CONIFEX

CONIFEX TIMBER INC.

2011 MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of February 17, 2012

This Management's Discussion and Analysis ("MD&A") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the year ended December 31, 2011 relative to 2010, the Company's financial condition and future prospects. This MD&A should be read in conjunction with Conifex's Consolidated Financial Statements and notes thereon for the years ended December 31, 2011 and 2010 filed on SEDAR at www.sedar.com.

In this 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 MD&A are in Canadian dollars.

References in this 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 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 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.

OVERVIEW OF 2011

During 2011, the Company continued to make progress towards the achievement of its strategic and financial objectives in each of its operating segments. The objectives of the Company are to capitalize on its acquisitions of favourably priced assets by developing each such asset in the optimal way, to achieve top-quartile margins in the lumber manufacturing segment by optimizing mill nets and maintaining cost effective operations, and to develop integrated businesses that facilitate the extraction of maximum revenue from each log harvested. The Company's main assets are comprised of a sawmill complex in Fort St. James ("FSJ"), two sawmill complexes, idled power generation assets and related infrastructure in Mackenzie, and access to a high quality timber base to support its lumber conversion facilities and future bioenergy operations potential.

Significant developments in the lumber segment

Completion of the major capital expenditure program at FSJ in March 2011

The capital expenditure program was focused largely on improving the finishing processes and upgrading the drying capabilities at this facility. Two primary benefits were realized with the completion of this program. The first was a significant improvement in grade outturns as a result of the addition of automated grading, cut-in-two and improved drying capabilities combined with a change in primary cutting protocols and log specifications. The second benefit realized was the ability to cost effectively add a second sawmill shift as a result of enhancements made to the planer.

Addition of a second shift at FSJ and Mackenzie in March 2011

The addition of a second shift at FSJ and Mackenzie in late March 2011 increased current year production volumes to 363 million board feet, an increase of 215% over the previous year. The operating rate during 2011 was approximately 49% of overall production capacity of approximately 745 million board feet on a two-shift annualized basis and compares to an operating rate of approximately 23% last year. The Company expects the operating rate to approach 65% during 2012 as the benefits of operating on a two-shift format for a full year are realized and as productivity improves with the additional experience gained by the operations personnel.

Cost of goods sold in 2011 included non-recurring costs related to significant turnover of operating personnel and changes in key management positions at both manufacturing facilities. Productivity was adversely impacted in the first quarter of 2011 at FSJ from the capital project and at both locations with the change to the two-shift operating format. The FSJ sawmill was reconfigured from a three-line to a two-line operating format in late 2011 and the cost benefits from this improvement are not expected to be realized until early 2012. As a result of these and other factors, the cash unit conversion costs during 2011 did not materially change from the previous year. The Company expects to realize significant unit cost improvements in 2012 due to the anticipated higher operating rates and the removal of the effects of the nonrecurring costs incurred during 2011.

Increased shipments to export markets with record shipments reported in Q2 2011

During 2011, the Company continued its progress towards developing alternative markets for its products and reducing its exposure to residential construction activity in the United States. The further development of new export markets was a result of increased production of the premium grades of lumber preferred by the Japanese market and the marketing and logistics capability to identify and deliver products to the markets that yield the highest return. During the second quarter of 2011, the Company shipped a record 83% of total volume to export markets including 14% by volume and 18% by value of overall total shipments to Japan.

Acquisition of a commodity lumber distribution business and a transportation and logistics business on December 31, 2011

The Company previously outsourced its marketing, sales and logistics function under a three-year lumber sales agreement with Welco Lumber Corp. (“Welco”) which expired in November 2011. Conifex has begun to transition these functions internally as a result of the acquisition of the commodity lumber distribution business and the transportation and logistics business previously owned by Welco. As part of the purchase agreement, the Company has retained the services of key personnel. Benefits that the Company expects to realize from the acquisition include:

- The ability to continue to service and maintain long-term relationships with customers in key markets with experienced personnel who are familiar with Conifex’s products
- The ability to retain superior logistical capabilities which provides the flexibility to shift between the three main softwood lumber import markets in the world
- The potential to earn premiums on commodity lumber, premium prices on shipments and industry leading mill net prices
- The ability to earn incremental revenue from wholesale lumber transactions and provision of third party logistics services
- The reduction of marketing and distribution costs compared to the cost of outsourcing these functions

Conifex intends to operate its lumber distribution business under a newly formed company named Conifex Fibre Marketing Inc. (“CFMI”) and maintain trading relationships previously established by its commodity lumber sales group. The transportation and logistics business will continue to operate as Navcor Transportation Services Inc. (“Navcor”). Both companies will be operated as independent profit centers.

Significant developments in the bioenergy segment

Initiation of a bioenergy project at Mackenzie BC

In March 2011 the Company announced the initiation of a bioenergy cogeneration project at its Mackenzie sawmill site, currently scheduled for commercial production of electricity in mid-2013 (the “Bioenergy Project”). The Bioenergy Project is currently estimated to cost approximately $64 million to complete including contingencies and estimated financing costs. The planned capital expenditures are to be utilized for the upgrade of the existing power island infrastructure and the purchase of a 36 megawatt per hour steam turbine generator set to replace the existing 13.8 megawatt per hour turbine.

The development of the Bioenergy Project is expected to provide a stable and diversified source of revenue in the energy segment for the Company as well as an assured market for a portion of the sawmill residuals produced in the manufacture of lumber. The existing power generation assets and related infrastructure allows the project to be developed at a lower capital cost than a greenfield project. The project is planned to utilize proven technology.

The power produced by the cogeneration plant is expected to meet the Company's own electricity needs at Mackenzie and the balance of the power produced is contracted to be sold to BC Hydro under the terms of a 20 year Electricity Purchase Agreement ("EPA"). The cogeneration plant is currently expected to produce approximately 230 gigawatt hours ("Gwh") of net energy per year.

Purchase of a 36 megawatt steam turbine generation set

In January 2011, the Company entered into arrangements with a manufacturer for the manufacture and purchase of a 36 megawatt per hour steam turbine generation set (the "Turbine") and ancillary equipment and services at a total estimated cost of U.S. $10.5 million. As the regulatory approval for the Company's EPA with BC Hydro has not yet been granted, there is no assurance the Bioenergy Project will proceed as currently planned or at all. In order to provide necessary flexibility, the Turbine acquisition agreement contains cancellation rights in favour of Conifex that may be exercised if the Bioenergy Project does not proceed as more particularly described in the agreement.

Completion of an EPA and Load Displacement Agreement ("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 Project.

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 mid-2013. 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 meet and supply the energy requirements of the Company's sawmills located in Mackenzie over the twenty year term of the LDA paralleling that of the EPA. In exchange for the Company agreeing to supply such energy for the sawmills, BC Hydro has agreed to provide incentive funding to be utilized towards the completion of the Bioenergy Facility.

The feedstock for the Bioenergy Facility is planned to 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 ("BCUC") as an energy supply contract. The EPA was filed for regulatory approval in January 2012.

Commencement of project development activities including the demolition, removal and sale of redundant assets at the site

With the completion of the EPA and LDA, the Company commenced extensive detailed project engineering work which enabled refinement of expected capital costs. The Company expects to secure project financing upon the receipt of BCUC approval. The Company entered into an agreement in September 2011 under the terms of which certain redundant assets at the project site, currently classified as assets held for sale, will be demolished and removed. Under the terms of the agreement, the Company will be paid for all material salvaged in the demolition.

Other notable developments

Other notable developments during 2011 included:

- The addition of management personnel in key positions including Kevin Horsnell as Chief Operating Officer
- The establishment of a regional office in Prince George, BC in March 2011
- The purchase of certain properties in Mackenzie in November 2011 which were previously leased by the Company and on which the Site II sawmill complex is situated
- The completion of a $12 million private placement of short term senior notes in December 2011

SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

For the year ended December 31, 2011, the Company recorded a net loss of $16.9 million or $1.11 per share and negative EBITDA of $6.8 million on sales of $125.0 million. For the year ended December 31, 2010, the Company recorded a net loss of $10.8 million or $1.02 per share and negative EBITDA of $5.7 million on revenues of $57.4 million. Negative EBITDA in 2011 was comprised of $3.2 million from the lumber segment, $0.9 million from the bioenergy segment and $2.7 million from corporate costs and other items. EBITDA from the lumber segment for 2011 remained flat to 2010 despite an $11 per thousand board feet (in Canadian dollars) year over year decline in average benchmark lumber prices.

Lumber shipments of 383 million board feet during 2011 represented an increase of 250% over 2010 shipment volumes. Unit mill net price realizations declined slightly more than indicated by the benchmark lumber price due to the steep decline in prices of the lower grades of lumber during the fourth quarter of 2011.

Total 2011 shipments to export markets increased to 64% of total volume compared to 45% in 2010. The increase of 19% was represented by a 7% increase in shipments to Japan and a 12% increase in shipments to China.

Lumber production of 363 million board feet during 2011, an increase of 215% over 2010, reflects an operating rate of approximately 49% of overall annualized production capacity compared to an operating rate of approximately 23% in 2010.

The 2011 operating results in the lumber segment, compared to 2010, were adversely impacted on a per unit basis by a decline in mill net price realizations and a minor increase in log costs due primarily to a lower lumber recovery factor. Factors that positively impacted results in the current year included an increase in revenue from residual products, a reduction in selling, general and administrative costs, and an increase in profits from lumber future derivatives. Costs related to the idled facilities at Mackenzie were incurred in 2010 as the Site II mill did not begin production until November 2010 and the Site I mill remains idled.

Conversion costs in 2011 included non-recurring expenses related to significant changes in management structure and operations personnel and the addition and ramp up of second shifts at both of the Company's facilities. Productivity was hampered by disruptions from the capital project at FSJ earlier in the year, the initiation of new personnel, and the reconfiguration of the FSJ sawmill and seasonal shutdowns in December. Fourth quarter 2011 lumber recoveries, grade outturns and manufacturing costs were adversely impacted by the converting of atypically low quality logs at Mackenzie because harvesting operations were located on legacy cutting permits on marginal stands put in place by the previous owner. As a result, overall unit cash conversion costs in 2011 improved only slightly over 2010 despite the higher operating rates.

Management expects unit cash conversion costs to improve significantly in 2012 as the effects of the non-recurring developmental expenses are removed, the log quality returns to that more typical of the Company's overall harvesting areas, and the benefits of the FSJ sawmill reconfiguration and the planned automated grading system at Mackenzie are fully realized.

Overall Company results for 2011 and 2010 include the fixed costs related to the idled Site I sawmill complex and the power generation related assets at Mackenzie.

SELECTED ANNUAL INFORMATION

(millions of dollars except share and per share amounts)	**2011**	**2010**	**2009**
Sales -Lumber	108.9	50.8	27.5
- By-products	16.1	6.6	3.8
Total Sales	125.0	57.4	31.3
Operating loss	(18.1)	(8.0)	(10.9)
Net loss	(16.9)	(10.8)	(10.3)
Net loss per share - basic and diluted	(1.11)	(1.02)	(2.45)
EBITDA	(6.8)	(5.7)	(8.5)
Shares outstanding - end of period (millions)	15.2	15.2	4.3
Shares outstanding - weighted average (millions)	15.2	10.6	4.2
Total assets	134.4	126.5	27.3
Total long-term debt	12.2	11.3	3.5
Statistics			
Lumber shipments (MMfbm)	383.0	152.6	103.6
Lumber production (MMfbm)	362.6	169.2	114.3
Average exchange rate - US$/Cdn$ (1)	1.012	0.971	0.880
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 255	$ 255	$ 181
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 252	$ 263	$ 205
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$218-$321	$188 - $320	$134 - $232

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

Reconciliation of EBITDA to Net Loss

(millions of dollars)	2011	2010	2009
Net loss	(16.9)	(10.8)	(10.3)
Add: Interest expense	0.6	0.1	-
Depreciation and amortization	6.5	2.5	1.0
Deferred union payroll liability	0.9	0.5	0.5
Share based compensation	1.0	0.5	0.3
Accretion of convertible debentures	1.0	1.0	-
Revaluation of Fourth shares to fair value	-	0.5	-
EBITDA*	(6.8)	(5.7)	(8.5)

*May not total exactly due to rounding.

The Company did not commence commercial operations until the first quarter of 2009. Sales for 2009 reflect shipments for the nine-month period commencing April 2009.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Operating Results by Business Segment

(millions of dollars)	2011	2010
Revenue		
Lumber	125.0	57.4
Bioenergy	-	-
	125.0	57.4
Net Loss		
Lumber	(11.4)	(6.5)
Bioenergy	(1.0)	(0.5)
Corporate costs and other items	(4.5)	(3.8)
	(16.9)	(10.8)
EBITDA		
Lumber	(3.2)	(3.3)
Bioenergy	(0.9)	(0.5)
Corporate costs and other items	(2.7)	(1.9)
	(6.8)	(5.7)

Profit and losses from lumber derivatives were previously included in the “corporate costs and other items” category. Current and prior periods have been restated to include profit and losses from lumber derivatives in the lumber segment. Profits from lumber future derivatives were $2.9 million in 2011 compared to a loss of $0.9 million in 2010.

Lumber Segment

Overview

The residential construction industry in the U.S. staged a modest recovery in 2011 as evidenced by the increase of 3.4% in new housing starts reported by the U.S. Census Bureau. There were an estimated 606,900 new housing units started during 2011 compared to 586,900 in 2010 with the growth predominantly in the construction of multi-unit structures. Housing starts in the U.S. have traditionally been a key determinant of North American lumber prices although strong demand from export markets has played an increasingly important role in shaping domestic prices over the last two years.

Average WSPF 2x4 #2 & Btr ("WSPF") prices remained flat at US$255 during 2011 and 2010[1]. The Canadian dollar strengthened year over year by 4% against the U.S. dollar effectively creating an $11 per thousand board feet decline in average benchmark lumber prices this year compared to the prior year.

The export tax rate charged on shipments of softwood lumber to the U.S. from British Columbia fluctuates based upon prices published by the Random Lengths Framing Lumber Composite Price. As the tax is intended to be punitive at lower price ranges, the export tax rate is reduced when the composite price level increases to specified levels and the increase is sustained over a specified period. The export tax rate remained at 15% throughout 2011 and averaged 12.9% during 2010 as sustained lumber price rallies in February, March and April reduced export tax rates during the ensuing three months.

The lumber segment recorded a net loss of $11.4 million on sales of $125.0 million for the year ended December 31, 2011 compared to a net loss of $6.5 million on sales of $57.4 million for the year ended December 31, 2010. EBITDA was negative $3.2 million for 2011 and negative $3.3 million for 2010.

Positive contributions to 2011 operating results from increased per unit revenues from residuals, gains from lumber price derivatives, and reduction of selling, general and administrative costs were offset by moderately higher log costs and a decline in mill net price realizations. Year over year unit cash conversion costs remained relatively unchanged.

Sales

Lumber revenues totalled $108.9 million on shipments of 383 million board feet during 2011 compared to $50.8 million on shipments of 153 million board feet during 2010. Overall mill net price realizations on a per unit basis declined by approximately 5.5% in 2011 compared to 2010 as a result of a 4% decline in year over year lumber prices and the steep decline in lower grade product prices during the fourth quarter of 2011.

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

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

	2011	2010
By Revenue (net of freight)		
Canada	16%	22%
USA	20%	36%
Japan	15%	7%
China	49%	35%
	100%	100%
By Shipment Volume		
Canada	17%	18%
USA	19%	36%
Japan	12%	5%
China	52%	41%
	100%	100%

The Company monitors markets on an ongoing basis to determine those that will yield the highest return for its lumber products on a product specific basis and has the logistics capability to shift significant volumes between key markets. Shipments to export markets ranged from a low of 44% during the first quarter of 2011 to a high of 83% during the second quarter. Overall 2011 export shipments represented 64% of total shipments compared to 45% in 2010.

With the recent internalization of its marketing, sales and logistics capabilities, the Company intends to continue to focus on the three largest softwood lumber import markets in the world and to work to achieve industry leading mill net prices. The Company expects to increase production of premium quality products and increase shipments to Japan upon the completion of the installation of an automated grading system at its Mackenzie mill in the second quarter of 2012. The Company believes considerable potential exists for continued growth in lumber demand from the Chinese market.

Revenue from by-products of $16.1 million in 2011 and $6.6 million in 2010 accounted for approximately 13% and 11% of total revenue respectively. The increase in revenue in 2011 was attributable to increased volume as prices for residual wood chips, which are related to fluctuations in NBSK pulp prices, declined by 2% year over year.

Production and Operations

Lumber production totalled 363 million board feet in 2011 and represented an operating rate of 49%, more than doubling 2010 production of 169 million board feet and operating rate of 23 %.

Cost of goods sold were $102.8 million in 2011 and $45.4 million in 2010, due principally to increased lumber production. Unit log costs increased by 3.6% in 2011 with approximately 70% of the increase attributable to lower lumber recoveries and the balance attributable to an increase in delivered log costs. During the summer of 2011, the harvesting program at Mackenzie included the fulfillment of a legacy cutting permit inherited from the previous owner of the site. The harvesting area had originally been targeted by an integrated operator tolerant of a lesser quality log specification. The conversion of the smaller and poorer quality logs during the fourth quarter of 2011 resulted in lower lumber recovery rates, higher outturn of lower grade lumber, higher conversion costs, and increased production of residual wood chips.

As previously mentioned, cost of goods sold in 2011 included non-recurring costs related to significant personnel changes at both of our manufacturing facilities. Disruptions to productivity from the capital project at FSJ and changes to operating format at both locations also added non-recurring operating costs. As a result, year over year per unit cash conversion costs did not materially change from 2010 but are expected to significantly improve in 2012 as the effect of the non-recurring costs are removed and the benefits of higher operating rates, change in operating format at FSJ and the installation of the automated grading system at Mackenzie are fully realized. Non-recurring costs of $1.5 million related to the idled Site II facility is included in the costs of goods sold for 2010. Fixed costs related to the idled Site I facility is included in selling, general and administrative ("SG&A") expenses for 2011 and 2010.

The increase in 2011 in freight and distribution costs of $14.4 million and SG&A expenses related to the lumber segment of $5.6 million is attributable to increased shipment volumes. SG&A expenses on a per unit basis declined by 20% during 2011 as a result of higher operating rates.

Bioenergy Segment

The Company is currently awaiting the acceptance of its EPA with BC Hydro as an energy supply contract by the BCUC. The EPA was submitted to the BCUC for approval in January 2012. Detailed scheduling of the project has been largely completed and all major equipment components have been ordered. The major equipment purchase agreement provides appropriate cancellation clauses in the event the project does not proceed. Demolition of redundant assets on the site is underway and new construction is expected to begin later in 2012. The Company intends to secure related financing and complete contracts with major vendors once the regulatory approval has been granted.

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 $7.0 million during 2011 of which $2.8 million was reflected in accounts payable at period end. The expenditures relate primarily to feasibility studies and project management, engineering, and other technical and professional services. The Company has also made a partial payment on the Turbine.

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

Income Tax

The Company has non-capital loss carry forwards totalling $25.4 million as at December 31, 2011 and $18.0 million as at December 31, 2010. The Company has not recognized certain future income tax assets arising from loss carry-forwards available to reduce future taxable income. The future income tax assets have been reduced by a valuation allowance each year.

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Company's financial position as at the end of the years 2011 and 2010:

(millions of dollars)	2011	2010
Cash	12.7	26.6
Operating working capital	14.2	13.7
Assets held for sale	0.9	1.6
Notes payable	(12.0)	-
Mortgage payable	(1.0)	-
Current portion of long-term debt	(1.7)	(1.2)
Net working capital	13.1	40.7
Long -term assets	87.4	74.6
Net assets	100.5	115.3
Non-interest bearing long-term liabilities	6.9	7.2
Long-term debt	12.2	11.3
Shareholders' equity	81.4	96.8
	100.5	115.3
Total assets	134.4	126.5
Total liabilities	53.0	29.7

The net change in operating working capital at December 31, 2011 from 2010 was negligible as the $8.5 million increase in accounts receivable and inventories at period end was offset by a corresponding increase in accounts payable and other short term liabilities. The increase in accounts receivable and inventories in 2011 resulted primarily from higher operating rates. Assets held for sale represent redundant assets acquired with the purchase of the Mackenzie Assets. The Company has completed an agreement to sell the remaining assets in this class for salvage value and expects proceeds from the sale to exceed the book value of the assets.

In December 2011, the Company issued short term promissory notes in the aggregate amount of $12 million under the terms of a senior secured financing agreement. The notes expire on December 31, 2012, subject to early redemption by the Company as provided in the notes, 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 issued 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 notes are intended to be used for general corporate purposes.

In November 2011, the Company assumed a mortgage of $1.0 million as part of the purchase price of certain properties acquired in Mackenzie BC. The mortgage is repayable by eleven monthly payments commencing in January 2012. The interest rate is based on the prime rate offered by a major Canadian financial institution plus an adjustment.

The current portion of long-term debt reflects the quarterly repayments that are payable on the Community Adjustment Fund ("CAF") loan.

Additions to long-term assets included $1.3 million related to the purchase of previously leased properties at Mackenzie, $7.0 million related to the Bioenergy Project at Mackenzie, $6.0 million related to the capital expenditure program at FSJ, and $2.1 million goodwill recognized on the acquisition of Conifex Fibre Marketing Inc. and Navcor Transportation Services Inc. The increases were offset by amortization of assets and by proceeds from the sale of redundant assets.

Non-interest bearing long-term liabilities include reforestation liabilities of $4.2 million and environmental liabilities of $2.0 million.

Long-Term Debt

Long-term debt is comprised of the long-term portion of the CAF loan in the amount of $5.6 million and convertible notes in the amount of $6.7 million.

The CAF loan program is sponsored by the Northern Development Initiative Trust. The CAF loan, in the principal amount of $8.5 million, was secured to help finance the capital expenditure program at FSJ. The CAF loan carries a fixed interest rate of 3.75% and is repayable in equal quarterly instalments over a five year period which commenced June 1, 2011. Principal and interest repayments totalling $1.9 million are payable during 2012.

In December 2009, the Company issued convertible notes in two tranches in the aggregate principal amount of $10 million. The notes have a five year term and carry an interest rate of 2.5% from issue to December 15, 2012 to be settled in common shares and 10.5% thereafter to be settled in cash. The convertible notes mature on December 15, 2014 and are convertible at $8.00 per share. The Company has the option to redeem the notes on or after December 15, 2013 at a redemption price equal to the principal amount plus accrued and unpaid interest.

The values of the liability component and the equity conversion component were determined at issuance of the notes. The fair value of the liability component, included in non-current liabilities, was calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the value of the equity conversion option, is included in shareholders' equity. The note discount equal to the value of the option and issuance costs are accreted over the term of the note.

On December 15, 2011, the Company paid interest due on the convertible notes by issuing 31,138 common shares as payment in kind and cash payments for fractional shares (2010: 31,151 common shares).

During January and February of 2011, the Company issued a total of 4,133 common shares to convert notes with principal amounts totalling $33,000 and to pay accrued interest.

CASH FLOW

During 2011 the Company used cash of $7.8 million in operating activities before changes in working capital compared to $7.4 million in 2010. Operating working capital changes used cash of $5.1 million in 2011 compared to $6.7 million in 2010.

Investing activities during 2011, reported net of non-cash transactions, included $4.2 million related to the Bioenergy Project, $6.0 million related to the capital project at FSJ, and $2.2 on the purchase of CFMI and Navcor. Net proceeds of $1.9 million from the sale of redundant assets were received. Major expenditures related to investing activities during 2010 included $23 million on the capital project at Fort St. James, net amount of $34.5 million on the purchase of the Mackenzie Assets and $2.5 million on capital projects and major maintenance to support the start-up of the Mackenzie Site II operations.

Financing activities during 2011 were comprised of $11.8 net proceeds from the issue of promissory notes and $0.3 million net proceeds from the CAF loan. Financing activities during 2010 included net proceeds from the private placement of $85.9 million, proceeds from the CAF loan of $7.0 million, and proceeds from the issue of convertible debentures of $2.0 million.

The net decrease in cash and cash equivalents for 2011 was $13.9 million compared to a net increase in cash of $20.6 million for 2010. At December 31, 2011, the Company had cash and cash equivalents on hand of $12.7 million of which $1.7 million was restricted. The restricted cash is used to secure a standby letter of credit issued in the same amount to BC Hydro pursuant to the terms of the EPA.

LIQUIDITY AND FINANCIAL REQUIREMENTS

The Company's current principal sources of funds are cash flow from operations and cash on hand. In February 2012, the Company completed a brokered and non-brokered private placement of common shares from treasury for total gross proceeds of approximately $28.5 million as described under Subsequent Events. 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 maintenance downtime, 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 in 2011 has increased the level of finished goods inventory typically held by the Company. Shipments of product to North American markets are invoiced to the customer on the date of shipment from the mill. Shipments to export customers are invoiced to the customer on the date the product is loaded on to the container ship. The typical time lapse between the date the product leaves the mill and the date it is loaded onto the vessel and becomes an accounts receivable is approximately four weeks. The Company believes its management practices with respect to working capital conform to common industry practices.

2011 Projected Capital Spending and Debt Repayments

As at December 31, 2011 the Company had operating working capital of $14.2 million and unrestricted cash of $11.0 million. The Company has committed approximately $3.2 million to be spent on an automated grading system at the Mackenzie Site II planer mill.

The Bioenergy Project at Mackenzie is expected to cost approximately $64 million including contingencies and financing costs. The Company has spent approximately $4.2 million to date on the project on critical path development activities and equipment commitments. The

Company intends to secure project financing upon regulatory approval of the EPA with BC Hydro.

Debt repayments due in 2012 are comprised of principal and interest payable of approximately $1.9 million on the CAF loan; $1.0 million on the mortgage; and $12 million on the promissory note.

Conifex intends to finance its planned capital expenditures and scheduled debt repayments from existing cash reserves, cash flow from operations, proceeds from the private placements completed in February 2012, and additional credit facilities the Company is seeking to secure in 2012.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary	**2011**				**2010**			
(millions of dollars except share and per share amounts)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales -Lumber	34.0	33.8	22.5	18.6	16.2	13.0	10.7	10.9
- By-products	4.7	4.4	4.4	2.6	2.0	1.5	1.9	1.2
Total Sales	38.7	38.2	26.9	21.2	18.2	14.5	12.6	12.1
Operating loss	(6.8)	(3.3)	(4.1)	(3.8)	(2.7)	(2.4)	(1.8)	(1.0)
Net loss	(7.5)	(2.2)	(3.6)	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)
Net loss per share - basic and diluted	(0.49)	(0.14)	(0.24)	(0.24)	(0.26)	(0.19)	(0.31)	(0.39)
EBITDA	(5.2)	0.6	(0.8)	(1.3)	(2.2)	(1.8)	(0.8)	(0.9)
Shares outstanding - end of period (millions)	15.2	15.2	15.2	15.2	15.2	15.1	15.1	4.3
Shares outstanding - weighted average (millions)	15.2	15.2	15.2	15.2	15.1	15.1	7.6	4.3
Statistics								
Lumber shipments (MMfbm)	123.6	115.4	81.5	62.5	49.0	40.2	30.7	32.8
Lumber production (MMfbm)	94.9	101.6	102.4	63.5	49.1	39.3	41.3	39.5
Average exchange rate - US$/Cdn$ (1)	0.981	1.020	1.0335	1.0142	0.987	0.962	0.973	0.961
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 239	$ 246	$ 240	$ 297	$ 268	$ 222	$ 266	$ 268
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 244	$ 241	$ 232	$ 293	$ 272	$ 230	$ 273	$ 279

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

Reconciliation of EBITDA to Net Loss	**2011**				**2010**			
(millions of dollars)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net loss	(7.5)	(2.2)	(3.6)	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)
Add: Interest expense	0.3	-	-	-	-	-	-	-
Depreciation and amortization	1.6	0.1	0.1	-	1.0	0.5	0.5	0.5
Deferred union payroll liability	(0.1)	1.8	1.7	1.4	0.2	0.2	-	0.2
Share based compensation	0.2	0.3	0.5	0.3	0.3	0.1	0.1	0.1
Accretion of convertible debentures	0.3	0.3	0.2	0.3	0.3	0.3	0.5	-
Revaluation of Fourth shares to fair value	-	0.3	0.3	0.3	-	-	0.5	-
EBITDA*	(5.2)	0.6	(0.8)	(1.3)	(2.2)	(1.8)	(0.8)	(0.9)

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

COMPARISON OF QUARTERS ENDED DECEMBER 31, 2011 AND QUARTERS ENDED SEPTEMBER 30, 2011 AND DECEMBER 31, 2010

Summarized operating results and statistics for each of the comparison periods are provided below.

(millions of dollars except share and per share amounts)	**Q4 - 2011**	**Q3 - 2011**	**Q4 - 2010**
Sales -Lumber	34.0	33.8	16.0
- By-products	4.7	4.4	2.2
Total Sales	38.7	38.2	18.2
Operating loss	(6.8)	(3.3)	(2.7)
Net loss	(7.5)	(2.2)	(3.9)
Net loss per share - basic and diluted	(0.49)	(0.14)	(0.26)
EBITDA	(5.2)	0.6	(2.2)
Shares outstanding - end of period (millions)	15.2	15.2	15.2
Shares outstanding - weighted average (millions)	15.2	15.2	15.2
Statistics			
Lumber shipments (MMfbm)	123.6	115.4	49.0
Lumber production (MMfbm)	94.9	101.6	49.1
Average exchange rate - US$/Cdn$ (1)	0.981	1.020	0.987
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$ 239	$ 246	$ 268
Average WSPF 2x4 #2&Btr lumber price (Cdn$)	$ 244	$ 241	$ 272
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$222 - $261	$225 - $258	$233 - $308

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

Reconciliation of EBITDA to Net Loss

(millions of dollars)	Q4 - 2011	Q3 - 2011	Q4 - 2010
Net loss	(7.5)	(2.2)	(3.9)
Add: Interest expense	0.3	0.1	0.0
Depreciation and amortization	1.6	1.8	1.0
Deferred union payroll liability	(0.1)	0.3	0.2
Share based compensation	0.2	0.3	0.3
Accretion of convertible debentures	0.3	0.3	0.3
EBITDA*	(5.2)	0.6	(2.2)

* May not total exactly due to rounding.

Operating Results by Business Segment

(millions of dollars)	Q4 - 2011	Q3 - 2011	Q4 - 2010
Net Loss			
Lumber	(5.8)	(1.4)	(2.5)
Bioenergy	(0.2)	(0.2)	(0.1)
Corporate costs and other items	(1.5)	(0.6)	(1.3)
	(7.5)	(2.2)	(3.9)
EBITDA			
Lumber	(4.1)	1.0	(1.2)
Bioenergy	(0.2)	(0.2)	(0.1)
Corporate costs and other items	(0.9)	(0.2)	(0.9)
	(5.2)	0.6	(2.2)

Profit and losses from lumber derivatives were previously included in the “corporate costs and other items” category. Current and prior periods have been restated to include profit and losses from lumber derivatives in the lumber segment. Profits from lumber future derivatives were $0.1 million in Q4 2011, $1.1 million in Q3 2011 and a loss of $0.7 million in Q4 2010.

Lumber Segment

<u>Overview</u>

During the fourth quarter of 2011, price movements in the North American lumber market continued to reflect the impact of fluctuations of both overall and product specific demand from the China market. The failure of the anticipated strong seasonal demand from China to materialize, coupled with increased production of low grade lumber by Interior BC lumber producers due to the impact of the Mountain Pine Beetle epidemic, led to an oversupply of lower grade products. This oversupply led to a quarter over quarter decline of 25% or US$52 per thousand board feet in average 2x4 #3 prices[2] while the average benchmark price declined by 3% or US$8 per thousand board feet.

The decline of 3% during the fourth quarter of 2011 in average WSPF prices over the previous quarter was largely offset by a 4% strengthening of the Canadian dollar against the U.S. dollar.

[2] Prices as published in Random Lengths Publications Inc.

The net loss in the lumber segment in the fourth quarter of 2011 was $5.8 million on sales of $38.7 million compared to a net loss of $1.4 million on sales of $38.2 million during the previous quarter. EBITDA in this segment was negative $4.1 million for the fourth quarter of 2011 compared to positive $1.0 million in the previous quarter. The variance in EBITDA between the quarters was comprised of an approximate $2.0 million decline in mill net price realizations coupled with a $2.0 million increase in conversion costs during the fourth quarter and the realization of $1.1 million profit from lumber futures derivatives in the third quarter.

The Company produced and shipped an unusually high volume of lower grade lumber during the fourth quarter of 2011 as a result of the poor quality of logs converted at the Mackenzie mill. The combination of the high proportion of the lower grade product in the Company's shipment profile and the steep decline in prices on the lower grade products during the fourth quarter adversely impacted mill net price realizations.
Productivity during the fourth quarter of 2011 was hampered by low lumber recoveries in Mackenzie as a result of the poor quality of logs, reconfiguration of the sawmill at FSJ and seasonal shut downs at both locations. The lower production output resulted in higher unit conversion costs.

WSPF prices for the fourth quarter of 2011 averaged US$239 compared to $US268 during the fourth quarter of 2010. The Canadian dollar averaged $0.99 U.S. in each of the comparative periods. The relative strength in prices last year was largely attributed to the strong seasonal demand from China concurrent with the replenishment of inventories by U.S. purchasers.

Net loss in the lumber segment in the fourth quarter of 2010 was $2.5 million and EBITDA was negative $1.2 million on sales of $18.2 million. Fourth quarter 2010 results were impacted by reduced efficiencies related to the capital improvement program at FSJ, idle costs and low operating rates during the start-up period at Mackenzie and seasonal shutdowns at both locations.

Sales

Fourth quarter of 2011 lumber shipments totalled 124 million board feet, an increase of 7% over the previous quarter. Lumber revenues were flat between the quarters as the increased volume in the fourth quarter was offset by a decline in unit sales realization.

Export sales accounted for 53% of total shipment during the fourth quarter of 2011 compared to 72% during the previous quarter. The change in shipment pattern reflects weaker demand from the Chinese market and relatively improved returns from the North American market.

During the fourth quarter of 2011, lumber shipments increased by 250% and lumber revenues increased by 212% over the fourth quarter of 2010 as a result of higher operating rates.

Production and Operations

Total production during the fourth quarter of 2011 totalled 95 million board feet, a decline of 7% over the previous quarter. The decline was attributable to a change in operating format at FSJ, the poor quality of logs at Mackenzie and seasonal shutdowns at both locations.

The sawmill at FSJ was reconfigured to operate as a two-line mill rather than a three-line mill in late December 2011. The benefits of the corresponding reduction of labour costs will not be realized until early 2012.

Throughout the fourth quarter of 2011, grade outturns, lumber recoveries and production efficiencies at Mackenzie suffered as the facility processed logs of a poorer quality than is typically specified. The fulfillment of the legacy cutting permits inherited by the previous owners of this location had a significant and prolonged adverse impact on mill nets realization, lumber recoveries and unit conversion costs during the closing months of 2011. Processing of the lower quality logs is expected to be completed in early 2012.

Total production during the fourth quarter of 2010 was 49 million board feet. Unit log costs increased by 8% during the fourth quarter of 2011 compared to the same quarter last year with 75% of the increase attributable to lower lumber recoveries and the balance to increases in delivered log costs. Unit conversion costs improved by 3.2% during the fourth quarter of 2011 compared to the fourth quarter of 2010.

Selling, general and administrative expenses related to this segment improved on a per unit basis by 21% in the fourth quarter of 2011 over the same quarter last year due to higher operating rates.

Cash Flow

During the fourth quarter of 2011, cash of $3.2 million was used in operating activities including changes in working capital. Investing activities of $5.0 million included $2.2 million spent on the Bioenergy Project at Mackenzie and $2.2 million on the acquisition of CFMI and Navcor. Financing activity consisted of net proceeds from the issue of promissory notes of $11.8 million and repayments of the CAF loan of $0.4 million. Net cash increased by $3.8 million during the quarter.

SUBSEQUENT EVENT

Close of $28.5 million private placement financing

On February 16, 2012, the Company completed its previously announced bought deal offering (the “Brokered Placement”) of 3,860,700 common shares of the Company, which includes the exercise of the underwriters’ over-allotment option, resulting in aggregate gross proceeds of $27,024,900. In connection with the Brokered Placement, the Company paid the underwriters a cash fee in the amount of 5% of the gross proceeds from the Brokered Placement.

The Company also completed its previously announced non-brokered private placement (the “Non-Brokered Placement”) of 214,286 common shares for aggregate gross proceeds of $1,500,002.

The Company intends to use net proceeds from the Brokered Placement and the Non-Brokered Placement to fund capital expenditures and for general corporate purposes.

OUTLOOK AND STRATEGY

Lumber Segment

The Company will continue to pursue its strategic and financial objectives with a particular focus on its objective of achieving operating margins comparable to top-quartile performers in the interior BC forestry and sawmilling sector. The Company believes that it can achieve superior operating margins from a combination of optimizing revenues and maintaining cost effective operations. Management expects that many of the benefits of the initiatives and developmental activities undertaken in 2011 will be more fully realized in the operating results of 2012. Key initiatives that are expected to benefit future operating results by optimizing mill nets price realization and reducing cash unit conversion costs include:

- *Internalization of its marketing, sales and logistics function.* The Company expects to increase mill nets price realization through its ability to quickly shift between key markets to secure the highest returns for its products and the development of customized sales programs with key customers through improved internal integration of marketing and production. The internalization of these functions is expected to reduce marketing and distribution costs as compared to outsourcing these functions.

- *Installation of automated grading system at Mackenzie in the second quarter of 2012*. The Company expects to meaningfully improve its mill nets price realization and further increase shipments to Japan as a result of improving grade outturns and to reduce planer operating costs.

- *Reconfiguration of the sawmill at FSJ in late December 2011.* The Company expects to reduce labour costs.

- *Addition of second shifts at FSJ and Mackenzie in April 2011*. The Company expects operating rates to increase from 49% in 2011 to approximately 65% in 2012 as the benefits of operating on a two-shift format for a full year are realized and as production consistency and productivity improves with the additional experience gained by the operations personnel.

The Company expects future operating margins to further improve with the potential for incremental sources of revenue as its forestry, marketing and logistics businesses are operated as profit centers rather than as cost centers. The Company sells logs it has harvested which are not optimally sized for its converting operations or trades such logs for those that more closely meet its specifications. CFMI intends to engage in wholesale lumber transactions and Navcor intends to continue to offer services as a third party logistics provider.

The Company believes most of the non-recurring developmental costs typically associated with the acquisition of idled assets have been undertaken in its lumber segment except for the future development of its idled Site I sawmill complex at Mackenzie.

In terms of softwood lumber markets, the Company expects lumber prices to gradually improve as the U.S. construction market continues a slow recovery and key export markets continue to exhibit steady growth.

Bioenergy Segment

Conifex intends to focus on the appropriate oversight and management of its Bioenergy Project at Mackenzie. The Company intends to secure project financing and to complete major vendor agreements upon regulatory approval of its EPA with BC Hydro. The Company also intends to pursue additional high return investment opportunities in this sector which are complementary to its existing operating facilities and assets.

CHANGES IN ACCOUNTING POLICY

New and amended standards adopted by the Company

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after January 1, 2011 that would be expected to have a material impact on the Company.

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2011 and not early adopted

IFRS 9, "Financial instruments", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and further amended in October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. IFRS 9 also provides for new measurement guidance for financial liabilities designated at fair value through profit or loss. In December 2011, the IASB deferred the mandatory effective date of IFRS 9 to annual periods beginning on or after January 1, 2015. The Company has not yet determined the impact of these standards on its financial statements.

IFRS 10, "Consolidated Financial Statements"; IFRS 11, "Joint Arrangements"; and IFRS 12, "Disclosure of Interests in Other Entities" were issued by the IASB in May 2011. These new standards provide more guidance on the identification of entities and joint arrangements that should be included in the consolidated statements of a parent company and also require additional disclosure of all forms of interests that an entity holds. The standards are effective for annual periods beginning on or after January 1, 2013 with early adoption permitted and will be effective for the year ending December 31, 2013. The Company has not yet determined the impact of these standards on its financial statements.

IFRS 13, "Fair value measurement" aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet determined the impact of IFRS 13 on its financial statements.

In June 2011, the IASB amended IAS 1, Presentation of Financial Statements, to require the grouping together of other comprehensive income items that may be reclassified to the Statement of Earnings within other comprehensive income. The amendment is effective for annual periods beginning on or after July 1, 2012 and will be effective for the year ending December 31, 2013. The Company has not yet determined the impact of this amendment on its financial statements.

RISKS AND UNCERTAINTIES

Fluctuations in Prices and Demand

Conifex's financial performance is principally dependent on the demand for and selling price of lumber, which is subject to significant fluctuations. The markets for lumber are highly volatile and are affected by factors such as North American economic conditions, including the strength of the U.S. housing market, the growing importance of the Asian market, changes in industry production capacity, changes in inventory levels and other factors beyond Conifex's control. In addition, interest rates have a significant effect on residential construction and renovation activity, which in turn influence the demand for and price of lumber.

On an annualized basis and based upon 2011 production volumes, Conifex estimates that a price increase/decrease of U.S.$10 per thousand board feet of lumber would increase/decrease operating earnings by approximately U.S.$3.6 million. Swings in price greater than U.S.$10 per thousand board feet of lumber would have a lesser impact on operating earnings due to offsetting changes in stumpage fees.

The selling price of Conifex's residual wood chips is tied by formula to the net pulp realizations obtained by its wood chip customers, in Canadian dollars. Fluctuations in pulp prices and foreign currencies will accordingly impact the selling price of Conifex's residual wood chips.

Currency Risk

Most of Conifex's lumber is sold at prices denominated in U.S. dollars or based on prevailing U.S. dollar prices, but nearly all operating costs and expenses are incurred in Canadian dollars. Therefore, an increase in the value of the Canadian dollar relative to the U.S. dollar reduces the revenue in Canadian dollar terms realized by Conifex from sales in U.S. dollars, which reduces operating margin and cash flow available to fund operations. Conifex is also exposed to the risk of exchange rate fluctuations in the period between sale and payment. This results in significant earnings sensitivity to changes in the Canadian/U.S. dollar exchange rate.

Conifex does not currently hedge its foreign exchange exposure with financial forward or open contracts. The Canadian/U.S. dollar exchange rate is affected by a broad range of factors which makes future rates difficult to predict.

Conifex estimates that an increase or decrease of 1% in the value of the Canadian dollar per US$1.00 would decrease or increase, respectively, operating earnings by approximately $0.7 million based upon the level of 2011 shipments denominated in U.S. dollars.

Softwood Lumber Agreement

Conifex cannot predict with any certainty the export tax rate applicable to future lumber shipments or the potential application and timing of the surge tax. The Softwood Lumber Agreement ("SLA") had an original term of seven years. In January 2012, representatives of the Canadian and U.S. government jointly announced a two-year extension of the SLA which is now due to expire in October 2015. Conifex cannot predict if the Softwood Lumber Agreement will be terminated before the expiration of its term, or what actions might be taken by the United States or Canada following such expiration or termination. Because of low lumber prices, the Canadian softwood industry has been paying the highest export charges mandated by the agreement since enactment, though such export charges decreased for several months in 2010.

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 delivered its response to the U.S. claim in November 2011 to which the U.S. filed a rebuttal. A hearing before the arbitration panel is expected to take place before the end of the first quarter in 2012. It is not possible at this time to predict the outcome or the value of the claim.

Potential Surge Tax

Under the Softwood Lumber Agreement, if monthly shipments from British Columbia's interior region exceed a certain prescribed volume, the applicable export rate for that month is increased by 50%. This would currently mean an increase from 15% to 22.5%. The calculation of prescribed volumes is based on estimated trailing U.S. lumber consumption.

Availability of Fiber and Changes in Stumpage Fees

Substantially all of Conifex’s log requirements are harvested from Crown lands in British Columbia. The Province prescribes the methodologies that determine the amount of stumpage fees that are charged in respect of harvesting on Crown lands and changes to the methodologies or rates may adversely affect Conifex's results.

Currently, the timberlands in which Conifex operates are owned by the Province of British Columbia and administered by the Ministry of Forests and Range. The *Forest Act* empowers the Ministry of Forests and Range to grant timber tenures to producers. The Provincial Chief Forester must conduct a review of the allowable annual cut (“AAC”) for each timber supply area on a periodic basis, which is usually once every five years. This review is then used to determine the AAC for licences issued by the Province under the *Forest Act*. Many factors affect the AAC such as timber inventory, the amount of operable forest land, growth estimates of young forests, regulation changes and environmental and social changes.

Competition

Markets for Conifex's lumber are highly competitive. Conifex's ability to maintain or improve the cost of producing and delivering products to those markets is crucial. Factors such as cost and availability of raw materials, energy and labor, the ability to maintain high operating rates and low per-unit manufacturing costs, and the quality of Conifex's final products and customer service all affect earnings. Additionally, Conifex’s products are sold in markets where Conifex competes against many producers of larger capacity. Many of Conifex’s competitors have existed for a longer period and have significantly greater financial resources.

Operational Curtailments

From time to time, Conifex may suspend operation of its sawmills or one of its logging operations in response to market conditions, environmental risks, workplace safety concerns or other operational issues, including power failure, equipment breakdown, dry forest conditions, adverse weather conditions, labor disruptions and fire hazards. These unscheduled operational suspensions could have a material adverse effect on Conifex's financial condition. Furthermore, pulp and paper mill production curtailments may require sawmills to find other ways to dispose of residual wood fiber and may result in curtailment or suspension of lumber production.

Transportation Limitations

Conifex relies primarily on third parties for the delivery of raw materials and the transportation of its products. From time to time, Conifex must also respond to rail car and truck shortages that limit raw material deliveries to it and/or product deliveries to customers, which may have a material adverse effect on Conifex's business.

Bioenergy Project

Conifex commissioned a feasibility study and conducted extensive due diligence prior to the Company's commitment to the Bioenergy Project at its Mackenzie sawmill site. Due diligence activities included extensive analysis of the Bioenergy Project plan by several independent industry experts. The Bioenergy Project is designed to employ dedicated in-house project managers, proven technology and equipment, experienced equipment manufacturers and installers, and experienced engineers and other professionals. The project plan and budget includes the commitment of considerable resources to the pre-production phase to ensure trained personnel and proven processes are in place and tested well before the commercial operation date. Despite these and other management practices, there are a variety of risks related to the Bioenergy Project. Risks include the failure to obtain the required regulatory approvals, cancellation penalty payable to a major equipment manufacturer if the project does not proceed, failure of the project to complete on time, on budget or at all, financial penalties if the project does not generate the contracted amount of energy, failure to attract required personnel and skills to operate the facilities, and failure of the equipment and technology to perform as expected. The realization of any of these risks could have a material adverse effect on Conifex's business, financial condition and operating results.

Capital Projects

Conifex undertakes ongoing maintenance activities and capital improvement projects at its manufacturing facilities. Capital projects require significant commitment of the Company's financial and other resources and the results of the project may not be immediately known or assessable. Conifex conducts extensive cost-benefit and other analysis prior to the commencement of each capital project to measure the feasibility and expected benefits of proposed projects against pre-established criteria. Each capital project is approved by the Company's Board of Directors. Conifex assigns experienced project managers to each project, employs proven technology, commits other resources as required and conducts post-project analysis to measure actual benefits to expected benefits. Conifex is subject to numerous risks related to the undertaking of capital projects, including extensive reliance on third party equipment manufacturers and installers, material cost and time overruns, equipment or technology failure, major unplanned disruptions to existing operations, and the failure of the completed project to deliver expected benefits. The realization of any of these risks could have a material adverse effect on Conifex's business, financial condition and operating results.

Labor Relations

Conifex employs a unionized work force in its sawmilling operations. While Conifex believes that its current labor relations are stable and does not anticipate any related disruptions to its operations in the foreseeable future, walkouts or strikes by employees could result in lost production and sales, higher costs and supply constraints that could have a material adverse impact on Conifex's business. Conifex also depends on a variety of third parties that employ unionized workers to provide critical services. Labor disputes experienced by these third parties could lead to disruptions at Conifex's facilities.

Natural Disasters

Conifex's operations are subject to adverse natural events such as forest fires, severe weather conditions, timber disease and insect infestation, and earthquake activity. These events could damage or destroy Conifex's physical facilities or its timber supply and similar events could also affect the facilities of its suppliers or customers. Any such damage or destruction could adversely affect Conifex's financial results. Although Conifex believes that it has reasonable insurance arrangements in place to cover certain of these incidents, there can be no assurance that these arrangements will be sufficient to fully protect Conifex against such losses. As is common in the industry, Conifex does not insure loss of standing timber for any cause.

Conifex's timber tenures are subject to the risks associated with standing forests, in particular forest fires, wind storms, insect infestations and disease. Procedures and controls are in place to manage such risk through prevention and early detection. Most of the timber that Conifex harvests comes from Crown tenures, and insurance coverage is maintained only for loss of logs due to fire and other occurrences following harvesting. However, this coverage does not extend to standing timber, and there is no assurance that this coverage would be adequate to provide protection against all eventualities, including natural catastrophes.

In addition, Conifex's operations may be adversely affected by severe weather including wind, snow and rain that may result in Conifex's operations being unable to harvest or transport logs to Conifex's sawmills. Conifex is unable to predict the impact of all these factors on its tenures or its forest practices.

While Conifex maintains insurance coverage to the extent deemed prudent, Conifex cannot predict that all potential insurable risks have been foreseen or that adequate coverage is maintained against known risks.

Mountain Pine Beetle

The long-term effect of the MPB infestation on Conifex's operations is uncertain. The potential effects include a reduction in future AAC levels to below current and pre−MPB AAC levels, a diminished grade and volume of lumber recoverable from MPB−killed logs, decreased quality of wood chips produced from such logs, and increased production costs. The timing and extent of the effect on Conifex's timber supply, lumber grade and recovery, wood chip quality and production costs will depend on a variety of factors which cannot be determined at this time with any certainty.

Environment

Conifex's operations are subject to regulation by federal and provincial environmental authorities, including industry specific environmental regulations relating to air emissions and pollutants, wastewater discharges, solid waste, landfill operations, forestry practices, site remediation and the protection of endangered species and critical habitat. No assurance can be given that changes in these laws and regulations or their application will not have a material adverse effect on Conifex's business, operations, financial condition and operational results.

Conifex may discover currently unknown environmental problems, contamination or conditions relating to its past or present operations. This may require site or other remediation costs to maintain compliance or correct violations or result in governmental or private claims for damage to person, property or the environment, which could have a material adverse effect on Conifex's business, financial condition and operational results.

Conifex has in place internal programs under which all its forestry and manufacturing operations are audited for compliance with laws and accepted standards and with its management systems. Conifex's woodlands operations and the harvesting operations of its key suppliers are third-party certified to internationally-recognized sustainable forest management standards. Conifex's operations and its ability to sell products could be adversely affected if those operations did not, or were perceived by the public as failing to, comply with applicable laws and standards, including responsible environmental and sustainable forestry standards.

Both the Fort St. James mill and the Mackenzie mills are currently in material compliance with all applicable environmental regulations.

First Nations Claims

Failure of the government of British Columbia to adequately discharge it obligations to First Nations groups may affect the validity of its actions in dealing with public rights, including the granting of Crown timber harvesting rights. Conifex cannot assure that First Nations claims will not in the future have a material adverse effect on its timber harvesting rights or its ability to exercise or renew them or secure other timber harvesting rights.

Regulatory Risks

Conifex's operations are subject to extensive general and industry-specific federal, provincial, municipal and other local laws and regulations, including those governing forestry, exports, taxes, employees, labor standards, occupational health and safety, waste disposal, environmental protection and remediation, protection of endangered and protected species and land use and expropriation. Conifex is required to obtain approvals, permits and licences for its operations, which may impose conditions that must be complied with. If Conifex is unable to extend or renew, or are delayed in extending or renewing, a material approval permit, or licence, Conifex's operations or financial condition could be adversely affected. There is no assurance that these laws, regulations or government policy, or the administrative interpretation or enforcement of existing laws and regulations, will not change in the future in a manner that may require Conifex to incur significant capital expenditures or could adversely affect its operations or financial condition. Failure to comply with applicable laws or regulations, including approvals, permits and licences, could result in fines, penalties or enforcement actions, including orders suspending or curtailing Conifex's operations or requiring corrective measures or remedial actions.

Liquidity Risk

Liquidity risk is the risk that Conifex will be unable to meet its financial obligations on a current basis. Conifex manages liquidity risk through regular cash-flow forecasting and undertaking appropriate financing activities as required. Conifex has forecasted financial results and cash flows for 2012 based upon management's best estimates of operating conditions. Based on these forecasts, the Company currently expects sufficient liquidity will be available to meet its obligations in 2012. The Company also intends to secure additional credit facilities in 2012. Although Conifex believes its actions will result in sufficient liquidity, there can be no assurance that it will be successful or that market forces or competition will not work to offset its actions.

OUTSTANDING SECURITIES

As at February 17, 2012, the Company had 19,322,041 issued and outstanding common shares, 100,000 options granted under the Company's stock option plan dated June 3, 2010, 550,017 long-term incentive plan awards issued under the Company's long-term incentive plan dated June 3, 2010, and amended June 21, 2011, 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.

ADDITIONAL INFORMATION

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