements throughout the comparative periods continued to reflect the impact of fluctuations of both overall and product specific demand levels from the China market. During the third quarters of both 2011 and 2010, benchmark lumber prices bottomed in mid-August as a result of seasonal and largely weather related reduced demand from China before recovering with the resumption of significant volume purchases in the fall. While strong demand and corresponding price increases were sustained well into subsequent quarters last year, the anticipated similar fall demand failed to materialize this year and the price gains experienced late in the third quarter of 2011 were starting to erode at period end. Reasons cited for reduced purchasing levels included restricted access to credit as the Chinese government tightened monetary policy in response to persistent inflation and the high level of inventories both in China and in China destined North American ports.

Despite the challenging conditions, the Company reported quarterly shipment volumes of 115 million board feet during the current quarter. The shipment volume outpaced current quarter production by 14% and same quarter 2010 shipments by 260%. Approximately 72% of total third quarter 2011 shipments went to export markets compared to 49% for the same quarter last year.

The export tax remained at 15% throughout the first nine months of 2011 compared to an average of 13.3% during the third quarter of 2010 and 12.2% for the first nine months of 2010.

The Company reported a net loss of \$2.5 million in its lumber segment for the third quarter of 2011 compared to \$1.5 million for the same quarter last year. Net loss in the lumber segment was \$8.5 million for the first nine months of 2011 compared to \$3.9 million for the same period last year.

A large portion of the current year net loss was attributable to non-cash items as lumber segment EBITDA in the current quarter improved to negative \$0.1 million compared to negative \$0.7 million for the same quarter last year. Year-to-date EBITDA in the lumber segment was flat for both years at negative \$1.9 million.

### Sales

Revenue from lumber shipments was \$33.8 million for the third quarter of 2011 compared to \$12.9 million for the same quarter last year. As unit gross sales realization was similar, the increase was due primarily to increased shipment volumes. Lumber revenue of \$74.9 million for the first nine months of 2011 was more than double lumber revenue of \$34.6 million for the same period last year.

---

<sup>1</sup> Prices as quoted in Random Lengths Publications Inc.

<sup>2</sup> Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

Year over year increase in shipment volumes accounted for 103% of increased revenue and was offset by a 3% decrease in revenue due to the decline in unit prices.

Lumber shipments totalled 115.4 million board feet during the third quarter of 2011 compared to 44.4 million board feet for the same quarter last year. The higher shipment volumes in the current quarter caught up a large portion of the shipment lag due to increased production levels, increased offshore sales and temporary logistical constraints reported in the previous quarter. Lumber shipments for the first nine months of 2011 were 259.4 million board feet and represented an increase of 223% over the same period last year. The increased shipment levels in the current year are attributable to the higher operating rates.

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

	Q3 2011	Q2 2011	YTD 2011	Q3 2010	YTD 2010
<b>By Revenue (net of freight)</b>					
Canada	14%	11%	15%	20%	23%
USA	16%	4%	17%	35%	41%
Export	70%	85%	68%	45%	36%
	100%	100%	100%	100%	100%
<b>By Shipment Volume</b>					
Canada	13%	13%	16%	15%	18%
USA	15%	4%	16%	36%	41%
Export	72%	83%	68%	49%	41%
	100%	100%	100%	100%	100%

The Company continues to focus on monitoring market dynamics for opportunities to optimize mill nets. During the current quarter, higher mill net realizations for most products were being obtained from offshore markets although short term price anomalies developed where certain products earned price premiums in the U.S. market despite attracting a 15% export tax. A widening of price differentials between standard and lower grade products is becoming more pronounced in the Chinese market and the Company expects that this trend will continue to influence optimal markets for specific products.

The Company believes effective navigation of market and logistical challenges is paramount to achieving optimal mill nets. In recognition of this objective and the significant recent growth in lumber volumes, the Company decided to internalize its marketing, sales and logistics capabilities by acquiring the commodity lumber distribution and logistics businesses as discussed in the Significant Events section. The Company is pleased with the calibre of employees and expects a relatively seamless transition from its current arrangement.

China remains Conifex's single largest market. Shipments to China during the first nine months of 2011 represented approximately 55% of total shipments compared to approximately 30% for the same period last year. Although there have been recent reports of a modest slowdown in the Chinese economy and tightening of government monetary policy, the Company has developed strong relationships with key customers and expects to continue to ship a significant portion of its lumber products to this important market.

During the third quarter of 2011, 72% of total shipments went to export markets, an increase of 47% over the same quarter last year. Approximately 68% of current year-to-date shipments went to export markets compared to 41% for the same period last year.

Mill net realizations from export sales and sales to the U.S. market improved by 5% and 10% respectively during the current quarter compared to the same quarter last year. However, mill net realization on Canadian sales declined by 23% quarter over quarter and 27% year over year as traditional premiums earned on wider dimensions (2x10 and 2x12) declined considerably this year.

Revenue from co-products for the third quarter of 2011 was \$4.4 million and accounted for 11.5% of total sales compared to \$1.5 million or 10.4% of total sales for the same quarter last year. For the first nine months of 2011, revenue from co-products totalled \$11.4 million or 13.2% of total revenue compared to \$4.5 million or 11.5% of total sales for the same nine month period last year. The increased revenue for co-products in the current year was attributable largely to increases in volume as a result of higher mill production volumes.

#### Production and Operations

The Company operated its Fort St. James mill and its Site II Mackenzie mill on a two-shift basis throughout the third quarter of 2011 with the exception of a short planned curtailment in July. The Company operated only the Fort St. James mill on a one-shift basis during the third quarter of 2010. Production volume totalled 101.6 million board feet, representing an operating rate of approximately 55% in the current quarter compared to 39.3 million board feet or an operating rate of 21% during the same quarter last year. Production volume totalled 267.6 million board feet during the first nine months of 2011 compared to 120.1 million board feet during the same period last year.

Unit log costs increased in the current quarter by approximately 9% over the same quarter last year with the increase largely attributable to the commencement of summer logging operations at Mackenzie, where the Company operates a remote logging camp and delivers logs by water. On a year-to-date basis, unit log costs increased by 2% this year compared to last year.

Cash unit conversion costs improved by 3% during the current quarter compared to the same quarter last year once the effects of inventory valuation adjustments and costs related to the idled facilities at Mackenzie recorded last year are removed. Measured on this basis, cash unit conversion costs for the comparative year-to-date periods were flat. Amortization costs increased by \$1.3 million during the current quarter and \$3.3 million during the first nine months of this year compared to the respective comparative periods last year.

Significantly increased shipment volumes to export markets resulted in lower export taxes and a 4% increase in per unit freight and distribution costs during the current quarter compared to the same quarter last year. The stronger Canadian dollar offset some of the increase in U.S. dollar denominated freight costs.

The increase in selling, general and administration expenses related to the lumber segment of \$1.3 million in the current quarter and \$4.3 million in the current year-to-date period is attributable primarily to variable costs incurred as a result of higher shipment volumes. Selling, general and administration expenses on a per unit basis improved by 17% during the current quarter and 12% during the current year-to-date period compared to the respective periods in the previous year.

#### **Bioenergy Segment**

The Company is currently awaiting the acceptance of its Electricity Purchase Agreement ("EPA"), completed with BC Hydro in June 2011, as an energy supply contract by the B.C. Utilities Commission ("BCUC"). While critical path project development activities continue to be undertaken, including the selection of the project engineering team and discussions with major vendors, the anticipated BCUC approval will provide additional project timing and cost certainty. The Company intends to secure related financing once sufficient clarity in this regard is attained.

The Company continues to explore 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.

Capital expenditures related to the bioenergy project at Mackenzie totalled \$0.9 million for the third quarter of 2011 and \$2.3 million for the first nine months of 2011. The expenditures relate primarily to feasibility studies and project management, engineering, and other technical and professional services.

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 nine months of 2011 increased by \$0.9 million compared to the same period last year. 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 \$1.1 million for the current quarter compared to a loss of \$0.1 million for the same quarter last year. Income from lumber price derivatives for the first nine months of 2011 totalled \$2.8 million compared to a loss of \$0.2 million for the first nine months of 2010.

## FINANCIAL POSITION AND LIQUIDITY

### SELECTED CASH FLOW ITEMS

	Q3	Q2	YTD	Q3	YTD
(millions of dollars)	2011	2011	2011	2010	2010
<b>Operating Activities</b>					
Cash used before working capital changes	0.5	(1.6)	(3.3)	(2.0)	(3.9)
Non - cash working capital change	2.3	2.8	(7.0)	(3.4)	(6.4)
Cash provided from (used in) operating activities	2.8	1.2	(10.3)	(5.4)	(10.3)
<b>Investing Activities</b>					
Additions to property, plant, equipment	(1.4)	(4.8)	(9.9)	(13.3)	(18.1)
Acquisition of Mackenzie Assets	-	-	-	-	(34.5)
Proceeds on disposal of assets held for sale	0.2	0.8	1.8	0.8	0.8
Cash used in investing activities	(1.2)	(4.0)	(8.1)	(12.5)	(51.8)
<b>Financing Activities</b>					
Net proceeds from private placement	-	-	-	-	85.9
Net proceeds from loans	(0.4)	1.1	0.7	2.0	4.3
Proceeds from convertible notes	-	-	-	-	2.0
Cash provided from (used in) financing activity	(0.4)	1.1	0.7	2.0	92.2
<b>Change in cash and cash equivalents</b>	<b>1.2</b>	<b>(1.7)</b>	<b>(17.7)</b>	<b>(15.9)</b>	<b>30.1</b>

Cash and cash equivalents during the current quarter increased by \$1.2 million compared to a net decrease of \$15.9 million in the same quarter last year. During the current quarter, cash of \$0.5 million was generated as a result of earnings from operations and \$2.3 million from positive changes in working capital. Uses of cash included lumber segment capital expenditures of \$0.5 million, capital expenditures related to the bioenergy project of \$0.9 million and repayment of \$0.4 million of the Community Adjustment Fund ("CAF") loan. During the third quarter of 2010, uses of cash

included net cash loss from operations of \$2 million, net increase in working capital of \$3.4 million and expenditures of \$13.3 million on the capital expenditure program at Fort St. James and were offset by net proceeds from the CAF loan of \$2 million.

During the nine months ended September 30, 2011, cash of \$3.3 million was used in operating losses, \$7 million in increased working capital, \$7.6 million in lumber segment capital expenditures and \$2.3 million in cash expenditures related to the bioenergy segment. Cash of \$1.8 million was provided from proceeds on the sale of redundant assets and \$0.7 million from net proceeds from the CAF loan. During the first nine months of 2010, cash of \$3.9 million was used in operating losses, \$6.4 million in working capital changes, \$18.1 million in capital expenditures primarily at Fort St. James, and \$34.5 million to acquire the Mackenzie assets. Cash of \$85.9 million was generated from the completion of a private placement, \$4.3 million from net CAF loan proceeds and \$2 million net proceeds from the issuance of convertible notes.

At September 30, 2011, the Company had cash on hand and cash equivalents totalling \$8.9 million. Included in this amount was \$1.7 million held in short term deposits to secure a standby letter of credit issued to BC Hydro pursuant to the terms of the EPA.

## **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 secure a line of credit for working capital purposes which remains subject to the successful completion of the financing agreement. The Company intends to secure additional financing specific to the development of its bioenergy project 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. The Company will periodically deliver logs to its Mackenzie sawmill complexes by water rather than road. Delivery by water requires longer transit periods and necessitates carrying higher than typical levels of log inventories during these periods. 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
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
(millions of dollars except share and per share amounts)								
Sales -Lumber	33.8	21.9	18.6	16.2	12.9	10.7	10.9	9.8
- Co-products	4.4	5.0	2.6	2.0	1.6	1.9	1.2	1.0
<b>Total Sales</b>	<b>38.2</b>	<b>26.9</b>	<b>21.2</b>	<b>18.2</b>	<b>14.5</b>	<b>12.6</b>	<b>12.1</b>	<b>10.8</b>
Operating loss	(3.3)	(4.1)	(3.8)	(2.7)	(2.4)	(1.8)	(1.0)	(2.5)
Net loss	(2.2)	(3.6)	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)
Net loss per share - basic and diluted	(0.14)	(0.24)	(0.24)	(0.26)	(0.19)	(0.31)	(0.39)	(0.52)
EBITDA	0.6	(0.8)	(1.3)	(2.2)	(1.8)	(0.9)	(0.8)	(1.7)
Shares outstanding - end of period (millions)	15.2	15.2	15.2	15.2	15.1	15.1	4.3	4.3
Shares outstanding - weighted average (millions)	15.2	15.2	15.2	15.1	15.1	7.6	4.3	4.3

### Statistics

Lumber shipments (MMfbm)*	115.4	81.5	62.5	53.5	44.4	34.3	37.4	39.9
Lumber production (MMfbm)	101.6	102.4	63.5	49.1	39.3	41.3	39.5	32.8
Average exchange rate - US\$/Cdn\$ (1)	1.020	1.0335	1.0142	0.987	0.962	0.973	0.961	0.947
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$ 246	\$ 240	\$ 297	\$ 268	\$ 222	\$ 264	\$ 268	\$ 205
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)	\$ 241	\$ 232	\$ 293	\$ 272	\$ 230	\$ 271	\$ 279	\$ 216

\* Shipment volumes from prior periods have been adjusted for consistency with current product classifications.

(1) Source: Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

(2) Source: Random Lengths Publications Inc.

Reconciliation of EBITDA to Net Loss	2011				2010			2009
(millions of dollars)	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Net loss	(2.2)	(3.6)	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)
Add:								
Net interest expense	0.1	0.1	-	-	-	-	-	-
Depreciation and amortization	1.8	1.7	1.4	1.0	0.5	0.5	0.5	0.3
Deferred union payroll liability	0.3	0.5	0.3	0.2	0.2	-	0.2	0.2
Share based compensation	0.3	0.2	0.3	0.3	0.1	0.1	0.1	0.1
Accretion of convertible debentures	0.3	0.3	0.3	0.3	0.3	0.5	-	-
Revaluation of Fourth shares to fair value	-	-	-	-	-	0.5	-	-
<b>EBITDA*</b>	<b>0.6</b>	<b>(0.8)</b>	<b>(1.3)</b>	<b>(2.2)</b>	<b>(1.8)</b>	<b>(0.9)</b>	<b>(0.8)</b>	<b>(1.7)</b>

\*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. Canada is expected to deliver its response to the U.S. claim in November 2011. A hearing before the arbitration panel is expected to take place in February 2012. 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.

### **SUBSEQUENT EVENTS**

#### **Amendment to EPA with BC Hydro**

In October 2011, the Company entered into an agreement (the “Amendment Agreement”) modifying certain terms of the EPA with BC Hydro. The EPA specified a period of 150 days from the date that the agreement was entered into within which acceptance for filing by the BCUC was required. The Amendment Agreement extends this period by 90 days to allow for the completion of the Province’s review of BC Hydro prior to the filing of the EPA with the BCUC. As a result of the filing delay, the project schedule has been impacted. Subject to the EPA being accepted by the BCUC as an energy supply contract, the Company now expects that delivery of energy under the EPA to BC Hydro will occur in approximately the second quarter of 2012.

#### **Purchase of property in the District of Mackenzie**

The Company currently leases property in the District of Mackenzie on which its Site II Mackenzie sawmill complex is situated. In October 2011, the Company entered into an agreement to purchase the property. The purchase price of approximately \$1.25 million is payable by a combination of cash and a vendor take back mortgage. The transaction is expected to close in November 2011.

#### **Entry into senior secured financing agreement**

In November 2011, the Company entered into a senior secured financing agreement under the terms of which it will issue promissory notes in the aggregate amount of \$12 million. The notes will expire on December 31, 2012 and bear interest rates of 10% for the first six months and 12% for the remaining term of the loan. As additional consideration for the loan, the Company will issue at the time of funding share purchase warrants entitling the holders to purchase up to an aggregate of 325,000 common shares of the unissued capital stock of the Company. The proceeds of the note will be used for general corporate purposes.

## **Acquisition of Lumber Distribution and Transportation Business**

In November 2011, further to the LOI discussed in the Significant Events section, the Company, through a wholly-owned subsidiary, entered into a definitive agreement to acquire the commodity lumber distribution business and transportation business as discussed. The Transaction is expected to close on or before December 31, 2011.

## **OUTLOOK AND STRATEGY**

### **Lumber segment**

The Company remains focused on developing and executing strategy to extract optimal value from its fibre baskets, core manufacturing and finishing facilities, significantly improved product mix and the anticipated internalization of its marketing, sales and logistics capabilities. Management believes knowledge and astute navigation of markets and superior logistical capabilities will play an increasingly important role in improving operating margins. The timing of a sustained meaningful recovery in the U.S. housing market remains highly uncertain and the importance of developing alternative markets will continue to be heightened. Management believes that with the Company's production of a relatively high proportion of premium grade products, it is well positioned to compete and achieve further growth in key markets such as Japan.

In terms of market outlook, management believes markets will remain challenging and a sustained recovery in lumber prices will continue to be thwarted unless changes in demand are mirrored with appropriate supply side response.

### **Bioenergy segment**

The Company will continue to undertake critical path project development activities while it awaits the anticipated approval of its EPA as an energy supply contract by the BCUC. Demolition and removal of equipment from the decommissioned paper mill at Mackenzie B.C. will commence in the fourth quarter of 2011 in preparation for the repurposing of this building. The Company intends to secure project related financing once key agreements are solidified and regulatory approval is granted. The Company continues to 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 November 18, 2011, the Company had 15,215,917 issued and outstanding common shares, 100,000 options granted under the Company's stock option plan dated June 3, 2010, 419,819 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*;
- IFRS 13, *Fair Value Measurement*; and
- IAS 19 Amendment, *Employee Benefits*.

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](http://www.sedar.com) or [www.conifex.com](http://www.conifex.com).

### **ADDITIONAL INFORMATION**

Additional information about the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).