Consolidated financial statements of

Conifex Timber Inc.

December 31, 2018 and 2017

Independent auditor's report

To the Shareholders of Conifex Timber Inc.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Conifex Timber Inc. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated balance sheets as at December 31, 2018 and 2017;
- the consolidated statements of net income (loss) and comprehensive income (loss) for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

PricewaterhouseCoopers LLP
PricewaterhouseCoopers Place, 250 Howe Street, Suite 1400, Vancouver, British Columbia, Canada V6C 3S7
T: +1 604 806 7000, F: +1 604 806 7806

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is David Neale.

PricewaterhouseCoopers LLP

Chartered Professional Accountants

Vancouver, British Columbia
March 26, 2019

Conifex Timber Inc.

Consolidated balance sheets
As at December 31, 2018 and 2017

(thousands of Canadian dollars)	Notes	**As at December 31, 2018**	As at December 31, 2017
		$	$
Assets			
Current assets			
Cash		**16,338.6**	16,860.4
Cash - restricted	15	**8,613.8**	9,280.8
Trade and other receivables		**38,364.5**	38,235.4
Prepaid expenses and deposits		**26,681.4**	11,644.9
Inventories	6	**67,413.1**	61,904.9
Assets held for sale	7	**883.5**	-
Current assets		**158,294.9**	137,926.4
Property, plant and equipment	8	**382,095.8**	272,950.0
Intangible assets	9	**5,361.0**	5,232.4
Goodwill	9	**163,811.9**	3,310.5
Long-term investments and other	10	**25,917.8**	25,398.8
Deferred income tax assets	22	**3,763.7**	-
Total assets		**739,245.1**	444,818.1
Liabilities			
Current liabilities			
Trade payables, accrued liabilities and other payables		**37,743.5**	34,813.2
Current portion of reforestation obligations	11	**6,128.4**	5,286.6
Employee liabilities		**2,452.8**	1,915.1
Operating loan	14	**-**	1,600.0
Current portion of revolving credit facilities	15	**12,020.0**	-
Current portion of long-term debt	15	**34,368.7**	5,874.9
Current liabilities		**92,713.4**	49,489.8
Reforestation obligations	11	**7,164.0**	7,785.2
Environmental liabilities	12	**1,301.6**	1,339.1
Other long-term liabilities	13	**10,474.0**	11,136.5
Revolving credit facilities	15	**23,679.5**	94,180.9
Long-term debt	15	**261,931.4**	68,137.5
Deferred income tax liabilities	22	**1,879.3**	3,105.5
Non-current liabilities		**306,429.8**	185,684.7
Total liabilities		**399,143.2**	235,174.5
Equity			
Share capital	16	**289,672.1**	174,282.0
Contributed surplus		**16,854.8**	11,444.6
Retained earnings		**16,862.8**	23,917.0
Accumulated other comprehensive income		**16,712.2**	-
Total equity		**340,101.9**	209,643.6
Total liabilities and equity		**739,245.1**	444,818.1

Refer to Liquidity risk (note 2)

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated statements of net income (loss) and comprehensive income (loss)
Years ended December 31, 2018 and 2017

		Year ended December 31,	
(thousands of Canadian dollars)	Notes	**2018**	2017
		$	$
Revenue	19	**669,918.8**	469,728.6
Costs and expenses			
Cost of goods sold		**536,585.3**	351,025.2
Freight and distribution costs		**68,132.4**	57,307.9
Softwood lumber duties	29	**24,658.6**	9,898.5
Selling, general and administrative	20	**22,607.2**	20,065.8
		651,983.5	438,297.4
Operating income		**17,935.3**	31,431.2
Gain (loss) on disposal of assets		**(105.0)**	7.0
Finance costs and accretion	21	**(17,398.9)**	(7,585.9)
Loss on derivative financial instruments		**(1,077.6)**	(1,904.0)
Foreign exchange loss on long-term debt		**(8,793.5)**	-
Foreign exchange loss		**(413.6)**	(1,871.4)
Acquisition costs		**(2,189.4)**	-
		(29,978.0)	(11,354.3)
Income (loss) before taxes		**(12,042.7)**	20,076.9
Income tax expense (recovery):	22		
Current		**1.4**	-
Deferred		**(4,989.9)**	3,105.5
		(4,988.5)	3,105.5
Net income (loss) for the year		**(7,054.2)**	16,971.4
Other comprehensive income			
Foreign exchange translation of foreign operations, net of tax		**16,712.2**	-
Other comprehensive income, net of tax		**16,712.2**	-
Total comprehensive income for the year		**9,658.0**	16,971.4
Net income (loss) per share, basic and diluted (in dollars)	23	**(0.19)**	0.67

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated statements of changes in equity
Years ended December 31, 2018 and 2017

(thousands of Canadian dollars)	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income	Total equity
	$	$	$	$	$
Balance at December 31, 2016	158,601.8	11,961.1	6,945.6	-	177,508.5
Net income for the year ended December 31, 2017	-	-	16,971.4	-	16,971.4
Public offering and private placement of common shares, net of issue costs	14,201.4	-	-	-	14,201.4
Issue of common shares upon vesting of share-based payment	1,478.8	(1,437.9)	-	-	40.9
Recognition of share-based payments	-	921.4	-	-	921.4
Balance at December 31, 2017	174,282.0	11,444.6	23,917.0	-	209,643.6
Net loss for the year ended December 31, 2018	**-**	**-**	**(7,054.2)**	**-**	**(7,054.2)**
Public offering of common shares, net of issue costs	**60,627.2**	**-**	**-**	**-**	**60,627.2**
Issue of common shares on acquisition of Cross City and Glenwood Mills	**54,156.0**	**-**	**-**	**-**	**54,156.0**
Issue of warrants on acquisition of Glenwood and Cross City Mills	**-**	**4,969.3**	**-**	**-**	**4,969.3**
Issue of common shares upon vesting of share-based payment	**606.9**	**(580.0)**	**-**	**-**	**26.9**
Recognition of share-based payments	**-**	**1,020.9**	**-**	**-**	**1,020.9**
Foreign exchange translation of foreign operations, net of tax	**-**	**-**	**-**	**16,712.2**	**16,712.2**
Balance at December 31, 2018	**289,672.1**	**16,854.8**	**16,862.8**	**16,712.2**	**340,101.9**

The accompanying notes are an integral part of these consolidated financial statements.

Conifex Timber Inc.

Consolidated statements of cash flows
Years ended December 31, 2018 and 2017

	Year ended December 31,	
(thousands of Canadian dollars)	**2018**	2017
	$	$
Cash flows from operating activities		
Net income (loss)	**(7,054.2)**	16,971.4
Items not affecting cash:		
Amortization and depreciation	**26,236.7**	18,312.3
Change in mark-to-market value of lumber price derivatives	**(1,077.8)**	515.7
Change in reforestation obligations	**220.7**	961.3
Finance costs and accretion	**17,398.9**	7,585.9
Income tax expense (recovery)	**(4,988.5)**	3,105.5
Share-based compensation	**1,049.3**	962.2
Load Displacement Agreement accretion	**(627.4)**	(627.2)
Loss (gain) on disposal of assets	**105.0**	(7.0)
Foreign exchange loss on long-term debt	**8,793.5**	-
Other	**-**	577.7
	40,056.2	48,357.8
Change in:		
Trade and other receivables	**11,452.2**	(10,169.3)
Prepaid expenses and deposits	**(3,533.3)**	(2,355.7)
Inventories	**5,465.3**	(5,567.0)
Accounts payable, accrued liabilities and other payables	**(2,080.8)**	1,587.1
Environmental liabilities	**(37.5)**	(134.9)
Employee liabilities	**371.1**	33.0
Net cash provided from operating activities	**51,693.2**	31,751.0
Cash flows from investing activities		
Additions to property, plant and equipment	**(28,299.4)**	(73,112.2)
Acquisition of Cross City and Glenwood Mills (note 5)	**(221,906.5)**	-
Proceeds on disposal of assets, net	**68.1**	204.3
Net cash used in investing activities	**(250,137.8)**	(72,907.9)
Cash flows from financing activities		
Proceeds of public offering and private placement, net	**60,625.7**	14,201.4
Proceeds of term loan facilities	**286,100.5**	-
Proceeds of senior secured revolving credit facility	**43,810.7**	-
Proceeds (repayment) of capital leases	**(136.1)**	6,304.2
Repayment of mortgage	**-**	(10,440.8)
Repayment of senior secured notes	**-**	(20,300.0)
Repayment of operating loan	**(1,600.0)**	(26,598.7)
Repayment of term loans	**(71,051.4)**	(5,807.8)
Proceeds (repayment) of revolving credit facility	**(97,487.1)**	95,887.1
Financing fees	**(9,175.8)**	(1,929.0)
Interest paid	**(14,155.5)**	(6,977.9)
Net cash provided from financing activities	**196,931.0**	44,338.5
Net increase (decrease) in cash	**(1,513.6)**	3,181.6
Foreign exchange effect on cash	**324.8**	-
Cash, beginning of year	**26,141.2**	22,959.6
Cash, end of year	**24,952.4**	26,141.2

The accompanying notes are an integral part of these consolidated financial statements.

In these notes, “Conifex” or the “Company” means Conifex Timber Inc. and its subsidiaries.

1. NATURE OF OPERATIONS

The primary business of Conifex in its lumber segment includes timber harvesting, reforestation, forest management, processing logs into lumber and wood chips, and value added lumber finishing. Conifex's lumber products are sold primarily in the United States, Canadian, Japanese and Chinese markets. The primary activity in its bioenergy segment is the production of electricity for external sale under an Electricity Purchase Agreement and internal supply under a Load Displacement Agreement at the power generation plant at Mackenzie, British Columbia (“BC”), Canada.

Conifex is a publicly traded company listed on the Toronto Stock Exchange under the symbol CFF. The Company is incorporated under the Canada Business Corporations Act and is headquartered in Vancouver, BC, Canada.

The address of its registered office is 1000 Cathedral Place, 925 West Georgia Street, Vancouver, BC V6C 3L2.

2. LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due.

The Company’s liquidity risk heightened towards the end of 2018 due primarily to a steep decline in lumber prices, the impact of duty deposits on US shipments, rapidly escalating log costs at our two BC mills, and increased debt levels incurred to fund our strategic expansion in the US South. The Company has taken a number of actions to reduce cash outflows at its BC mills, increase cash inflows at its US mills, and more actively manage debt and working capital levels. The Company continues to manage controllable expenses to optimize liquidity.

In the fourth quarter of 2018, in response to market conditions characterized by lower lumber prices and elevated log costs in the northern interior of BC, the Company announced a temporary change in operating format at its Fort St. James mill which is expected to reduce investment in working capital and reduce overall costs. The Company also subsequently announced a three-week production curtailment in early 2019 at this site. The Company continues to focus on operational enhancements and cost containment as its two Arkansas mills ramp up two-shift production to targeted operating rates. The Company has worked closely with its principal lenders and renegotiated key covenants and repayment terms under its senior secured Credit Facility (note 15).

The Company has assessed and is prepared to consider implementing other options to alleviate constrained liquidity. This includes minimizing discretionary capital expenditures, further reducing working capital levels, and potentially monetizing certain assets that are not central to the Company's mid- and long-term development as a North American lumber producer. Some of these options are necessarily based on the agreement of other parties and, although believed to be reasonable, are nevertheless outside the Company’s direct control.

The Company manages liquidity risk by regularly preparing rolling cash flow forecasts of the Company’s liquidity requirements to ensure it has sufficient cash to meet operational needs and debt service commitments. Based on the current level of operations and present expectations for future periods in light of the existing economic environment, coupled with the actions already taken and the alternatives available to the Company, the Company believes that cash flow from operations and available cash, together with available borrowings under the revolving credit facility, will be adequate to meet our obligations through 2019.

3. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

3.1 Statement of compliance

The consolidated financial statements of Conifex have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were approved by the Board of Directors on March 26, 2019.

3.2 Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

3.3 Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances, income and expenses are eliminated on consolidation, where appropriate. Profits and losses resulting from inter-company transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Joint ventures are accounted for using the equity method.

3.4 Business combinations

The Company applies the acquisition method to account for business combinations. Goodwill is initially measured as the excess of the aggregate of the consideration transferred over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss. Acquisition-related costs are expensed as incurred.

3.5 Functional and presentation currency

The Canadian dollar is the functional and presentation currency of the Company.

3.6 Foreign currency translation

Foreign currency denominated monetary assets and liabilities of the Company are translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Gains or losses on translation of these items are included in earnings.

Foreign operations with a functional currency that differs from the Company's presentation currency have their assets and liabilities translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Foreign exchange differences are recognized in other comprehensive income.

3.7 Changes in significant accounting policies

The Company adopted IFRS 9, *Financial Instruments,* and IFRS 15, *Revenue from Contracts with Customers,* effective January 1, 2018. The adoption of these standards had no significant impact on the Company's consolidated financial statements and no retrospective adjustments were necessary. The Company has adopted the additional disclosure requirements under these standards.

(a) IFRS 9, Financial Instruments

IFRS 9 supersedes International Accounting Standards ("IAS") 39, *Financial Instruments: Recognition and Measurement*. The new standard includes amended guidance for the classification and measurement of financial assets. It also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management and contains a new impairment model which could result in earlier recognition of losses.

(b) IFRS 15, Revenue from Contracts with Customers

The Company adopted IFRS 15, *Revenue from Contracts with Customers,* using the full retrospective method. The new standard for revenue replaces IAS 18, *Revenue*, IAS 11, *Construction Contracts*, and the related interpretations. The standard provides a new framework to determine the timing of revenue recognition and the measurement of revenue. IFRS 15 requires that revenue be recognized at the transaction price when control of the goods or services is obtained by a customer.

In the comparative period, revenue was measured at the fair value of the consideration received or receivable, and represented amounts receivable for goods supplied, stated net of returns and value added taxes. The Company recognized revenue when the amount could be reliably measured, the significant risks and rewards of ownership were passed to the customer, and collectability was reasonably assured.

3.8 Cash

In the consolidated statement of cash flows, cash includes cash on hand, deposits held with banks, and other short-term highly liquid investments.

3.9 Financial instruments

(a) Non-derivative financial instruments

The Company measures non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market at amortized cost using the effective interest rate method. The amortized costs are reduced by any impairment losses. These financial assets are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets.

Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial. Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated future cash flows of the asset have been impacted.

(b) Derivative financial instruments

The Company utilizes derivative financial instruments to manage its commodity lumber price exposures in the ordinary course of business and interest rate variability. Lumber derivatives are classified as financial assets at fair value through profit and loss ("FVTPL"). These financial assets are initially recognized at fair value on the date a lumber derivative contract is entered into and are subsequently re-measured at their fair value. The fair values are determined by using observable market inputs for identical assets and liabilities and thus reflect the estimated amount that the Company would have paid or received if required to settle all outstanding contracts at period end. The resulting gain or loss is recognized as a gain (loss) on lumber derivative instruments in the statement of net income each period unless the lumber derivative is designated as a hedging instrument under

IFRS. If the lumber derivative is designated as a hedging instrument, any unrealized gains or losses are deferred and recognized in earnings when the related hedge transaction occurs.

(c) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares or options are shown in equity as a deduction from the proceeds.

3.10 Inventories

Logs and lumber inventories are valued at the lower of average cost and net realizable value. The cost of logs and lumber comprises all costs that relate to purchasing, harvesting and delivery of the logs to their present location, plus costs of production, including labour, overhead and amortization. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost for completion and applicable variable selling expenses.

Operating and maintenance supplies are valued at the lower of average cost and replacement cost.

3.11 Goodwill and intangible assets

(a) Goodwill

Goodwill arises on the acquisition of subsidiaries and associates and represents the excess of the consideration transferred over the fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. Goodwill impairment is assessed by comparing the fair value of the cash generating unit ("CGU") to the underlying carrying amount of the CGU's net assets, including goodwill. CGUs are the lowest levels of business units for which there are separately identifiable cash flows. When the carrying amount of the CGU exceeds its recoverable amount, the recoverable amount of the CGU's goodwill is compared with its carrying amount to measure the amount of impairment loss, if any. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

(b) Other intangible assets

Other intangible assets, comprising forestry licences and software licences, are stated at cost less accumulated amortization.

The forestry licences are amortized on a straight-line basis over 60 years. Software licences are amortized on a straight-line basis over their useful lives.

3.12 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditures that are directly attributable to the acquisition of the assets.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land and assets classified as held for sale are not depreciated. All other assets are depreciated on a straight-line basis over their estimated useful lives. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Estimated useful lives of property, plant and equipment are reflected with the following rates:

Buildings and fixtures	2% - 5%
Machinery and equipment	5% - 50%
Mobile equipment	20% - 50%
Computer hardware	10% - 50%

The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over their useful lives. These periods are assessed at least annually to ensure that they continue to approximate the useful lives of the related assets. The carrying amount of an asset is written down if it is determined to be greater than the asset's estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the income statement.

3.13 Government grants

Government grants are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to property, plant and equipment are recorded as a reduction to the cost base of the related asset and are credited to the income statement through the recognition of a lower depreciation expense than would be recognized in the absence of the grant.

Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.

3.14 Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized in net income at the amount the asset's carrying amount exceeds its recoverable amount. For the purposes of assessing impairment, assets are grouped into CGUs. Non-financial assets other than goodwill that have suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

3.15 Employee benefits

The Company has a defined contribution plan, which is a post-employment benefit plan under which the Company makes contributions to a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense when they are earned.

3.16 Provisions

Provisions for reforestation, environmental restoration, restructuring costs and legal claims are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is charged to the income statement in the same expense category as the original expense related to the obligation.

3.17 Share-based compensation

The Company operates a long-term performance incentive plan and a stock option plan which provide for options, restricted share units, performance share units and deferred share units to be awarded as consideration for services from directors, employees and consultants. The fair value of the equity instrument and the employee services received in exchange for the grant of the options or share awards is measured at the grant date.

The share awards and stock options vest over multiple periods. The fair value of each tranche is considered to be a separate grant based on its vesting period. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period based on the Company's estimate of equity instruments that will eventually vest.

3.18 Revenue recognition

Revenue from the sale of goods is measured based on the transaction price, net of rebates and discounts, as specified in contracts with customers. The Company recognizes revenue when transfer of control occurs.

Amounts charged to customers for freight and distribution are recognized as revenue as the services are provided. Freight and distribution costs and softwood lumber duties incurred by the Company are recorded to cost of sales in the income statement.

(a) Lumber segment

The Company markets and sells a range of lumber grades by various dimensions and by-products.

For lumber sales, revenue is recognized when control is transferred to the customer. The timing of the transfer of control varies depending on the individual terms of the contract of sale. The transfer of control typically occurs at the time lumber is loaded onto the mode of transportation. The amount of revenue recognized is adjusted for discounts related to early payment and rebates related to purchase volumes at the time that control is transferred.

For lumber by-products sales, revenue is recognized when control over by-products is transferred to the customer. The timing of the transfer of control varies depending on the individual terms of the contract of sale. The transfer of control typically occurs at the time the by-products leave the Company's sawmill. The amount of revenue is recognized at that point in time. The Company does not offer discounts or rebates on by-products sales.

For transportation services, revenue is recognized as the service is provided to the customer. The Company does not offer discounts or rebates on transportation services.

(b) Bioenergy segment

Revenue is recognized when control over electrical energy is transferred to the customer. The timing of the transfer of control and recognition of revenue occurs at the time electrical energy is generated as agreed to within the Electricity Purchase Agreement and Load Displacement Agreement. The Company does not offer discounts or rebates on electrical energy sales.

3.19 Borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

3.20 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

3.21 Income taxes

The income tax expense for the period comprises current and deferred tax.

Current income tax is the expected tax payable on the taxable income for the period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

3.22 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the executive management team that makes strategic decisions.

3.23 Critical judgements and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make critical judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could materially differ from those estimates. Such differences in estimates are recognized when realized on a prospective basis.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and judgements have been applied in a manner consistent with prior periods. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include valuation of inventory, income taxes, provision for accrued liabilities, environmental and reforestation obligations, share-based compensation, impairment and contingencies.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

3.24 Accounting standards issued and not yet adopted

In January 2016, the IASB issued IFRS 16, *Leases*, which replaces the existing lease accounting guidance. IFRS 16 requires all leases to be reported on the balance sheet unless certain criteria for exclusion are met. IFRS 16 is effective for the year beginning on or after January 1, 2019 with early adoption permitted if IFRS 15 is also adopted at the same time.

The Company will be applying the modified retrospective approach upon adoption of IFRS 16 on January 1, 2019. Under this approach, the right-of-use asset will be initially measured at an amount equal to the lease liability discounted at the Company's incremental borrowing rate. The Company continues to assess the quantitative impact of adoption of this new standard on the Company's consolidated financial statements. Based on the lease information available to date, the adoption of IFRS 16 will not have a significant impact on the Company's consolidated financial statements. The Company will recognize approximately $8.5 million in right-of-use assets under property, plant and equipment on the consolidated balance sheet and approximately $8.5 million of long-term liabilities in connection with the leases for office spaces and equipment, with minimal impact on the Company's consolidated statement of net income.

3.25 Reclassification of comparative amounts

Certain comparative amounts for the prior year have been reclassified to conform to the current year's presentation.

4. SEASONALITY OF OPERATIONS

The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories at its BC mills during the fall and winter months to ensure adequate supply of fibre to its mills during the spring months when logging operations are largely curtailed due to road conditions.

The operating results of the bioenergy segment will experience variability as a result of the application of a "time of delivery factor" to electricity pricing which adds a seasonal effect to quarterly revenues. The lowest revenues are expected to be generated in the spring months and the highest in the fall and winter months of each year.

5. ACQUISITION OF CROSS CITY AND GLENWOOD MILLS

On July 9, 2018, the Company completed the acquisition of all the outstanding membership interests of Suwannee Lumber Holding Company LLC, Suwannee Timber Management LLC and Caddo River Forest Products LLC (collectively, the "BW Group") pursuant to a Securities Purchase Agreement (the "SPA") with BW SLC Holdings LLC and the minority shareholders of Caddo River Forest Products LLC (together, the "Vendors"). The total purchase price under the transaction was (i) cash consideration of US$153.2 million plus US$17.1 million, representing the net working capital of the BW Group at closing, (ii) $54.2 million through the issuance of 9,273,291 common shares of the Company (the "Shares") to the Vendors at fair market value on closing date of $5.84 per Share, and (iii) 3.5 million warrants to purchase Shares for a period of five years (subject to extension in certain circumstances for a one-year period) at an exercise price of $8.78 per Share.

The cash portion of the purchase price was paid by the Company using the net proceeds of $60.6 million from the offering of subscription receipts (the "Subscription Receipts") and borrowings under the Company's new Credit Facility (note 15(d)). A total of 10,806,332 Shares were issued to the holders of the Subscription Receipts.

The BW Group operations include a sawmill in Cross City, Florida (the "Cross City Mill") and a sawmill in Glenwood, Arkansas (the "Glenwood Mill"), which both primarily produce Southern Yellow Pine softwood lumber and specialty products. The Cross City Mill and Glenwood Mill each have an annual dimension lumber capacity of 185 million board feet on a two-shift basis. Both the Cross City Mill and Glenwood River Mill completed significant modernization capital projects in recent years.

The acquisition has been accounted for as a business combination using the acquisition method, with the Company being the acquirer and BW Group being the acquiree, and where the assets and liabilities assumed are recorded at their fair values at the acquisition date. Balances that required significant fair value adjustments for the purchase price accounting included inventory, property, plant and equipment and goodwill. The Company has allocated the purchase price based on preliminary estimated fair value of the assets acquired and the liabilities assumed as follows:

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

	Preliminary Allocation (US dollars)	**Preliminary Allocation**
	$	**$**
Net assets acquired	215,380.3	**282,083.6**
Less: cash acquired	(803.1)	**(1,051.8)**
Net non-cash assets acquired	214,577.2	**281,031.8**
Allocation of net non-cash assets:		
Current assets	25,103.8	**32,878.5**
Current liabilities	(6,490.1)	**(8,500.1)**
Property, plant and equipment	77,700.2	**101,764.0**
Other assets	826.0	**1,081.9**
Capital lease obligations	(249.6)	**(327.0)**
Goodwill	117,686.9	**154,134.5**
	214,577.2	**281,031.8**

Factors contributing to goodwill include the workforce at each of the Glenwood and Cross City Mills, assets that are geographically complementary to the Company's existing facility and offer close access to large markets, the favourable timber basket and multiple outlets for residuals. This transaction strengthens the Company's core lumber business in the US and provides increased scale and geographical diversification.

The following table summarizes the results of the Cross City and Glenwood Mills operations and the estimated pro-forma consolidated results for the year ended December 31, 2018 as if the acquisition occurred on January 1, 2018:

	Cross City and Glenwood Mills	Pro forma consolidated
	$	$
Revenue	197,372.2	791,856.1
Net income (loss) for the year	5,317.9	(5,829.0)

Transaction costs related to the acquisition of $2.19 million have been expensed in the statement of net income and comprehensive income during the year.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

6. INVENTORIES

	2018	2017
	$	$
Logs	**16,324.7**	22,196.2
Lumber	**39,342.2**	32,795.3
Supplies	**11,411.9**	6,492.1
By-products	**334.3**	421.3
	67,413.1	61,904.9

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has been written down at December 31, 2018 by $4.0 million (2017 – $0.8 million). Write-downs are included in cost of goods sold when incurred.

7. ASSETS HELD FOR SALE

The Company has identified for disposal and classified as "assets held for sale" certain assets acquired with the purchase of the Cross City Mill. Transactions within this asset category were as follows:

	2018	2017
	$	$
Balance at beginning of year	**-**	-
Acquisition of assets held for sale	**883.5**	-
	883.5	-

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

8. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings / equipment	Capital work in progress	Bioenergy assets	Bioenergy capital work in progress	Total
	$	$	$	$	$	$
Cost						
At December 31, 2016	5,464.0	133,400.3	15,030.1	127,926.2	-	**281,820.6**
Net additions	-	11,696.2	65,537.0	725.9	-	**77,959.1**
Disposals	-	(222.2)	-	-	-	**(222.2)**
At December 31, 2017	5,464.0	144,874.3	80,567.1	128,652.1	-	**359,557.5**
Net additions	-	99,465.5	(78,534.8)	1,950.9	402.1	**23,283.7**
Acquisition of Cross City and Glenwood Mills (note 5)	1,674.4	100,089.6	1,081.9	-	-	**102,845.9**
Disposals	-	(315.6)	-	-	-	**(315.6)**
Effect of foreign exchange revaluation	156.5	10,182.3	(750.1)	-	-	**9,588.7**
At December 31, 2018	**7,294.9**	**354,296.1**	**2,364.1**	**130,603.0**	**402.1**	**494,960.2**
Accumulated depreciation						
At December 31, 2016	-	(58,650.3)	-	(9,831.3)	-	**(68,481.6)**
Depreciation charge for the year	-	(13,255.5)	-	(4,896.1)	-	**(18,151.6)**
Disposals	-	25.7	-	-	-	**25.7**
At December 31, 2017	-	(71,880.1)	-	(14,727.4)	-	**(86,607.5)**
Depreciation charge for the year	-	(20,972.5)	-	(4,971.7)	-	**(25,944.2)**
Disposals	-	140.5	-	-	-	**140.5**
Effect of foreign exchange revaluation	-	(453.2)	-	-	-	**(453.2)**
At December 31, 2018	-	(93,165.3)	-	(19,699.1)	-	**(112,864.4)**
Carrying amount						
At December 31, 2017	5,464.0	72,994.2	80,567.1	113,924.7	-	**272,950.0**
At December 31, 2018	**7,294.9**	**261,130.8**	**2,364.1**	**110,903.9**	**402.1**	**382,095.8**

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

9. GOODWILL AND INTANGIBLE ASSETS

(a) Goodwill

	2018	2017
	$	$
Cost and carrying amount at beginning of year	**3,310.5**	3,310.5
Acquisition of Cross City and Glenwood Mills (note 5)	**154,134.5**	-
Effect of foreign exchange revaluation	**6,366.9**	-
	163,811.9	3,310.5

The Company has allocated $3.3 million of goodwill to a CGU made up of the Canadian operations and $160.5 million of goodwill to a CGU made up of the US operations based on purchase price allocations when the related assets were acquired. The recoverable amount of goodwill for each CGU is determined based on an assessment of the value in use estimates using a discounted cash flow model. The cash flow model projections are based on the Company's operating plan for 2019, a forecast for 2020 and 2021, and an estimate of trend cash flows for subsequent years.

Cash flows have been discounted using a pre-tax discount rate of 11% based on the Company's weighted average cost of capital and risks specific to each CGU. Key assumptions used in the discounted cash flow models include forecast prices and foreign exchange rates, which the Company's management determined with reference to external publications.

The recoverable amount of goodwill for each CGU has been determined to be higher than the carrying value of the Company's investment in these assets, including goodwill, at year end. Based upon management's analysis, no impairment of goodwill has been recognized.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

(b) Intangible assets

	Forestry licences	Software licences	Total
	$	$	**$**
Cost			
At December 31, 2016	5,983.5	466.4	**6,449.9**
Net additions	-	273.3	**273.3**
At December 31, 2017	5,983.5	739.7	**6,723.2**
Net additions	-	418.5	**418.5**
Effect of foreign exchange revaluation	-	3.0	**3.0**
At December 31, 2018	**5,983.5**	**1,161.2**	**7,144.7**
Accumulated amortization			
At December 31, 2016	(901.5)	(428.6)	**(1,330.1)**
Amortization charge for the year	(104.4)	(56.3)	**(160.7)**
At December 31, 2017	(1,005.9)	(484.9)	**(1,490.8)**
Amortization charge for the year	(99.7)	(192.8)	**(292.5)**
Effect of foreign exchange revaluation	-	(0.4)	**(0.4)**
At December 31, 2018	**(1,105.6)**	**(678.1)**	**(1,783.7)**
Carrying amount			
At December 31, 2017	4,977.6	254.8	5,232.4
At December 31, 2018	**4,877.9**	**483.1**	**5,361.0**

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

10. LONG-TERM INVESTMENTS AND OTHER

	2018	2017
	$	$
Joint venture investment	**20,000.0**	20,000.0
Deposits and long-term receivables (note 29)	**3,684.8**	3,165.8
Timber inventory development	**2,233.0**	2,233.0
	25,917.8	25,398.8

The Company's 50% ownership interest in a company which holds a forestry licence with an annual timber harvest of 300,000 m^3 is classified as a joint venture. At December 31, 2018, the carrying value of the equity investment is $20.0 million (2017 - $20.0 million).

11. REFORESTATION OBLIGATIONS

	2018	2017
	$	$
Reforestation obligations		
Current	**6,128.4**	5,286.6
Non-current	**7,164.0**	7,785.2
	13,292.4	13,071.8

	2018	2017
	$	$
Balance at beginning of year	**13,071.8**	12,110.5
Additional provisions recognized	**5,811.1**	6,650.1
Reductions arising from payment	**(5,309.5)**	(5,591.5)
Change arising from re-measurement or settlement without cost	**(281.0)**	(97.3)
	13,292.4	13,071.8

The total undiscounted amount of the future estimated expenditures required to settle the reforestation obligation at December 31, 2018 is $14.7 million (2017 – $14.4 million). The reforestation expenditures are expected to occur over the next one to 20 years and have been discounted at a risk-free interest rate of 3% (2017 – 3%). Reforestation expenses resulting from obligations arising from current year activities, changes in estimated future expenses and accretion of the discount are included in cost of sales for the year.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

12. ENVIRONMENTAL LIABILITIES

	2018	2017
	$	$
Balance at beginning of year	**1,339.1**	1,474.0
Reductions arising from payment	**(94.8)**	(96.2)
Change arising from re-measurement or settlement without cost	**57.3**	(38.7)
	1,301.6	1,339.1

13. OTHER LONG-TERM LIABILITIES

	2018	2017
	$	$
Other liabilities	**195.7**	230.8
Deferred revenue	**10,278.3**	10,905.7
	10,474.0	11,136.5

Deferred revenue of $10.3 million (2017 – $10.9 million) comprises the incentive funds drawn under the Load Displacement Agreement (“LDA”) with BC Hydro and is secured by letters of credit totaling $7.2 million (2017 – $12.7 million). The incentive funding is recognized in earnings over the term of the LDA. The incentive funding began on April 30, 2015 and has a term of 20 years. The Company recognized $0.6 million (2017 – $0.6 million) of the incentive funding as revenue during the year.

14. OPERATING LOAN

Conifex Power Limited Partnership (“CP Partnership”), a wholly-owned subsidiary of the Company, had a $1.8 million revolving operating facility in connection with the project financing secured in November 2013 (note 15(b)).

During the year, the outstanding revolving operating facility balance was fully repaid and the revolving operating facility was extinguished (note 15(c)).

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

15. BORROWINGS

	2018	2017
	$	$
Non-current		
Capital leases (a)	**5,641.5**	5,635.2
Term loan (b)	**-**	62,502.3
CP Partnership term loan (c)	**63,357.1**	-
Senior secured term loan (d)	**192,932.8**	-
	261,931.4	68,137.5
Revolving credit facilities (d), (e)	**23,679.5**	94,180.9
Total non-currrent borrowings	**285,610.9**	162,318.4
Current		
Current portion of capital leases (a)	**2,183.1**	1,571.9
Current portion term loan (b)	**-**	4,303.0
Current portion of CP Partnership term loan (c)	**2,904.2**	-
Current portion of senior secured term loan (d)	**29,281.4**	-
	34,368.7	5,874.9
Current portion of revolving credit facilities (d)	**12,020.0**	-
Total current borrowings	**46,388.7**	5,874.9
Total borrowings	**331,999.6**	168,193.3

The aggregate amount of contractual cash outflows for borrowings, which reflects payments in full before accretion, is as follows:

	Amount
	$
2019	**46,388.7**
2020	**61,695.2**
2021	**172,122.5**
2022	**4,792.9**
2023	**3,700.0**
Thereafter	**51,983.9**
	340,683.2

(a) Capital leases

Capital leases are for mobile and other equipment. The capital leases expire between 2020 and 2022. The principal balance outstanding at December 31, 2018 is $7.8 million (2017 – $7.2 million).

(b) Term loan

CP Partnership secured project financing (the "Project Financing") with a syndicate of institutional lenders led by a Canadian chartered bank in November 2013. The Project Financing was for an aggregate of up to $102.7 million and included a development and construction loan facility of up to $82.0 million (the "Construction Facility"). On July 30, 2015, CP Partnership converted the Construction Facility into an amortized term loan (the "Term Loan") that was to mature on December 1, 2019. The balance of the Project Financing was in the form of an $19.0 million letter of credit facility and a $1.8 million revolving operating facility. The letter of credit facility was utilized primarily to secure certain obligations of CP Partnership under its LDA and a debt service reserve fund.

The Project Financing comprised floating rate and fixed rate tranches. Interest rates on the floating rate tranche borrowings were based on either banker's acceptances or the Canadian chartered bank prime rate, at CP Partnership's option, plus an applicable margin. The fixed rate tranche bore an interest rate largely consistent with the floating rate tranche. The Company had entered into an interest rate swap on the floating rate tranche.

CP Partnership entered into a new term loan (note 15(c)) on October 30, 2018. The new term loan was used to fully repay the balance owing on the Term Loan.

(c) CP Partnership term loan

On October 30, 2018, CP Partnership completed a $70.0 million secured term loan (the "CP Partnership Term Loan") with a syndicate of private lenders to refinance the existing revolving operating facility and Term Loan (notes 14 and 15(b)). The CP Partnership Term Loan is for a term of 15 years, repayable quarterly commencing December 2018 and bears interest at a fixed rate of 6.1% per annum.

The CP Partnership Term Loan is primarily secured by a first priority security interest on existing and after acquired assets of the bioenergy segment. The CP Partnership Term Loan is non-recourse to the Company's other operations.

As at December 31, 2018, CP Partnership held $8.6 million of cash in restricted accounts (2017 – $9.3 million). Funds from restricted accounts are distributed in accordance with the terms of the CP Partnership Term Loan.

Deferred financing costs of $2.2 million were netted against the CP Partnership Term Loan as at December 31, 2018 (2017 – nil).

(d) Senior secured credit facility

On July 9, 2018, the Company entered into a syndicated five-year US$225.0 million senior secured credit facility led by a leading US commercial bank, along with a syndicate of other lenders (the "Credit Facility"). The Credit Facility consists of a US$165.0 million term loan facility and a US$60.0 million revolving credit facility. The Credit Facility is secured by substantially all of the Company's lumber segment assets. In addition to financing a part of the acquisition of the Cross City and Glenwood Mills, a portion of the Credit Facility was utilized to repay and retire the Revolving Facility (note 15 (e)).

Interest is payable on the Credit Facility at floating rates based on the lenders' Canadian prime rate, CDOR, US dollar base rate or US dollar LIBOR rate, plus a margin that varies with the Company's maximum total leverage ratio.

The borrowings of the Company under the Credit Facility are subject to customary covenants, including a fixed charge coverage ratio and a maximum total leverage ratio. The financial covenants are measured quarterly based on the performance and financial position of the loan parties, which excludes certain of the Company's subsidiaries.

The term loan is subject to quarterly scheduled repayments and amortized at 5% of the principal amount over the first two years, 7.5% in year three, and 10% in years four and five. Additional annual principal repayments commence in the second quarter of 2020 and are based on 50% of excess cash flow from the prior fiscal year.

Availability under the revolving credit facility is determined by a borrowing base calculation tied to eligible receivables and inventory, net of specific reserves. Borrowings can be drawn in Canadian or US dollars. As at December 31, 2018, the Company has drawn $42.2 million under the revolving credit facility (2017 – nil). Deferred financing costs of $6.5 million were netted against the revolving credit facility (2017 – nil).

Certain covenants and repayment terms under the Credit Facility were amended subsequent to completion of the credit agreement. Terms of the amendments included the elimination of measurement of the financial covenants for the quarters ended December 31, 2018 through December 31, 2019, with measurement to resume March 31, 2020; an increase ranging from 1% to 2.25% in the applicable margin depending on the maximum total leverage ratio; revisions to availability under the revolving facility and a periodic reduction of the revolving credit facility. The reduction in the revolving credit facility is not expected to materially impact forecast borrowing base availability.

The amendments provide for accelerated repayment of the term loan from additional scheduled repayments and an increase in the annual non-scheduled principal repayments from 50% to 80% of excess cash flow. The commitments schedule (note 15) incorporates the required scheduled repayments. In addition, the term of the Credit Facility was revised to mature on June 30, 2021. The Company believes that cash flow from operations and available cash, together with available borrowings under the revolving credit facility and successful completion of other initiatives underway to enhance liquidity, will be adequate to meet our obligations through 2019. The Company was in compliance with its covenants under the Credit Facility at December 31, 2018.

(e) Revolving credit facility

In January 2017, the Company entered into a five-year $130.0 million secured revolving asset based credit facility (the “Revolving Facility”) with a syndicate of institutional lenders. Under the terms of the Revolving Facility, amounts drawn and to be repaid were determined by a borrowing base calculation that fluctuated with eligible accounts receivable and inventory balances, plus appraised values of certain forestry licences, net of specific reserves. Borrowings could be in Canadian or US dollars. Interest rates on borrowings against the Revolving Facility were based on either CDOR or LIBOR plus an applicable margin.

In July 2018, the Company repaid in full and extinguished the Revolving Facility (balance at December 31, 2017 – $94.2 million, net of financing costs). The remaining deferred financing costs associated with the Revolving Facility of $1.5 million has been written off to interest expense and accretion in the year.

16. SHARE CAPITAL

Authorized

Unlimited number of common voting shares without par value.

Common share activity of the Company is as follows:

	Number of common shares (in thousands)	Amount
		$
Balance at December 31, 2016	21,203	158,601.8
Public offering and private placement of common shares, net of issue costs	5,050	14,201.4
Shares vested under share-based compensation plan (note 17)	185	1,478.8
Balance at December 31, 2017	26,438	174,282.0
Public offering of common shares, net of issue costs	**10,806**	**60,627.2**
Issue of common shares on acquisition of Cross City and Glenwood Mills (note 5)	**9,273**	**54,156.0**
Shares vested under share-based compensation plan (note 17)	**93**	**606.9**
Balance at December 31, 2018	**46,610**	**289,672.1**

17. SHARE-BASED COMPENSATION

17.1 Stock option plan

The Company has a stock option plan primarily applicable to directors and officers. The total outstanding stock options are limited to 10% of the outstanding common shares of the Company at any one time. Under the plan, each option granted shall be for a term not exceeding 10 years from the grant date and the vesting period is determined based on the discretion of the Board of Directors. The option exercise price is set at the date of the grant and cannot be less than the closing trading price of the Company's common shares on the day immediately preceding the day of the grant of the option.

There are 100,000 options outstanding at December 31, 2018 (2017 – 100,000 options) with an exercise price of $8.25 per share. The options were granted on August 20, 2010 with an expiry date of August 20, 2020 and have fully vested. The options are exercisable only to the extent that they have vested.

The fair value of the options granted was estimated at the time of the grant using the Black-Scholes option pricing model. Based on a share price of $6.50 on the day of the grant, expected life of 10 years, risk-free interest rate of 3.05% and annualized volatility of 33%, the fair value of the options granted on August 20, 2010 was estimated at $265,000 or $2.65 per option. No expense related to the stock option plan was recognized in the years ended December 31, 2018 and 2017.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

17.2 Long-term performance incentive plan

The Company operates a long-term performance incentive plan which provides for long-term incentive plan units, restricted share units, performance share units and deferred share units to be awarded to directors, executives and salaried employees. The Company measures the fair value of the services received as consideration for equity instruments indirectly by reference to the fair value of the equity instruments granted. The fair value is measured on the basis of an observable market price subject to a minimum price.

(a) Long-term incentive plan units and restricted share units

The following table illustrates the number and weighted average fair value ("WAFV") of, and movements in, long-term incentive plan awards and restricted share units granted during the year:

	2018 Number	**2018 WAFV**	2017 Number	2017 WAFV
		$		$
Outstanding at January 1	**942,257**	**3.60**	666,962	5.33
Granted during the year	**290,000**	**5.10**	540,000	3.14
Forfeited during the year	**-**	**-**	(80,000)	4.75
Vested during the year	**(92,699)**	**6.56**	(184,705)	8.01
Outstanding at December 31	**1,139,558**	**3.74**	942,257	3.60

The awards typically vest in three years. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period.

Expense related to the grant of long-term incentive plan awards and restricted share units of $1.0 million was recognized in the year ended December 31, 2018 (2017 – $1.0 million). The compensation expense is allocated between cost of goods sold and selling, general and administrative expense.

(b) Performance share units

Performance share units ("PSUs") generally vest on the third anniversary of the issuance date with the number of vesting shares determined by the 10-day volume-weighted average share price at vesting relative to the share price at issuance. Payments for vested units can be made in cash at the discretion of the Company's Board of Directors. The Company records an expense based on the 10-day volume-weighted average share price at each balance sheet date. No expense was recognized and no cash payments were made in regards to vested PSUs in the years ended December 31, 2018 and 2017.

(c) Deferred share units

Deferred share units ("DSUs") are awarded to directors who elect to have all or a portion of their directors' fees compensated by DSU awards rather than cash. The election can be made annually. The DSUs may only be redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. The number of DSUs awarded is determined by the 10-day volume-weighted average share price at the time of the award. The Company records an expense based on the 10-day volume-weighted average share price at each balance sheet date. There was no expense recognized for the grant of DSUs in the years ended December 31, 2018 and 2017.

18. WARRANTS

	Number of warrants (in thousands)	Amount
		$
Balance at December 31, 2016	1,060	3,611.5
Warrants expired and cancelled during 2017	(1,060)	(3,611.5)
Balance at December 31, 2017	-	-
Warrants issued on acquisition of Cross City and Glenwood Mills (note 5)	**3,500**	**4,969.3**
Balance at December 31, 2018	**3,500**	**4,969.3**

In connection with the acquisition of the Cross City and Glenwood Mills (note 5), the Company issued share purchase warrants to purchase up to an aggregate of 3,500,000 common shares of the unissued capital stock of the Company at a price of $8.78 per share until July 9, 2023. The fair market value of the warrants was recorded to contributed surplus.

19. REVENUE

	2018	2017
	$	$
Lumber	**575,616.2**	400,233.9
Lumber by-products	**48,092.6**	26,117.0
Bioenergy	**26,770.3**	25,858.0
Transportation services	**19,439.7**	17,519.7
	669,918.8	469,728.6

20. SELLING, GENERAL AND ADMINISTRATIVE

	2018	2017
	$	$
Selling and logistics services	**10,483.5**	9,361.9
Salaries and benefits	**6,394.0**	4,605.0
Other administrative expenses	**2,914.3**	2,855.2
Legal, professional and organizational	**2,530.4**	2,949.6
Depreciation and amortization	**285.0**	294.1
	22,607.2	20,065.8

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

21. FINANCE COSTS AND ACCRETION

	2018	2017
	$	$
Interest expense	14,984.0	6,360.3
Financing expense	2,414.9	565.8
Accretion	-	659.8
	17,398.9	7,585.9

During the year, interest of nil (2017 – $2.8 million) had been capitalized to the El Dorado Mill.

22. INCOME TAX

22.1 Current income taxes

The components of income tax expense (recovery) for operations are as follows:

	2018	2017
	$	$
Current	1.4	-
Deferred	(4,989.9)	3,105.5
	(4,988.5)	3,105.5

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

	2018	2017
	$	$
Income (loss) before taxes	(12,042.7)	20,076.9
Income tax expense (recovery) at corporation rate of 27.3% (2017 - 26.0%)	(3,287.6)	5,220.0
Non-deductible (non-taxable) items for tax purposes	(1,239.3)	373.8
Rate differentials between jurisdictions	73.2	-
Effect on deferred balances due to changes in income tax rates	-	(33.1)
Change in deferred tax assets not recognized	(52.9)	(2,491.8)
Other	(481.9)	36.6
Total income tax expense (recovery)	(4,988.5)	3,105.5

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

22.2 Deferred income taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities on the consolidated balance sheet and the amounts used for income tax purposes.

The source of deferred income taxes is as follows:

	2018	2017
	$	$
Property, plant, equipment and intangibles	**(13,038.8)**	(9,903.4)
Loss carryforwards	**8,566.2**	2,069.5
Reforestation and environmental obligations	**3,771.8**	3,864.3
Other	**2,371.1**	864.1
Goodwill	**214.1**	-
	1,884.4	(3,105.5)
Represented by:		
Deferred income tax assets	**3,763.7**	-
Deferred income tax liabilities	**(1,879.3)**	(3,105.5)
	1,884.4	(3,105.5)

22.3 Non-capital loss carryforwards

As at December 31, 2018, the Company has non-capital losses from the following years:

Year of Loss	Non-capital loss amount
	$
2010	**65.8**
2011	**982.4**
2012	**-**
2013	**267.5**
2014	**644.2**
2015	**1,493.6**
2016	**1,275.4**
2017	**7,941.5**
2018	**18,742.0**
	31,412.4

The non-capital losses can be carried forward for 20 years from the year the loss was incurred.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

23. NET INCOME (LOSS) PER SHARE

	Year ended December 31, 2018			Year ended December 31, 2017		
	Net loss	Weighted average number of shares	Per share	Net income	Weighted average number of shares	Per share
	$		$	$		$
Basic and diluted income (loss) per share	(7,054.1)	36,284	(0.19)	16,971.4	25,446	0.67

24. RELATED PARTY TRANSACTIONS

Key management personnel

Compensation of key management (directors and officers) consists of amounts paid and accrued as at the year end.

	2018	2017
	$	$
Short-term benefits	2,610.3	2,800.6
Share-based payments	876.4	591.7
	3,486.7	3,392.3

25. SEGMENT AND GEOGRAPHICAL INFORMATION

The Company is organized into business units based on its products and services and has two reportable segments as follows:

- Lumber - The main activities of the lumber segment include timber harvesting, reforestation, forest management, processing logs into lumber and wood chips, and value added lumber finishing. The Company markets and distributes its lumber products through its wholly-owned subsidiaries, Conifex Fibre Marketing Inc. (“CFMI”), Lignum Forest Products LLP (“Lignum”), and Navcor Transportation Services Inc. (“Navcor”). CFMI, Lignum, and Navcor generate additional revenue from third party transactions.

- Bioenergy - The primary activities of the bioenergy segment are the generation of electrical power and the development of other opportunities in bioenergy and bioproducts which are complementary to the Company’s harvesting and manufacturing operations.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

Summary by segment:

	Lumber	Bioenergy	Corporate & other	Consolidated
	$	$	$	$
Year ended December 31, 2018				
Sales to external customers	**643,148.5**	**26,770.3**	**-**	**669,918.8**
Operating income (loss)	**16,565.5**	**9,155.8**	**(7,786.0)**	**17,935.3**
Loss on disposal of assets	**(105.0)**	**-**	**-**	**(105.0)**
Finance costs and accretion	**-**	**(5,884.8)**	**(11,514.1)**	**(17,398.9)**
Loss on derivative financial instruments	**(1,077.6)**	**-**	**-**	**(1,077.6)**
Foreign exchange loss	**-**	**(8.4)**	**(405.2)**	**(413.6)**
Foreign exchange loss on long-term debt	**-**	**-**	**(8,793.5)**	**(8,793.5)**
Acquisition costs	**-**	**-**	**(2,189.4)**	**(2,189.4)**
Income tax recovery	**-**	**-**	**4,988.5**	**4,988.5**
Net income (loss)	**15,382.9**	**3,262.6**	**(25,699.7)**	**(7,054.2)**
Depreciation and amortization	**21,097.8**	**4,990.1**	**148.8**	**26,236.7**
Capital expenditures	**133,538.5**	**2,423.8**	**167.1**	**136,129.4**
Identifiable assets	**427,251.8**	**128,557.6**	**183,435.7**	**739,245.1**
Year ended December 31, 2017				
Sales to external customers	443,870.6	25,858.0	-	469,728.6
Operating income (loss)	31,381.3	7,550.1	(7,500.2)	31,431.2
Gain on disposal of assets	7.0	-	-	7.0
Finance costs and accretion	-	(4,682.1)	(2,903.8)	(7,585.9)
Other expense	(1,326.3)	-	(577.7)	(1,904.0)
Foreign exchange loss	-	(5.9)	(1,865.5)	(1,871.4)
Income tax expense	-	-	(3,105.5)	(3,105.5)
Net income (loss)	30,062.0	2,862.1	(15,952.7)	16,971.4
Depreciation and amortization	13,278.9	4,896.0	137.4	18,312.3
Capital expenditures	77,689.5	138.9	404.0	78,232.4
Identifiable assets	292,095.6	132,294.8	20,427.7	444,818.1

Revenues by geographic area were as follows:

	2018	2017
	$	$
United States	**431,366.9**	273,167.1
Canada	**131,324.8**	105,749.5
Japan	**53,022.4**	41,689.7
China	**40,600.1**	36,184.0
Other	**13,604.6**	12,938.3
	669,918.8	469,728.6

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

The Company's harvesting, manufacturing and power generation operations are located in the interior of British Columbia, Canada and in Arkansas and Florida, United States.

26. COMMITMENTS

Lease payments

The amount of operating lease payments charged to the consolidated statement of net income and comprehensive income during the year comprised:

	2018	2017
	$	$
Equipment	**1,731.8**	363.6
Office and office equipment	**866.5**	871.4
Vehicles	**398.7**	375.5
	2,997.0	1,610.5

Lease commitments

The future aggregate minimum lease payments under non-cancellable leases are as follows:

	2018	2017
	$	$
Less than 1 year	**2,538.7**	1,577.3
Later than 1 year and not later than 5 years	**7,067.3**	4,834.3
Later than 5 years	**350.7**	942.7
	9,956.7	7,354.3

27. FINANCIAL RISK AND CAPITAL MANAGEMENT

Financial risk management

The Company's activities expose it to a variety of financial risks: liquidity risk (note 2), market risk (including foreign exchange risk, commodity price risk and interest rate risk), and credit risk. The Company's overall financial risk management activities focus on the unpredictability of financial markets and seek to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to reduce certain risk exposures.

The Company's financial risk management activities are governed by Board-approved financial policies that cover risk identification, tolerance, measurement, hedging limits, hedging products, and authorization levels.

(a) Market risk

(i) Foreign exchange risk

The Company is exposed to currency risk, primarily with respect to the US dollar, as its products are sold principally in US dollars and its costs of production at its BC mills are incurred principally in Canadian dollars. Foreign exchange risk arises from future commercial transactions and recognized assets and liabilities. The Company does not currently use financial derivative instruments for its foreign exchange risk management program.

As at December 31, 2018, the Company's operations in Canada has US dollar denominated accounts receivable totaling US$8.6 million (2017 – US$15.8 million) and accounts payable totaling US$5.1 million (2017 – US$8.5 million). The US dollar denominated amount drawn on the revolving credit facilities is $24.7 million (2017 – $18.1 million).

(ii) Commodity price risk

The Company is exposed to commodity price risk related to the sale of lumber and residual products and purchase of certain manufacturing inputs which are purchased primarily on the open market. From time to time, the Company enters into futures contracts on the Chicago Mercantile Exchange to reduce its exposure to risks associated with fluctuations in lumber prices. At December 31, 2018, the fair value of non-covered outstanding commodity financial instruments was $1.2 million (2017 – $1.7 million). The fair value of these instruments was determined based on market rates for instruments with similar characteristics. An increase (decrease) in the futures market price of lumber of US$10 per thousand board feet would result in a pre-tax gain (loss) of approximately US$114,000 in relation to the lumber futures held at year end.

(iii) Interest rate risk

Exposure to interest risk arises primarily when financial assets and financial obligations bear variable interest rates.

The Company may utilize interest rate swaps to reduce its interest rate risk associated with its financial obligations that bear variable interest rates. At December 31, 2018, the Company had no fixed interest rate swaps (2017 – $39.3 million) outstanding.

(b) Credit risk

Credit risk is the risk of financial loss to the Company in the event a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily related to its trade receivable balances. The Company's credit department is responsible for managing and analyzing the credit risk for each new client before standard payment and delivery terms and conditions are offered. The Company utilizes a combination of credit insurance, letters of credit and self-insurance to manage risks associated with its trade receivables. Management regularly reviews the collectability of trade receivables and makes provisions where the collectability is uncertain. The Company does not have significant credit risk related to its cash and cash equivalent balances as deposits are held with major Canadian and US banks.

Capital management

The Company's objective when managing capital is to maintain a strong balance sheet that ensures adequate capital resources to support operations and to sustain future business development.

The Company monitors capital on the basis of the net debt to total capitalization ratio. Net debt is calculated as current and non-current borrowings (notes 14 and 15) less cash and cash equivalents. Total capital is calculated as the sum of net debt and equity.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

The Company's capital structure at year end consisted of the following:

	2018	2017
	$	$
Borrowings, current	**46,388.7**	7,474.9
Borrowings, non-current	**285,610.9**	162,318.4
Less: cash	**(24,952.4)**	(26,141.2)
Net debt	**307,047.2**	143,652.1
Shareholders' equity	**340,101.9**	209,643.6
Total capitalization	**647,149.1**	353,295.7
Net debt to capitalization	**47%**	41%

The Company's capital structure, excluding borrowings by CP Partnership as described in note 14 and note 15, at year end consisted of the following:

	2018	2017
	$	$
Borrowings, current (excluding non-recourse borrowings)	**43,330.2**	1,571.9
Borrowings, non-current (excluding non-recourse borrowings)	**221,749.8**	99,816.1
Less: cash	**(14,597.8)**	(16,557.7)
Net debt	**250,482.2**	84,830.3
Shareholders' equity	**340,101.9**	209,643.6
Total capitalization	**590,584.1**	294,473.9
Net debt to capitalization	**42%**	29%

There were no changes in the Company's approach to capital management during the year.

28. FINANCIAL INSTRUMENTS

The Company's financial assets, with the exception of certain derivative instruments, and financial liabilities are measured at amortized cost subsequent to initial recognition. Cash and cash equivalents and derivative instruments are measured at FVTPL.

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are classified within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

The following table summarizes the Company's financial instruments at December 31, 2018 and 2017, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

	Fair value hierarchy level	**2018**	2017
	$	**$**	$
Financial assets			
Fair value through profit and loss			
Derivative financial instruments	Level 2	**1,193.3**	1,665.9
		1,193.3	1,665.9

29. SOFTWOOD LUMBER DISPUTE

On November 25, 2016, a coalition of US lumber producers petitioned the US Department of Commerce ("USDOC") and the US International Trade Commission ("USITC") to investigate alleged subsidies to Canadian producers by the Federal and provincial governments and to therefore levy countervailing ("CV") and antidumping ("AD") duties against Canadian imports of softwood lumber. On January 6, 2017, a preliminary determination was announced by the USITC that there was reasonable indication that the US industry is materially injured by imports of Canadian softwood lumber products and the USDOC imposed duties on such shipments into the US.

CV duties were imposed from April 28, 2017 until August 26, 2017 and from December 28, 2017 onwards, initially at 19.88%, but subsequently amended to 14.19%. AD duties were imposed from June 30, 2017 through December 26, 2017 and from December 28, 2017 onwards, initially at 6.87%, but subsequently amended to 6.04%.

The rate amendments resulted in an overpayment of duty deposits in 2017 of $2.3 million which the Company recorded as a reduction of CV and AD duty deposit expense in September 2017. The overpayment is included in deposits and long-term receivables.

During the year, the Company expensed CV and AD duty deposits totaling $24.7 million (2017 – $9.9 million), based on the final "all other" CV rate of 14.19% and AD rate of 6.04%, on shipments of softwood lumber to the US.

The duty rates are subject to change based on administrative reviews and appeals available to the Company. Notwithstanding the deposit rates assigned under the investigations, the Company's final liability for the assessment of CV and AD will not be determined until each annual administrative review process is complete and related appeal processes are completed. Cumulative duties of $34.6 million paid by the Company since the inception of the current trade dispute remain held in trust by the US pending the First Administrative Review and conclusion of all appeals of US decisions.

Like other Canadian forest product companies, the Federal Government and Canadian provincial governments, the Company denies the US allegations and strongly disagrees with the current CV and AD determinations made by the USDOC. The Federal Government has proceeded with legal challenges under the North American Free Trade Agreement and through the World Trade Organization, where Canadian litigation has proven successful in the past.