CONIFEX

CONIFEX TIMBER INC.
THIRD QUARTER 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of October 24, 2012

*This interim Management's Discussion and Analysis ("**MD&A**") provides a review of the financial performance of Conifex Timber Inc. for the quarter ended September 30, 2012 relative to the quarters ended June 30, 2012 and September 30, 2011, 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 and accompanying notes of Conifex for the quarters ended September 30, 2012 and 2011, as well as the 2011 annual MD&A and the December 31, 2011 audited consolidated financial statements and notes thereon which are filed on SEDAR at 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" in accordance with applicable Canadian securities laws. 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", "budget", "scheduled", "expects", "plans", "anticipates", "projects", "will", "intends", "believes", "should", "could", "may", "mitigate" 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.*

SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

CONSOLIDATED OPERATING RESULTS

(millions of dollars except share and per share amounts)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Sales -Lumber	46.1	45.5	131.1	33.7	74.7
- By-products	5.1	5.7	15.2	4.4	11.4
- Logistics services	3.2	4.6	11.3	-	-
Total Sales	54.4	55.8	157.6	38.1	86.1
Operating loss	(2.8)	(1.6)	(10.5)	(3.3)	(11.3)
Net loss	(3.7)	(2.4)	(12.6)	(2.2)	(9.4)
Net loss per share - basic and diluted	(0.19)	(0.13)	(0.68)	(0.14)	(0.62)
EBITDA	(0.5)	0.6	(3.7)	0.6	(1.6)
Shares outstanding - end of period (millions)	19.4	19.4	19.4	15.2	15.2
Shares outstanding - weighted average (millions)	19.4	19.4	18.7	15.2	15.2
Statistics					
Lumber shipments - Conifex product (MMfbm)	107.5	111.7	334.0	115.4	259.4
Lumber production (MMfbm)	102.8	102.1	316.1	101.6	267.6
Average exchange rate - US$/Cdn$ (1)	1.005	0.990	0.998	1.020	1.023
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 301	$ 296	$ 288	$ 246	$ 261
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (3)	$ 299	$ 299	$ 288	$ 241	$ 255

(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.
(3) Source: Prices as quoted in Random Lengths Publications Inc., expressed in Canadian dollars using average monthly rates as quoted on Bank of Canada website.

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Net loss	(3.7)	(2.4)	(12.6)	(2.2)	(9.4)
Add: Interest expense	0.5	0.5	1.6	0.1	0.3
Depreciation and amortization	1.9	1.8	5.6	1.8	4.9
Deferred union payroll liability	-	-	-	0.3	1.0
Share based compensation	0.4	0.2	0.7	0.3	0.8
Accretion of convertible debentures	0.3	0.3	0.8	0.3	0.8
Loss on disposal of assets	0.1	0.2	0.3	-	-
EBITDA*	(0.5)	0.6	(3.7)	0.6	(1.6)

*May not total exactly due to rounding.

Overview

For the quarter ended September 30, 2012, the Company recorded a net loss of $3.7 million or $0.19 per share and negative EBITDA of $0.5 million on sales of $54.4 million. Consolidated EBITDA of negative $0.5 million was comprised of $1.0 million positive EBITDA from the lumber segment offset by negative EBITDA of $0.3 million from the bioenergy segment and $1.2 million from corporate costs and other items. The Company recorded an inventory valuation expense of $0.3 million and foreign exchange loss of $0.4 million in the current quarter compared to a positive inventory valuation adjustment of $1.6 million and foreign exchange gain of $0.1 million in the previous quarter. Costs related to the bioenergy segment, and corporate costs when normalized for the effects of foreign exchange gain or loss, were consistent throughout the comparative periods. Net loss for the third quarter of 2011 was $2.2 million or $0.14 per share and EBITDA was positive $0.6 million.

For the nine months ended September 30, 2012, net loss was $12.6 million or $0.68 per share and EBITDA was negative $3.7 million on sales of $157.6 million. Net loss for the first nine months of 2011 was $9.4 million or $0.62 per share and EBITDA was negative $1.6 million on sales of $86.1 million.

The year to date results for 2012 include wholesale lumber shipments of 57 million board feet and revenue from logistics services provided to third parties of $11.3 million.

At September 30, 2012, the Company had $14.8 million cash and cash equivalents on hand compared to $12.7 million at December 31, 2011. Non-cash working capital levels employed in the lumber segment were similar in each of the comparative quarters. The Company ended the third quarter of 2012 with net debt of $11.4 million (December 31, 2011 - $14.2 million) and net debt to capitalization ratio of 10.5% (December 31, 2011 – 15%) with the improvement primarily attributable to the completion of our private placement of common shares during the first quarter of 2012 which resulted in net proceeds of approximately $26.9 million.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Operating Results by Business Segment

(millions of dollars)	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
Revenue					
Lumber	54.4	55.8	157.6	38.1	86.1
Bioenergy	-	-	-	-	-
	54.4	55.8	157.6	38.1	86.1
Net Loss					
Lumber	(1.2)	(0.7)	(6.5)	(1.4)	(5.7)
Bioenergy	(0.3)	(0.2)	(0.8)	(0.2)	(0.7)
Corporate costs and other items	(2.2)	(1.5)	(5.3)	(0.6)	(3.0)
	(3.7)	(2.4)	(12.6)	(2.2)	(9.4)
EBITDA					
Lumber	1.0	1.7	(0.1)	1.0	0.9
Bioenergy	(0.3)	(0.3)	(0.8)	(0.2)	(0.7)
Corporate costs and other items	(1.2)	(0.8)	(2.8)	(0.2)	(1.8)
	(0.5)	0.6	(3.7)	0.6	(1.6)

Lumber Segment

Overview

WSPF 2x4 #2 & Btr **("WSPF"**) averaged US$301 during the third quarter of 2012 compared to US$296 during the previous quarter and US$246 during the third quarter of 2011.[1] The current quarter WSPF price expressed in Canadian dollars remained unchanged from the previous quarter as the strengthening of Canadian dollar against the U.S. dollar by 1.5% offset the quarter over quarter increase in price.[2] The benchmark price expressed in Canadian dollars increased by 24% over the third quarter of 2011 and incorporates a 1.5% weakening of the Canadian dollar in the current quarter. Current year to date WSPF prices in Canadian dollar equivalent averaged $288, an increase of 13% over the 2011 year to date average.

The Company's concentration of lumber shipments to the U.S. and Canadian markets was greater during the current quarter as continuing strong demand sustained the same level of benchmark price established during the previous quarter. Mill net realizations from the U.S. market further benefitted from a 5% quarter over quarter reduction of the average export tax rate. The Company continued to experience solid demand from the Chinese market and shipments of targeted products to that market totalled approximately 28% of current quarter shipments compared to 38% during the previous quarter and 59% during the same quarter last year. Shipments to the Japanese market remained relatively consistent at around 5% during the third and second quarters of 2012 compared to 12% during the third quarter of 2011 when relatively steeper premiums to the benchmark price were earned on higher grade products shipped to that market.

The operating results of our recently acquired lumber marketing and transportation and logistics businesses, Conifex Fibre Marketing Inc. and Navcor Transportation Services Inc., are included in those of the lumber segment effective the first quarter of 2012. Year to date wholesale lumber shipments totalled 57 million board feet or approximately 15% of total shipments. Year to date revenues of $11.3 million from the provision of third party logistics services represented approximately 7% of total segment revenues.

Per unit mill net realizations during the third quarter of 2012 increased by 9% over the previous quarter with approximately 3% of the improvement attributable to a lower average export tax rate and the balance primarily attributable to the shipment of an improved sales mix. The higher value sales mix was largely attributable to improved grade outturns as a result of the capital upgrade completed during the previous quarter and a return to a more representative sawlog profile at Mackenzie.

Production volumes were approximately 102 million board feet for each of the comparative quarters and represented annualized operating rates of approximately 55%. Production levels and costs during the current and previous quarters were negatively impacted by approximately 5% by the planned maintenance and capital upgrade downtime taken at both of our mills to focus on dust mitigation and other workplace safety initiatives.

The export tax rate averaged 8.33% during the third quarter of 2012 compared to 13.33% during the previous quarter and 15% during the third quarter of 2011.

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

[2] Average monthly rates as quoted on Bank of Canada website www.bankofcanada.ca

The Company recorded a net loss of $1.2 million in its lumber segment on sales of $54.4 million for the third quarter of 2012 compared to a net loss of $0.7 million on sales of $55.8 million for the previous quarter and a net loss of $1.4 million on sales of $38.1 million for the same quarter last year. Net segment loss for the first nine months of 2012 was $6.5 million on sales of $157.6 million compared to a net loss of $5.7 million on sales of $86.1 million for the first nine months of 2011.

Lumber segment EBITDA was $1.0 million for the third quarters of 2012 and 2011 compared to $1.7 million for the second quarter of 2012. Current year to date lumber segment EBITDA was negative $0.1 million compared to positive $0.9 million for the same period last year.

Inventory valuation adjustments, short-term consulting fees and gains from lumber future derivatives resulted in a net expense of $0.4 million for the current quarter compared to a net benefit of $1.5 million in the previous quarter and net benefit of $0.5 million in the third quarter of 2011. The previous quarter benefitted from a positive inventory valuation of $1.6 million and the third quarter of 2011 included a gain of $1.1 million from lumber futures derivatives.

A 9% improvement in current quarter per unit mill net realizations over the previous quarter was offset by lower per unit chip prices and higher unit conversion costs. The 5% increase in unit conversion costs over the previous quarter is primarily attributable to the costs related to training and heightened focus on preventative maintenance activities concentrated in the early implementation phase of the performance improvement program at the Fort St. James mill. A large portion of the current EBITDA in the lumber segment was generated in the closing month of the quarter as sawmill productivity increased by about 9% at both mill locations. The improvement in productivity is largely attributable to the continuing development of the new leadership team and the implementation of the year-long remedial program recently underway at Fort St. James and the commencement of deliveries and processing of a more representative sawlog profile at the Mackenzie sawmill in September.

Compared to the third quarter of 2011, the relative improvement in current quarter segment EBITDA once the effects of the variation in inventory valuation adjustments, short-term consulting fees and gain from lumber futures derivatives are removed, is largely attributable to a 34% increase in per unit mill net realizations, compared to a 24% increase in average benchmark prices, the benefit of increased shipment volume and revenue contributed by our marketing and logistics subsidiaries, partly offset by a 16% decline in unit chip prices and higher unit log and conversion costs.

Sales

Lumber shipments during the third quarter of 2012 totalled 127 million board feet and included wholesale lumber shipments of 19 million board feet. Conifex produced lumber shipments declined by approximately 4% from the previous quarter and 7% from the same quarter last year. Current year to date lumber shipments totalled 391 million board feet including 57 million board feet of wholesale lumber shipments compared to 259 million board feet during the same period last year.

Gross revenues from lumber shipments totalled $46.1 million, a slight increase over the previous quarter despite the 4% lower shipment volume and flat quarter over quarter benchmark price. Approximately three quarters of the $12.4 million increase in gross revenues from lumber shipments over the third quarter of 2011 is attributable to higher unit sales price realization with the balance mainly attributable to increased shipment volumes. Approximately two thirds of the year over year 75% increase in gross lumber revenues is attributable to higher shipment volumes with the balance primarily attributable to increased unit sales realization.

Per unit mill net realization during the third quarter of 2012 increased by over 9% over the previous quarter although there was no change over the same period in the benchmark lumber price expressed in Canadian dollars. Factors contributing to the improvement in mill net realization included the shipment of an improved sales mix and a 5% reduction in the average export tax rate on shipments to the U.S. during the current quarter. The improved sales mix is primarily attributable to the higher value grade outturns from the installation of the automated lumber grading system in April 2012 and a return to a more typical log profile at Mackenzie. The benefits of the higher value product mix is more pronounced when compared to the same quarter last year as current quarter per unit mill net realization increased by 34% compared to an increase of 24% in the benchmark lumber price.

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

	Q3 2012	Q2 2012	YTD 2012	Q3 2011	YTD 2011
By Revenue (net of freight)					
Canada	15%	17%	16%	14%	15%
USA	54%	41%	41%	16%	17%
Japan	5%	6%	5%	15%	16%
China and other	26%	36%	38%	55%	52%
	100%	100%	100%	100%	100%
By Shipment Volume					
Canada	15%	17%	15%	14%	16%
USA	53%	40%	39%	15%	16%
Japan	4%	5%	4%	12%	13%
China and other	28%	38%	42%	59%	55%
	100%	100%	100%	100%	100%

During the third quarter of 2012, the Company shipped 68% of total shipment volume to the North American market which continued to offer attractive mill net realizations relative to export markets. Shipments to export markets represented 32% of total shipments compared to 43% during the previous quarter and 71% during the same quarter last year. On a year-to-date basis, shipments to export markets represented 46% of total shipments compared to 68% for the same nine month period last year.

Revenues derived from chips and other residuals totalled \$5.1 million for the third quarter of 2012 and \$5.7 million for the previous quarter, with the change mainly attributable to shipment volume fluctuations as unit sales prices have remained relatively flat over the first nine months of 2012. Year to date average unit chip prices, which are related to fluctuations in NBSK pulp prices, declined by approximately 11% compared to the first nine months of 2011.

<u>Production and Operations</u>

Lumber production totalled approximately 102 million board feet for each of the comparative quarters and represented operating rates of approximately 55%. Planned curtailments for dust mitigation and other safety related maintenance and capital upgrades were taken in the third and second quarters of 2012. The downtime in each quarter represented approximately 5% of

typical total quarterly operating hours. Year to date lumber production totalled 316 million board feet and represents an increase of 18% over the same period last year during which both of our mills operated on a one shift basis during the first quarter.
Unit log costs were comparable during the third and second quarters of 2012 as a 2% improvement in lumber recoveries was offset by slightly higher stumpage costs. Unit log costs in the current quarter increased by 12% over the third quarter of 2011. The increase was primarily attributable to an increase in volume of purchased logs at Mackenzie and higher hauling and stumpage costs.

Unit conversion costs during the third quarter of 2012 increased by 5% over the previous quarter and 17% over the third quarter of 2011. The increase is largely attributable to costs related to higher insurance premiums, ongoing dust mitigation activities, and heightened focus on training and preventative maintenance initiatives related to the performance improvement program at Fort St. James.

In late June 2012, the Company engaged the services of experienced consultants to assist with the implementation of cost improvement initiatives at Fort St. James and to provide targeted organizational and development support to the new mill leadership team. The study, analysis and planning for the new management and measurement system was completed in July and the new operating plan was adopted in August. The initial phase requires substantial employee training to implement the redesigned operating protocols and measurement systems simultaneously in four key operating areas. The plan also involves extensive upfront maintenance activity on machine centers to minimize downtime and additional outside services have been contracted to perform the work. These combined initiatives appear to have produced a positive result in September as sawmill productivity improved by 9% over the year to date average. Unit conversion costs in September also positively reflect the increased productivity and management expects this trend to improve further.

The consultants' analysis has identified potential favourable financial impact of $6 million to $10 million per year without the need to incur any additional capital expenditures once the year-long remediation program is completed. The potential financial improvements are expected to be realized from improved machine center availability due to enhanced maintenance programs, production efficiencies, improved recoveries, and product and log optimization. While some of the initiatives are expected to produce early benefits, a larger portion of the financial benefits are expected to be realized during the last six months of the program as the program involves extensive training as well as the redesign of management and measurement processes. During the third quarter of 2012, the Company expensed $0.5 million of program related costs in the lumber segment compared to $0.2 million in the previous quarter.

During the current quarter, the Company recorded a negative inventory valuation adjustment of $0.3 million compared to a positive benefit of $1.6 million in the previous quarter and negative adjustment of $0.6 million in the third quarter of 2011. The net gain from lumber future derivatives was $0.4 million during the current quarter compared to $0.1 million during the previous quarter and $1.1 million during the third quarter of 2011.

The change in export tax expense between the comparative periods is reflective of the export tax rate, the fluctuation of shipment volumes to the U.S. market and the per unit valuation on which the export tax rate is applied. The export tax rate averaged 8.33% during the third quarter of 2012 compared to 13.33% during the previous quarter and 15% during the third quarter of 2011. The export tax rate is determined on a monthly basis with the rate based upon predetermined trigger prices. The Company shipped 53% of its total shipment volume to the

U.S. during the third quarter of 2012 compared to 40% during the previous quarter and 15% during the third quarter of 2011.

Bioenergy Segment

Background

The Company is constructing a 36 megawatt biomass power plant in Mackenzie B.C. The Bioenergy Project is planned to be constructed adjacent to our currently idled Site I sawmill complex within an existing building with supporting infrastructure that formerly housed a newsprint production facility. The project involves the construction of a bioenergy electricity generator plant designed for annual generating capacity of 230 gigawatt hours. Project scope includes the upgrade of the existing power island infrastructure and the purchase of a 36 megawatt steam turbine generator.

The Company has executed an Electricity Purchase Agreement **("EPA"**) and Load Displacement Agreement **("LDA"**) with BC Hydro. Under the EPA, the Company has agreed to supply the contracted amount of electrical energy each year to BC Hydro over a 20-year term. Under the LDA, the Company has agreed to deliver a contracted amount of electrical energy to supply the energy requirements of its two Mackenzie sawmills over the concurrent 20-year term of the EPA. The EPA was accepted as an energy supply contract by the British Columbia Utilities Commission in April 2012. The Company expects to commence delivery of electricity under the agreements in or about the third quarter of 2013.

The management prepared estimated budget for the Bioenergy Project is approximately $80 million and includes a $6 million general contingency for uncertainty surrounding the amounts remaining to be expended. In addition to the existing site infrastructure and power related assets that were acquired with the purchase of the Mackenzie assets, the Company has invested an additional $17.2 million in project development and equipment costs.

The Company is in well advanced negotiations with a significant financial institution to secure approximately $75 million in funding for its Mackenzie generation project. One alternative being pursued is to secure approximately $60 million in long-term senior secured project debt and approximately $15 million through a sale of a minority equity interest in the Mackenzie project. However, currently there can be no assurance that the Company will obtain the necessary funding for the project on the foregoing terms, other terms reasonably satisfactory to it or at all.

The Company drew down a portion of the LDA incentive funds and concurrently issued a letter of credit representing approximately 50% of the proceeds to BC Hydro during the third quarter of 2012.

Project site mobilization and construction activities commenced in August 2012.

Capital expenditures related to the Bioenergy Project totalled $5.5 million during the third quarter of 2012, $2.8 million during the previous quarter and $10.2 million during the first nine months of 2012.

The net loss reported in the bioenergy segment for the comparative periods arises from costs related to holding idled facilities, such as insurance and property tax, and to professional fees related to activities undertaken in this segment.

The Bioenergy Project is subject to a number of risks and uncertainties, including, among others financial penalties if the project does not deliver the contracted amount of energy under the EPA, failure to attract required personnel and skills to operate the facilities, failure of the equipment and technology to perform as expected, failure to obtain the necessary funding on satisfactory terms, or at all, changes in project parameters, delays in the completion of development activities and capital expenditure estimates. There is no assurance that the Bioenergy Project will be completed on time, on budget or at all.

Corporate costs and other items

Corporate costs and other items totalled $5.3 million for the first nine months of 2012 compared to $3.0 million for the same period last year. Approximately $1.3 million of the increase in the current period is attributable to higher interest expense and $0.6 million to increased foreign exchange loss.

FINANCIAL POSITION AND LIQUIDITY

SELECTED CASH FLOW ITEMS

(millions of dollars)	**Q3 2012**	**Q2 2012**	**YTD 2012**	**Q3 2011**	**YTD 2011**
Operating Activities					
Cash used before working capital changes	(1.1)	0.4	(3.1)	0.6	(3.0)
Non - cash working capital change	1.8	8.7	(2.9)	2.3	(7.2)
Cash provided from (used in) operating activities	0.7	9.1	(6.0)	2.9	(10.2)
Investing Activities					
Additions to property, plant, equipment	(8.2)	(7.8)	(20.5)	(1.4)	(9.9)
Proceeds on disposal of assets held for sale	-	0.2	0.4	0.2	1.8
Cash used in investing activities	(8.2)	(7.6)	(20.1)	(1.2)	(8.1)
Financing Activities					
Net proceeds from private placements	-	-	26.9	-	-
Net proceeds from (repayment of) loans	(0.4)	(0.4)	(0.8)	(0.4)	0.7
Proceeds from incentive funding	3.3	-	3.3		
Interest expense paid	(0.1)	(0.7)	(1.3)	(0.1)	(0.1)
Cash provided from (used in) financing activities	2.8	(1.1)	28.1	(0.5)	0.6
Change in cash	(4.7)	0.4	2.0	1.2	(17.7)

Cash used in operations before working capital changes totalled $1.1 million in the third quarter of 2012, with the increase of $1.5 million over the previous quarter and $1.7 million over the third quarter of 2011 attributable primarily to the increase in net loss. Cash provided from non-cash working capital change was similar during the third quarters of 2012 and 2011, and significantly less than the $8.7 million generated during the second quarter of 2012 when the seasonal build in log inventories was drawn down. There was no material differences in the levels of noncash working capital employed in the lumber segment during each of the comparative quarters. Compared to the third quarter of 2011, the higher accounts receivable balances resulting from increased volumes and higher unit sales prices during the second and third quarters of 2012 were largely offset with lower finished goods inventory as a result of a relative decrease in export shipment volumes and an increase in accounts payable.

During the first nine months of 2012, the Company invested $17.8 million in capital assets compared to $9.9 million during the same period last year. Additions to property, plant and equipment during the current year on a cash basis reflects a payment of $2.7 million on equipment that was accrued during a previous period. Capital expenditures for the current year included $10.2 million on the Bioenergy Project, $3.0 million on the automated lumber grading system at Mackenzie and $4.6 million primarily on initiatives related to workplace safety and asset protection. Capital additions during the first nine months of 2011 included $2.3 million on the Bioenergy Project with the balance largely related to the major capital project undertaken at the Fort St. James complex.

Financing activities during the first nine months of 2012 consisted of net proceeds from the private placements of common shares of $26.9 million during the first quarter, receipt of $3.3 million LDA incentive funds during the third quarter, repayment of the Community Adjustment Fund **("CAF"**) loan of $1.3 million and payment of interest expenses of $0.8 million. Financing activities during the first nine months of 2011 consisted of proceeds from the CAF loan of $1.5 million offset by repayments of $0.8 million and payment of interest expense of $0.1 million.

During the first nine months of 2012, cash and cash equivalents increased by $2.0 million compared to a decrease of $17.7 million during the first nine months of 2011. The Company had cash and cash equivalents on hand of $14.8 million at September 30, 2012 compared to $12.7 million at December 31, 2011 and $8.9 million at September 30, 2011. The Company ended the third quarter of 2012 with net debt of $11.4 million and net debt to capitalization ratio of 10.5%.

LIQUIDITY

The Company's current principal sources of funds are cash flow from operations and cash on hand. The Company's current principal uses of funds consist of operating and capital expenditures and repayment of debt.

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.

In addition, our management is considering various alternatives for future financing requirements. These alternatives could include the issuance of equity, instruments convertible into equity and debt.

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. An increase in shipments to export markets requires carrying a higher level of transit finished goods inventory. Working capital is also required to support the third party transactions undertaken by the Company's wholesale lumber and logistics services businesses. The Company believes its management practices with respect to working capital conform to common industry practices.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary	2012			2011				2010
(millions of dollars except share and per share amounts)	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Sales -Lumber	46.1	45.5	39.4	34.0	33.7	22.5	18.5	16.2
- By-products	5.1	5.7	4.5	4.7	4.4	4.4	2.6	2.0
- Freight services	3.2	4.6	3.5	-	-	-	-	-
Total Sales	54.4	55.8	47.4	38.7	38.1	26.9	21.1	18.2
Operating loss	(2.8)	(1.6)	(6.2)	(6.8)	(3.3)	(4.1)	(3.8)	(2.7)
Net loss	(3.7)	(2.4)	(6.5)	(7.5)	(2.2)	(3.6)	(3.6)	(3.9)
Net loss per share - basic and diluted	(0.19)	(0.13)	(0.38)	(0.49)	(0.14)	(0.24)	(0.24)	(0.26)
EBITDA	(0.5)	0.6	(3.8)	(5.2)	0.6	(0.8)	(1.3)	(2.2)
Shares outstanding - end of period (millions)	19.4	19.4	19.4	15.2	15.2	15.2	15.2	15.2
Shares outstanding - weighted average (millions)	19.4	19.4	17.3	15.2	15.2	15.2	15.2	15.1
Statistics								
Lumber shipments - Conifex product (MMfbm)	107.5	111.7	114.8	123.6	115.4	81.5	62.5	49.0
Lumber production (MMfbm)	102.8	102.1	111.1	94.9	101.6	102.4	63.5	49.1
Average exchange rate - US$/Cdn$ (1)	1.005	0.990	0.999	0.977	1.020	1.0335	1.0142	0.987
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 301	$ 296	$ 267	$ 239	$ 246	$ 240	$ 297	$ 268
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 299	$ 299	$ 267	$ 244	$ 241	$ 232	$ 293	$ 272

(1) Source: Bank of Canada website www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.

Reconciliation of EBITDA to Net Loss	2012			2011				2010
(millions of dollars)	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Net loss	(3.7)	(2.4)	(6.5)	(7.5)	(2.2)	(3.6)	(3.6)	(3.9)
Add: Interest expense	0.5	0.5	0.5	0.3	0.1	0.1	-	-
Depreciation and amortization	1.9	1.8	1.8	1.6	1.8	1.7	1.4	1.0
Deferred union payroll liability	-	-	-	(0.1)	0.3	0.5	0.3	0.2
Share based compensation	0.4	0.2	0.1	0.2	0.3	0.2	0.3	0.3
Accretion of convertible debentures	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Loss on disposal of assets	0.1	0.2	-	-	-	-	-	-
EBITDA*	(0.5)	0.6	(3.8)	(5.2)	0.6	(0.8)	(1.3)	(2.2)

*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, fluctuation in other commodity prices which impacts by-product revenue and manufacturing costs, 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 and the Mackenzie Site II mill operated on a one shift basis during the first quarter of 2011. A second shift was added at both sites in the second quarter of 2011.

On December 31, 2011, the Company internalized its previously outsourced marketing and logistics function by completing the acquisition of a commodity lumber business and a transportation and logistics business. Both of the newly acquired businesses generate incremental revenue from third party transactions.

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 future taxable income.

OUTLOOK AND STRATEGY

Lumber segment

Management believes that the improvement in sawmill productivity at the Fort St. James operations evidenced in September 2012 is sustainable and is an early benefit of the continuing development of the new leadership team at the site and the initial implementation of newly designed management and measurement systems. Management expects the improved performance to produce immediate financial benefit by way of lower unit conversion costs but expects that some of the benefit will be offset by higher initial investments in training and other program related costs. Accordingly, management expects more significant financial benefits from the remedial program to become evident during the latter half of the program, to take place in the first half of 2013. Management is pleased with the significant improvement in product grade outturns at the Mackenzie mill as a benefit of the GradExpert installation in the previous quarter. The Company has now completed the harvesting of some legacy low value timber stands committed to by the previous owner and commenced deliveries of a more representative sawlog profile to its Mackenzie mill in September. Management expects that the improved log diet will contribute to higher lumber recoveries, increased productivity and improved grade outturns.

Management believes that these and other ongoing initiatives will contribute to its objective of achieving a level of EBITDA per thousand board feet in its lumber segment that is competitive with industry leaders in the northern interior region of B.C.

In terms of market, the Company expects benchmark lumber prices for the closing quarter of 2012 to approach the average recorded for the two most recent quarters. We expect continued firm demand from the U.S. market as recent residential construction activity has been higher than expected by industry observers and meaningful supply side response has yet to materialize. Management expects North American lumber prices to be further supported by continued solid demand from China ahead of its traditional seasonal holiday early in the first quarter due to reports of low inventories in the supply chain and a stable level of log imports. While prices on premium products typically destined for the Japanese market remained relatively flat during the last two quarters and did not keep pace with the increase in the benchmark price, management expects modest price increases on these products over the next two quarters.

Bioenergy segment

The Bioenergy Project development team intends to continue to progress critical path elements of the construction project. A significant portion of the critical path activities which are sensitive to weather conditions have been completed and it is anticipated much of the work will move indoors over the winter months.

OUTSTANDING SECURITIES

As at October 19, 2012, the Company had 19,377,611 issued and outstanding common shares, 100,000 stock options, 802,806 long-term incentive plan awards issued under the Company's long-term incentive plan dated June 3, 2010, as amended, 325,000 warrants, 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.

ACCOUNTING POLICY CHANGES

Effective January 1, 2012, the Company retroactively changed its accounting policy to reclassify costs related to shipping and administrative activities at its lumber manufacturing locations included in selling, general and administrative expense to cost of goods sold. Management considers classification of shipping and administrative costs directly related to the lumber manufacturing locations with cost of goods sold to provide more relevant information on the operating results of the Company, particularly with the recent acquisition of its marketing and transportation subsidiaries.

NEW ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET APPLIED

For a review of new accounting pronouncements issued but not yet applied, see the 2011 annual MD&A which is available on www.sedar.com and www.conifex.com.

RISKS AND UNCERTAINTIES

A discussion of the risks and uncertainties to which the Company is subject is included in the 2011 annual MD&A which is available on www.sedar.com and www.conifex.com.

ADDITIONAL INFORMATION

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