CONIFEX

CONIFEX TIMBER INC.
SECOND QUARTER 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 9, 2017

This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial condition and results of operations of Conifex Timber Inc. (the "Company", "Conifex", "us", "we", or "our"), on a consolidated basis, for the quarter ended June 30, 2017 relative to the quarters ended March 31, 2017 and June 30, 2016. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the quarters ended June 30, 2017 and 2016, as well as the 2016 annual MD&A and the December 31, 2016 audited consolidated financial statements and notes thereon, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") and filed on SEDAR at www.sedar.com.

In this interim MD&A, reference is made to "EBITDA, "adjusted EBITDA" and "adjusted EBITDA margin." EBITDA represents earnings before finance costs, taxes, and depreciation and amortization. Adjusted EBITDA is calculated to exclude unusual items or items that are not ongoing and do not reflect ongoing operations of the Company. Adjusted EBITDA excludes gains or losses resulting from asset sales, disposals or revaluations, the proceeds from our business insurance claim settlement, and preliminary lumber export duty deposits. "Adjusted EBITDA margin" is defined as adjusted EBITDA as a percentage of sales. The Company discloses EBITDA, adjusted EBITDA and adjusted EBITDA margin, as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA, adjusted EBITDA and adjusted EBITDA margin are non-GAAP measures, they may not be comparable to EBITDA, adjusted EBITDA and adjusted EBITDA margin calculated by others. In addition, EBITDA, adjusted EBITDA and adjusted EBITDA margin are not substitutes for net earnings and cash flow, therefore readers should consider earnings in evaluating the Company's performance.

In this interim MD&A, all references to "$" are to Canadian dollars and references to "US$" are to the United States dollar.

FORWARD-LOOKING STATEMENTS

This interim MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to our beliefs, assumptions, estimates and forecasts about our business and the industries and markets in which we operate. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include statements regarding: growth and future prospects of our business; our expectation for the preliminary and final countervailing or antidumping duty rates, if any, assessed on lumber shipments to the U.S.; our expectation for sales realizations; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; our expectation for market volatility associated with the softwood lumber dispute with the U.S.; that we could be negatively impacted by the imposition of duties or other protective measures on our customers, such as antidumping duties or countervailing duties on softwood lumber; our expectations for U.S. dollar benchmark prices; benefits that may accrue to the Company as a result of certain capital expenditure programs, such as the lumber segment capital plan and equipment upgrades; our expectations regarding the Mackenzie Plant *power production; use of proceeds of financing operations; and the anticipated benefits, cost, timing and completion dates for projects, including the El Dorado Mill upgrade.*

Assumptions underlying our expectations regarding forward-looking information contained in this interim MD&A include, among others: that we will be able to effectively market our products; that the U.S. housing market will continue to improve; that there will be no unforeseen disruptions affecting the operation of the power generation plant and that we will be able to continue to deliver power therefrom; that the U.S. Department of Commerce's final rates of countervailing duties and antidumping duties will not be materially different than the preliminary rates; that the critical circumstances finding by the U.S. Department of Commerce will not be upheld in final determinations; that softwood lumber will experience sustained demand in the marketplace; the general stability of the economic, political and regulatory environments within the countries where we conduct operations; our ability to obtain financing (if necessary) on acceptable terms or at all; that interest and foreign exchange rates will not vary materially from current levels; that the equipment at our mills and power plant will operate at expected levels; and that management will effectively execute the Company's strategy to grow and add value to its business. Persons reading this interim MD&A are cautioned that statements comprising forward-looking information are only predictions, and that our actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other similar factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials, including log costs; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments; availability of financing (as necessary); and other risk factors detailed in our Annual Information Form dated March 28, 2017 available on SEDAR at www.sedar.com and other filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to update any forward-looking information, except as required by applicable securities law.

RECENT DEVELOPMENTS IN SECOND QUARTER 2017

Softwood Lumber Dispute

On November 25, 2016, a coalition of U.S. lumber producers petitioned the U.S. Department of Commerce ("USDOC") and the U.S. International Trade Commission ("USITC") to investigate alleged subsidies to Canadian producers by the Federal and provincial governments and to therefore levy countervailing and antidumping duties against Canadian imports of softwood lumber.

On April 24, 2017, the USDOC announced its preliminary determination on countervailing duties ("CVD") and imposed a preliminary duty rate of 19.88% on a majority of Canadian lumber producers' lumber shipments into the U.S., including Conifex. The countervailing duty is to be posted by cash deposits or bonds on the export of softwood lumber to the U.S. effective April 28, 2017 for a period of 120 days, in accordance with U.S. law. During the second quarter of 2017, we recorded an operating expense of $4.6 million related to the CVD deposits.

The USDOC also made a preliminary determination that "critical circumstances" existed, which resulted in CVD deposits on shipments of lumber applying retroactively effective 90 days prior to the publication of the determination in the Federal Register. For accounting purposes, we have not accrued any retroactive CVD for this 90-day period, which is estimated to be US$5.6 million in total. Management believes, similar to management of other lumber producers, that the critical circumstances finding by the USDOC will not be upheld by either the USDOC or the USITC in their final determinations. We expect that we will be required to pay this amount in trust pending final determinations by the USDOC and USITC and will record it as a deposit receivable if made. Any adjustments to management's estimates will be made prospectively if assumptions or conclusions change due to new information warranting a change in the estimates.

On June 26, 2017, the USDOC announced its preliminary determination on antidumping duties ("ADD") and imposed an "all others" preliminary duty rate of 6.87% to be posted by cash deposits or bonds on lumber shipments into the U.S. effective June 30, 2017. We did not incur any expense related to the ADD deposits in the second quarter of 2017.

As a result of the previously noted critical circumstances finding made by the USDOC, ADD deposits will be required on shipments of lumber applying retroactively effective 90 days prior to the publication of the preliminary ADD determination in the Federal Register. For accounting purposes, we have not accrued any retroactive ADD for this 90-day period, which is estimated to be US$1.6 million. As noted, management believes that the critical circumstances finding will not be upheld by either the USDOC or the USITC in their final determinations. We expect that we will be required to pay this amount in trust pending final determinations by the USDOC and the USITC and will record it as a deposit receivable if made. Any adjustments to management's estimates will be made prospectively if assumptions or conclusions change due to new information warranting a change in the estimates.

Like other Canadian forest product companies, the Federal Government and Canadian provincial governments, we deny the U.S. allegations and disagree with the preliminary determinations made by the USDOC and USITC, and, collectively continue to aggressively defend the Canadian industry in this trade dispute. Depending on the outcome of the final phase of the investigations, an appeal to the decision of these administrative agencies to the appropriate courts, North American Free Trade Agreement panels and the World Trade Organization may be made.

The USDOC is expected to announce final rates as early as September 2017, but with extensions the announcement could be as late as November 2017. The USITC is expected to make a ruling on "injury" as early as October 30, 2017 but with extensions the ruling could be as late as January 2018. The requirement that we pay CVD will be suspended on September 2, 2017 until final determination is published by the USITC. Notwithstanding the preliminary rates established in the investigations, our final liability for the assessment of CVD and ADD will not be determined until each annual administrative review process is complete.

SUMMARY OF OPERATING RESULTS

Selected Financial Information

(millions of dollars except share and per share amounts and exchange rate information, unaudited)	Q2 2017	Q1 2017	YTD 2017	Q2 2016	YTD 2016
Sales by Segment					
Lumber	111.7	93.5	205.2	98.7	190.5
Bioenergy	4.7	6.8	11.6	5.0	12.7
	116.4	100.3	216.8	103.7	203.2
Operating Earnings by Segment					
Lumber	7.1	1.8	8.9	5.4	6.6
Bioenergy	0.9	1.3	2.2	1.6	4.2
Corporate and other unallocated items	(1.6)	(1.6)	(3.2)	(1.9)	(2.7)
	6.4	1.5	7.9	5.1	8.1
Adjusted EBITDA by Segment					
Lumber	15.4	5.1	20.5	8.7	13.2
Bioenergy	1.8	2.8	4.6	2.4	6.6
Corporate and other unallocated items	(2.4)	(1.8)	(4.2)	(2.1)	(3.9)
	14.8	6.1	20.9	9.0	15.9
Net income (loss)	4.2	(1.4)	2.8	35.2	63.7
Net income (loss) per share - basic	0.16	(0.06)	0.12	1.67	3.01
Net income (loss) per share - diluted (1)	0.16	(0.06)	0.12	1.54	2.78
Shares outstanding - weighted average (millions)	26.3	22.5	24.4	21.1	21.1
Average exchange rate - US$/Cdn$ (2)	0.744	0.756	0.750	0.776	0.752
Reconciliation of adjusted EBITDA to Net Income (Loss)					
Net income (loss)	4.2	(1.4)	2.8	35.2	63.7
Add: Finance costs	1.7	2.6	4.3	2.3	4.8
Amortization	4.3	4.9	9.2	3.9	8.8
EBITDA (3)	10.2	6.1	16.3	41.4	77.3
Less: Gain on sale of asset	-	-	-	(19.0)	(48.0)
Less: Gain on revaluation	-	-	-	(19.2)	(19.2)
Add: Impairment of property, plant and equipment	-	-	-	5.8	5.8
Add: Lumber export duty deposits	4.6	-	4.6	-	-
Adjusted EBITDA (4)	14.8	6.1	20.9	9.0	15.9

(1) If the conversion of convertible notes and/or the inclusion of outstanding warrants and options is anti-dilutive, it is excluded from the calculation of diluted net income per share.
(2) Source: Bank of Canada, www.bankofcanada.ca.
(3) The Company's EBITDA calculation represents earnings before finance costs, taxes, and depreciation and amortization.
(4) The Company's adjusted EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization, gains or losses from asset sales, disposals or revaluations, and preliminary lumber export duty deposits.

Our revenues totaled $116.4 million in the second quarter of 2017, an improvement of 16% over the prior quarter and 12% over the same quarter last year. Our revenue growth over the previous quarter was mainly attributable to a 19% increase in our lumber segment revenues, partially offset by seasonally lower revenues from electricity sales. Our lumber segment revenues increased by 13% and our bioenergy segment revenues declined by 6% compared to the second quarter of 2016.

Operating income, which includes preliminary CVD deposits of $4.6 million on lumber shipments to the U.S., improved to $6.4 million compared to $1.5 million in the previous quarter and $5.1 million in the same quarter last year. Compared to the prior quarter, an increase in lumber segment operating earnings of $5.3 million was partially offset by a modest decline in bioenergy segment operating earnings. Lumber segment operating earnings increased by $1.7 million and bioenergy segment operating earnings were lower by $0.7 million compared to the second quarter of 2016.

Net income for the second quarter of 2017 was $4.2 million, or $0.16 per diluted share, compared to a net loss of $1.4 million or $0.06 per basic share in the previous quarter and a normalized net income of $2.8 million or $0.13 per diluted share in the second quarter of 2016. Net income for the second quarter of 2016 included a net gain of $32.4 million from the sale and revaluations of certain assets and was $35.2 million or $1.67 per basic and $1.54 per diluted share. Year to date net income was $2.8 million, or $0.12 per diluted share, compared to a normalized net income of $2.3 million or $0.11 per diluted share for the same period last year. Including the unusual items above, net income was $63.7 million, or $3.01 per basic and $2.78 per diluted share for the first six months of 2016.

Adjusted EBITDA, which excludes CVD deposits of $4.6 million, was $14.8 million in the second quarter of 2017 compared to $6.1 million in the first quarter of 2017 and $9.0 million in the second quarter of 2016. Compared to the previous quarter, the improvement was comprised of an increase in lumber segment adjusted EBITDA of $10.3 million which was partially offset by lower bioenergy segment results and a variance in foreign exchange translation loss of $0.6 million. Compared to the second quarter of 2016, lumber segment adjusted EBITDA improved by $6.7 million and bioenergy segment adjusted EBITDA was lower by $0.6 million. Adjusted EBITDA was $20.9 million for the six month period ended June 30, 2017 compared to $15.9 million for the six month period ended June 30, 2016.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, other than statistical and exchange rate information and lumber prices, unaudited)	Q2 2017	Q1 2017	YTD 2017	Q2 2016	YTD 2016
Sales -Lumber - Conifex produced	70.8	56.7	127.5	63.8	120.9
- Lumber - wholesale	28.6	28.4	56.9	26.0	51.1
- By-products	7.2	5.4	12.7	6.2	12.7
- Logistics services	5.1	3.0	8.1	2.7	5.8
Total Sales	111.7	93.5	205.2	98.7	190.5
Adjusted EBITDA	15.4	5.1	20.5	8.7	13.2
Amortization and other	3.7	3.3	7.0	3.3	6.6
Lumber export duty deposits	4.6	-	4.6	-	-
Operating income	7.1	1.8	8.9	5.4	6.6
Statistics (in millions, other than exchange rate and lumber prices)					
Lumber production (MMfbm)	131.6	123.7	255.2	134.7	270.5
Lumber shipments - Conifex produced (MMfbm)	128.5	110.7	239.2	138.4	265.4
Lumber shipments - Wholesale (MMfbm)	38.4	41.0	79.4	41.0	81.7
Average exchange rate - US$/Cdn$ (1)	0.744	0.756	0.750	0.776	0.752
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$388	$348	$368	$311	$292
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (3)	$522	$460	$491	$401	$387

(1) Source: Bank of Canada, www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc.
(3) Average WSPF 2x4 #2&Btr lumber price (US$) divided by average exchange rate.

The U.S. Census Bureau reported privately-owned housing starts averaged a seasonally adjusted annualized rate of approximately 1.16 million units over the second quarter of 2017, a level which was consistent with the same quarter last year and approximately 6% lower than first quarter of 2017. Single-family housing starts accounted for 71% of total second quarter 2017 U.S. housing starts, a level generally comparable to the previous quarter and an increase in units of 9% over the second quarter of 2016. Lumber consumption per unit in single-family housing starts is generally considered to be two to three times greater than in multi-family units.

Prices for the bell-weather WSPF #2 & Btr product averaged US$388 during the second quarter of 2017, an improvement of 11% over the previous quarter and 25% over the second quarter of 2016.[1] Several industry analysts have attributed the improvement in the U.S. dollar benchmark price to strong underlying seasonal demand coupled with the uncertainty surrounding the imposition of CVD on Canadian lumber shipments to the U.S. prior to the April 24, 2017 preliminary rate announcement.

The U.S. dollar averaged US$0.744 for each Canadian dollar during the second quarter of 2017, which represented a depreciation of 2% compared to the previous quarter and 4% compared to the same quarter last year.[2] Canadian dollar-denominated benchmark lumber prices, which averaged $522 in the second quarter of 2017, improved by 13% or $62 over the previous quarter and 30% or $121 over the second quarter of 2016.

The U.S. and China remained our principal markets and accounted for approximately 80% of total lumber shipments in each of the comparative quarters while shipments to Japan remained steady at approximately 6%. Shipments to other offshore markets averaged 5% of our total volumes in the comparative quarters. The balance of lumber shipments were directed to the Canadian market.

Revenue from Conifex produced lumber was $70.8 million in the second quarter of 2017. The 25% increase over the previous quarter was generally attributable to 16% higher shipment volumes and a 7% improvement in unit sales realizations. Lumber shipments, which were hampered by challenging weather conditions and resulted in logistical constraints in the prior quarter, returned to more typical levels. The higher sales realizations generally reflected stronger lumber prices coupled with a modestly weaker Canadian currency. The growth in revenue of 11% over the second quarter of 2016 was largely due to a 20% improvement in sales realizations partially offset by a 7% reduction in shipment volumes.

Wholesale lumber revenues were consistent in the first and second quarters of 2017 and increased by 10% over the second quarter of 2016. The growth in revenue was primarily attributable to improved sales realizations due to shipment of a higher value product mix.

Revenues from wood chips and other residuals increased by 33% over the previous quarter with the increase evenly due to higher shipment volumes and improved pricing for sawmill residual chips. The increase over the second quarter of 2016 was mainly due to higher unit prices.

The increase in revenues from provision of third party logistics services of 70% over the previous quarter and 89% over the same quarter last year was generally attributable to revitalized seasonal demand in certain sectors.

Lumber production totalled approximately 132 million board feet during the second quarter of 2017 and represented an annualized operating rate of 100% (excluding production capacity attributed to the idled Mackenzie Site I sawmill) compared to 94% in the previous quarter and 103% in the same quarter last year. Production in the first quarter of 2017 was held back by the completion and planned ramp of our new log line at the Mackenzie sawmill and, to a lesser extent, inclement weather conditions in Western Canada.

---

[1] As quoted in Random Lengths Publications Inc.

[2] Source: Bank of Canada, www.bankofcanada.ca

The two main elements of our lumber manufacturing costs are log costs and conversion costs. Log costs typically account for the majority of costs. Cash conversion costs exclude depreciation and amortization expense. We improved our unit manufacturing costs by 5% compared to the previous quarter. Unit manufacturing costs increased by 12% over the second quarter of 2016.

Unit log costs increased by 2% over the previous quarter and 18% over the same quarter last year. The higher log costs were mainly attributable to higher market based stumpage and purchased log costs.

An improvement of 13% in unit cash conversion costs over the previous quarter was mainly attributable to higher operating rates and lower energy and weather related maintenance costs. An increase in unit cash conversion costs of 4% over the second quarter of 2016 was primarily due to lower operating rates.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were 6% higher than the previous quarter and 8% higher than the second quarter of 2016 mostly due to the weaker Canadian currency.

Preliminary CVD deposits of $4.6 million on lumber shipments to the U.S. were expensed in the second quarter of 2017.

Including the preliminary CVD deposits expense, the lumber segment recorded operating income of $7.1 million in the second quarter of 2017 compared to $1.8 million in the previous quarter and $5.4 million in the second quarter of 2016. Compared to the previous quarter, current quarter lumber segment operating results benefited from higher lumber prices, increased shipments of Conifex produced lumber, growth in revenue from residuals, improved productivity and lower unit cash conversion costs, which were partially offset by CVD deposits and a modest increase in unit log costs.

Compared to the second quarter of 2016, current quarter operating results benefited from higher lumber prices, a weaker Canadian currency and increased residuals revenue, partially offset by payment of CVD deposits, lower shipment and production volumes, and higher unit log and cash conversion costs. Year-to-date lumber segment operating earnings were $8.9 million, an improvement of $2.3 million including CVD deposits, and $6.9 million excluding CVD deposits, over the same period last year.

Lumber segment adjusted EBITDA, which excludes CVD deposits, was $15.4 million in the second quarter of 2017 compared to $5.1 million in the previous quarter and $8.7 million in the second quarter of 2016. Lumber segment adjusted EBITDA was $20.5 million for the six months ended June 30, 2017 and $13.2 million for the six months ended June 30, 2016.

Bioenergy Segment

The Mackenzie power generation plant (the “Mackenzie Plant”) commenced commercial operations in May 2015.

Dispatch Notice

Our Electricity Purchase Agreement (“EPA”) with BC Hydro, similar to other electricity purchase agreements, provides BC Hydro with the option to “turn down” electricity purchased from independent power producers during periods of low demand by issuing a “dispatch order” outlining the requested dispatch period. In April 2017, BC Hydro issued a dispatch order with respect to, among others, the Mackenzie Plant, advising of a dispatch period of 122 days, encompassing the months of April, June, July and August. Last year, the Mackenzie Plant, among others, was dispatched for 61 days in the second quarter. During the dispatch period, we only produce electricity to fulfill volume commitments under our Load Displacement Agreement with BC Hydro. We continue to be paid revenues under the EPA based upon a reduced rate and on volumes that are generally reflective of contracted amounts.

Operating Results

(millions of dollars, other than statistical information, unaudited)	**Q2 2017**	**Q1 2017**	**YTD 2017**	**Q2 2016**	**YTD 2016**
Electricity sales under EPA - GWh	51.0	46.3	97.3	55.1	110.0
Electricity revenues	4.7	6.8	11.6	5.0	12.7
Adjusted EBITDA	1.8	2.8	4.6	2.4	6.6
Amortization	0.9	1.5	2.4	0.8	2.4
Operating income	0.9	1.3	2.2	1.6	4.2

The Mackenzie Plant sold 51.0 gigawatt hours of electricity under our EPA in the second quarter of 2017, which represents approximately 94% of targeted operating rates, compared to 85% in the previous quarter and 100% in the second quarter of 2016. Electricity sales and plant operating costs in the first quarter of 2017 were impacted by some unplanned outages and challenging weather conditions earlier in the quarter, which impacted feedstock quality and deliverability.

Electricity revenues of $4.7 million, generally consistent with the same quarter last year, were $2.1 million lower than the previous quarter mainly due to discounted rates during the dispatch period combined with lower seasonal rates. Cash operating costs improved by $1.1 million over the previous quarter and increased by $0.3 million over the same quarter last year. Amortization expense was lower compared to the previous quarter as idled components are not depreciated during the dispatch period.

Bioenergy segment adjusted EBITDA was $4.6 million for the first six months of 2017 compared to $6.6 million in the first six months of 2016 and reflected adjusted EBITDA margin of 40% compared to 52% in the comparative period last year. Adjusted EBITDA margin is defined as adjusted EBITDA as a percentage of sales.

The Mackenzie Plant achieved hourly production of 105% of our operating target over the first twelve months of commercial operations. We expect the improvements that we made during the planned maintenance days in June 2017 will result in operating rates approaching historic levels when production resumes in September 2017. Although the Mackenzie Plant will be dispatched for two months in the third quarter of 2017, we expect an improvement in year-over-year quarterly operating performance as results in the third quarter of 2016 were hampered by maintenance downtime.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $1.6 million in the first and second quarters of 2017 and $1.9 million in the second quarter of 2016. Corporate costs were $3.2 million for the six months ended June 30, 2017 compared to $2.7 million for the six months ended June 30, 2016. Corporate costs for the current year included professional fees related to the softwood lumber trade dispute.

Interest Expense and Finance Costs

Finance costs related to debt issuance are amortized over the remaining term of each respective credit facility. Interest and finance costs totalled $1.7 million in the second quarter of 2017, $2.7 million in the previous quarter and $2.3 million in the second quarter of 2016. Year to date interest and finance costs were $4.4 million for 2017 compared to $4.8 million for 2016. Finance costs in the first quarter of 2017 included accelerated amortization of costs related to the early repayment of our senior secured notes.

Gain or Loss on Derivative Financial Instruments

We utilize derivative financial instruments to manage commodity lumber price exposures in the ordinary course of our business and to manage interest rate variability. Gains or losses on lumber derivative instruments are recognized as other income or expense and allocated to lumber segment operating results, either as they are settled or as they are marked to market for each reporting period. We recorded gains from lumber derivative instruments of $0.4 million in the second quarter of 2017 and $0.3 million in the second quarter of 2016.

The term loan provided under our power project financing consists of a floating rate tranche and a fixed rate tranche. Our wholly-owned subsidiary, Conifex Power Limited Partnership, entered into interest rate swap transactions with the lead arranger to swap the interest rates on the floating rate tranche of the term loan to fixed interest rates. Losses of $0.3 million on the interest rate swap instruments were recorded as interest expense in each of the comparative quarters.

Foreign Exchange Translation Gain or Loss

The foreign exchange translation gain or loss recorded for each period results from the revaluation of U.S. dollar-denominated working capital balances and the U.S. dollar-denominated debt to reflect the change in the value of the Canadian dollar relative to the value of the U.S. dollar. U.S. dollar-denominated monetary assets and liabilities are translated using the period end rate. The relative magnitude of the translation gain or loss is largely determined by the net amount of U.S. dollar-denominated monetary assets and liabilities and the change in the exchange rates at the end of each period.

The exchange rate for one Canadian dollar was US$0.771 at June 30, 2017, US$0.752 at March 31, 2017 and US$0.774 at June 30, 2016.[3] The foreign exchange translation loss was $0.8 million in the second quarter of 2017 and $0.2 million in the first quarter of 2017 and the second quarter of 2016. We recorded foreign exchange translation losses of $1.0 million for the six months ended June 30, 2017 and $1.3 million for the same period last year.

Income tax

At December 31, 2016, the Company had unused non-capital tax losses carried forward totalling $21.1 million and unrecognized deferred tax assets totalling $2.3 million. Although the Company expects to realize the full benefit of the loss carry forwards and unrecognized deferred tax assets in the future, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefits of its deferred tax assets available to reduce taxable income.

---

[3] Source: Bank of Canada, www.bankofcanada.ca

SUMMARY OF FINANCIAL POSITION

The following table is a summary of selected financial information as at the end of each of the comparative quarters:

(millions of dollars, unaudited)	Q2 2017	Q4 2016	Q2 2016
Cash	24.8	12.7	22.6
Cash - restricted	10.3	10.3	8.5
Operating working capital	60.7	62.8	51.2
Operating loans	(1.6)	(28.2)	(8.3)
Current portion of convertible notes	-	-	(11.9)
Current portion of mortgage	-	(10.5)	(11.1)
Current portion of long-term debt	(4.2)	(4.4)	(4.1)
Net current assets	90.0	42.7	46.9
Long-term assets related to power project	116.2	118.7	122.7
Long-term assets - lumber segment and corporate	160.3	124.8	116.0
	366.5	286.2	285.6
Non-interest bearing long-term liabilities	21.5	20.0	23.0
Long-term debt - power project construction loan	66.9	68.4	72.9
Revolving credit facility	83.1	-	-
Long-term debt - other	-	20.3	19.1
Shareholders' equity	195.0	177.5	170.6
	366.5	286.2	285.6
Ratio of current assets to current liabilities	3.3	1.5	1.7
Net debt to capitalization	38%	38%	36%
Net debt to capitalization (1)	23%	16%	10%

(1) Excluding borrowings by Conifex Power Limited Partnership, which are non-recourse to our other operations.

In January 2017, we completed a $130 million secured revolving credit facility (the "Credit Facility") with a syndicate of institutional lenders. The Credit Facility is available for a term of 5 years. A portion of the Credit Facility was used to repay in full drawn amounts under our existing lumber segment credit facilities and our secured notes, which generally carried higher interest rates. We are primarily utilizing the Credit Facility to finance working capital in our lumber segment and a portion of the capital expenditures related to the modernization and re-start of our sawmill complex in El Dorado, Arkansas (the “El Dorado Mill”).

In March 2017, we completed a bought deal offering (the "Offering") of 3.45 million common shares at a price of $3.05 per share for aggregate gross proceeds of approximately $10.5 million. We subsequently completed a non-brokered private placement of 1.6 million common shares at the same price for aggregate gross proceeds of approximately $4.9 million. The net aggregate proceeds of $14.2 million from the Offering and the private placement were initially used to partially repay outstanding indebtedness under the Credit Facility.

The ratio of current assets to current liabilities at June 30, 2017 improved to 3.3:1 compared to 1.5:1 at December 31, 2016 and 1.7:1 at June 30, 2016. During the first six months of 2017, the ratio was most significantly impacted by the relatively longer tenor of the Credit Facility, from which advances were drawn to repay and extinguish lumber segment operating loans and the El Dorado mortgage, which had been classified as current liabilities.

We manage capital with the objective of maintaining a strong balance sheet that helps ensure adequate capital resources to support operations, sustain future development and facilitate access to capital markets at competitive rates. We use the net debt to total capitalization ratio to measure our relative debt position and as an indicator of the relative strength and flexibility of our balance sheet. Net debt is calculated as the principal value of long-term debt, including the current portion, bank advances, the present value of convertible notes, and any mortgages, less cash on hand. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

Net debt at June 30, 2017 was $120.8 million. The increase of $12.0 million during the first six months of 2017 was due primarily to capital expenditures related to the El Dorado Mill, somewhat offset by net proceeds from the Offering and private placement. The net debt to capitalization ratio was 38% at June 30, 2017 and December 31, 2016.

Excluding the effects of borrowings by Conifex Power Limited Partnership, the net debt to capitalization ratio was 23% at June 30, 2017 compared to 16% at December 31, 2016.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	**Q2 2017**	**Q1 2017**	**YTD 2017**	**Q2 2016**	**YTD 2016**
Cash generated from (used in)					
Operating activities	25.9	(4.6)	21.4	18.0	18.6
Financing activities	(1.6)	33.5	31.9	(23.2)	(23.5)
Investing activities	(13.5)	(27.6)	(41.1)	18.5	17.5
Increase (decrease) in cash	10.8	1.3	12.2	13.3	12.6

<u>Operating Activities</u>
We operate in a cyclical industry and our operating cash flows vary accordingly.

Working capital levels fluctuate through the year and are impacted by a variety of factors, including changes in sales volume and price, shipment patterns, operating rates, seasonality and timing of receivables and payment of payable and expenses. Our fibre inventories exhibit seasonal swings as log inventories are increased during the fall and winter months to help ensure adequate supply of fibre to our mills during the spring months. Factors such as disruption of transportation services by third party providers and variability in export shipments can impact the level of lumber inventories. We believe our management practices with respect to working capital conform to common business practices.

We generated cash from operations before working capital changes of $17.4 million in the first six months of 2017 and the first six months of 2016. Changes in non-cash working capital provided cash of $4.0 million in the first six months of 2017 and $1.2 million in the same period last year.

<u>Financing Activities</u>
Financing activities provided net cash of $31.9 million in the first six months of 2017 and included net proceeds from operating loans of $56.5 million and the Offering and private placement of $14.2 million. Cash outflows included repayment in full of senior secured notes of $20.3 million and the El Dorado mortgage of $10.4 million, partial repayment of our term loan of $2.8 million, and the payment of finance expenses of $5.7 million. The comparative increase in cash finance expenses was mainly attributable to costs related to the completion of the Credit Facility.

Financing activities consumed net cash of $23.5 million in the first six months of 2016 and were comprised of repayment of operating loans of $10.1 million, debt repayments of $8.9 million and payment of financing costs of $4.5 million.

Investing Activities

Investing activities consumed cash of $41.1 million in the first six months of 2017 and mainly consisted of $3.6 million on capital improvements in the lumber segment, $0.1 million related to the power generation plant and $37.3 million on the capital upgrades at the El Dorado Mill. Lumber segment capital expenditures for our Canadian mills were primarily related to the completion of the upgrade of a log line at the Mackenzie Site II sawmill, a project which was initiated in December 2016. The El Dorado Mill capital project is discussed further under “El Dorado Mill Capital Project” below.

Investing activities provided cash of $17.5 million in the first six months of 2016 and were comprised of proceeds from sale of assets of $20.1 million offset by $1.3 million lumber segment capital expenditures, $0.3 million bioenergy segment capital expenditures and $1.0 million in pre-development and carrying costs related to the El Dorado Mill.

Liquidity

Our principal sources of funds are cash on hand, cash flow from operations, and our revolving credit facilities. Our principal uses of funds consist of operating expenditures, interest payments, repayment of debt, and capital expenditures.

Total liquidity is comprised of unrestricted cash and available credit under our revolving credit facilities. At June 30, 2017, we had total liquidity of $63.0 million, compared to $22.3 million at December 31, 2016 and $44.3 million at June 30, 2016. Liquidity at June 30, 2017 was comprised of unrestricted cash of $24.8 million and unused availability under our revolving credit facilities of $38.2 million. Availability under the Credit Facility is determined by periodic borrowing base calculations that fluctuate with eligible accounts receivable and inventory balances, plus the appraised values of certain forest licences, net of specific reserves. The Credit Facility provides for calculation of availability on an expanded borrowing base, relative to our previous lumber segment revolving credit facilities. The expanded borrowing base, cash flow generated from operations, and net proceeds from the Offering and private placement contributed to our enhanced liquidity during the first six months of 2017.

We were required to begin depositing cash on account of softwood lumber export duties imposed by the U.S. in April 2017. The timing of deposits required for retroactive duties is currently unclear and therefore creates some uncertainty for our cash flows. We expect future cash flow will be adversely impacted by the CVD and ADD deposits, to the extent the additional costs on U.S. destined shipments are not mitigated by higher lumber prices.

We monitor expected liquidity levels and compliance with debt covenants by regularly preparing rolling cash flow forecasts to ensure sufficient resources are available to meet operational requirements, debt service commitments and to sustain future business development. Based on the current level of operations and our current expectations for future periods in light of the current economic environment, we believe that cash flow from operations and available cash, together with available borrowings under our revolving credit facilities, will be adequate to meet our obligations in 2017. We expect liquidity for the balance of the year to remain generally consistent with 2016 levels, after taking into account budgeted capital expenditures for our Canadian mills and the El Dorado Mill upgrade which we expect to complete by or about the end of the third quarter or early in the fourth quarter of this year.

In the future, we may make acquisitions of businesses or assets or commitments to additional capital projects. To achieve the long-term goals of expanding our assets and earnings, including through acquisitions, additional capital resources will be required. We expect such additional capital resources will be generated from debt financing and/or the sale of equity securities, but no assurance may be given that such additional capital resources will be available on satisfactory terms, or at all.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements at June 30, 2017 were comprised of standby letters of credit totalling $18.75 million posted by our subsidiary, Conifex Power Limited Partnership, and operating leases for vehicles, equipment and machinery.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(millions of dollars, except share and per share amounts, statistical and exchange rate information and lumber prices)	2017 Q2	2017 Q1	2016 Q4	2016 Q3	2016 Q2	2016 Q1	2015 Q4	2015 Q3
Sales - lumber segment	111.7	93.5	94.4	99.2	98.7	91.8	92.7	80.0
Sales - electricity	4.7	6.8	7.6	4.9	5.0	7.70	7.8	5.9
Operating income (loss)	6.4	1.5	6.7	3.3	5.1	3.0	1.6	(4.5)
Net income (loss)	4.2	(1.4)	5.1	1.4	35.2	28.5	(0.3)	(5.6)
Net income (loss) per share - basic	0.16	(0.06)	0.24	0.07	1.67	1.35	(0.01)	(0.26)
Net income (loss) per share - diluted (1)	0.16	(0.06)	0.24	0.07	1.54	1.24	(0.01)	(0.26)
Adjusted EBITDA (2)	14.8	6.1	9.3	8.5	9.0	6.8	7.3	1.5
Shares outstanding - weighted average (millions)	26.3	22.5	21.2	21.2	21.1	21.1	21.1	21.1
Statistics (in millions, other than exchange rate and lumber prices)								
Lumber production (MMfbm)	131.6	123.7	118.7	136.2	134.7	135.8	131.1	112.3
Lumber shipments - Conifex produced (MMfbm)	128.5	110.7	124.4	132.3	138.4	127.0	139.4	107.6
Lumber shipments - wholesale (MMfbm)	38.4	41.0	40.5	39.6	41.0	40.7	38.6	42.6
Electricity production - GWh	51.0	46.3	53.0	37.6	55.1	54.90	54.5	46.2
Average exchange rate - US$/Cdn$ (3)	0.744	0.756	0.750	0.766	0.776	0.727	0.749	0.764
Average WSPF 2x4 #2&Btr lumber price (US$) (4)	$388	$348	$316	$321	$311	$272	$264	$267
Average WSPF 2x4 #2&Btr lumber price (Cdn$)(5)	$522	$460	$421	$418	$401	$373	$353	$349
Reconciliation of Adjusted EBITDA to Net Income (Loss)								
Net income (loss)	4.2	(1.4)	5.1	1.4	35.2	28.5	(0.3)	(5.6)
Add: Finance costs	1.7	2.6	2.1	2.3	2.3	2.5	2.6	2.6
Amortization	4.3	4.9	4.6	4.8	3.9	4.8	5.0	4.5
EBITDA (6)	10.2	6.1	11.8	8.5	41.4	35.8	7.3	1.5
Less: Gain on sale of assets	-	-	-	-	(19.0)	(29.0)	-	-
Less: Gain on revaluation of joint venture	-	-	-	-	(19.2)	-	-	-
Less: Net proceeds from insurance settlement	-	-	(2.5)	-	-	-	-	-
Add: Impairment of property, plant and equipment	-	-	-	-	5.8	-	-	-
Add: lumber export duty deposits	4.6	-	-	-	-	-	-	-
Adjusted EBITDA	14.8	6.1	9.3	8.5	9.0	6.8	7.3	1.5

(1) If the conversion of convertible notes and/or the inclusion of outstanding warrants is anti-dilutive, it is excluded from the calculation of diluted net income per share.
(2) The Company's adjusted EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization, gains or losses from asset sales, disposals or revaluation, proceeds from business interruption insurance claim settlement, and preliminary lumber export duty deposits..
(3) Source: Bank of Canada, www.bankofcanada.ca.
(4) Source: Random Lengths Publications Inc.
(5) Average WSPF 2x4 #2&Btr lumber price (US$) divided by average exchange rate.
(6) The Company's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization.

Our quarterly financial results are impacted by a variety of market related or regulatory factors, including fluctuations in lumber prices and prices of certain commodities related to by-product revenue and manufacturing inputs, changes in the lumber export duty deposit rates, stumpage rates, and foreign exchange rates. Other micro-level factors that influence quarterly financial trends include operating rates, shipment volumes, raw material and manufacturing costs, and transactions of a non-recurring nature. We rely primarily on third parties for transportation of our products, as well as delivery of raw materials, and any significant or prolonged disruption of services provided by third party carriers may adversely impact our operations, cost structure or shipment volumes.

Quarterly trends are also impacted by the seasonal nature of activities such as logging operations and construction and remodelling activity. Our fibre inventories exhibit seasonal swings as we increase log inventories during the fall and winter months to ensure adequate supply of fibre to our mills during the spring months when logging operations are generally largely curtailed due to unstable road conditions. Operating rates are typically lower, and unit manufacturing costs are typically higher, during the fourth quarter of each year due to planned curtailments related to seasonal holidays.

The application of a “time of delivery factor” to the fixed price provided under the EPA produces a seasonal effect on and considerable variability on quarterly revenues from electricity deliveries with the lowest revenues generally generated in the second quarter and the highest in the first and fourth quarters of each year. Quarterly electricity revenues can vary up to 30% between the strongest and weakest quarters. As a major portion of the costs of electricity production, as well as depreciation and interest charges, are fixed in nature, quarterly operating results in the bioenergy segment are expected to reflect the variability in revenues.

OUTLOOK AND STRATEGIC CAPITAL EXPENDITURES

Lumber Market Outlook

Through the remainder of 2017, we expect average benchmark lumber prices for Western SPF to be similar to average levels achieved in the first six months of this year. We expect continued uncertainty around the softwood lumber dispute, including the suspension of preliminary CVD in September 2017, and timing related to the final determination of CVD and ADD rates and the potential resolution of the dispute, will contribute to further volatility in U.S. market conditions and pricing. We expect prices on the premium grade and lower grade products shipped to Japan and China, respectively, will be primarily determined by traditional supply and demand factors and will not be materially impacted by duties imposed by the U.S. We expect demand and pricing to continue to remain solid in the Japanese and Chinese markets through the balance of the year. We expect our mill net price realizations from the sale of construction grade lumber to the Canadian market will be somewhat discounted as a result of the duty impositions on U.S. exports. We expect average log costs through the remaining six months of the year will generally remain consistent with those in the first half of 2017.

Strategic Capital Expenditures

El Dorado Mill Capital Project

In January 2017, we commenced the construction phase of our capital project to modernize and re-start our El Dorado Mill (the "Project"). Upon completion, the Project is planned to incorporate significant capital upgrades to the log processing yard and sawmill and planer and add two continuous dry kilns. The Project has been designed to maximize both log recovery and lumber grade yield and quality. Upon completion, the El Dorado Mill is expected to have approximately 180 million board feet of annual lumber capacity on a two-shift basis. We expect to complete the Project by or about the end of the third quarter or early in the fourth quarter of this year.

We currently estimate that the Project will require capital expenditures of approximately US$50 million, consisting of approximately US$27 million for equipment and materials, US$16 million in subcontract costs and US$7 million for indirect costs, including engineering, construction management, freight and project contingency. At June 30, 2017, approximately 77% of budgeted expenditures had been committed. The Project is currently within management’s budgeted amounts and progressing as scheduled.

We believe our planned expansion into the U.S. South will provide an important source of revenue diversification and reduce cash flow volatility in our lumber segment, particularly in light of punitive trade actions on Canadian softwood lumber recently initiated by the U.S.

CRITICAL ACCOUNTING ESTIMATES

There were no significant changes to the Company's critical accounting estimates during the quarter ended June 30, 2017. Conifex's critical accounting estimates are described in its MD&A for the year ended December 31, 2016, filed under the Company's profile on SEDAR at www.sedar.com.

Lumber Export Duty Deposits

The current softwood lumber dispute is the fifth such dispute since 1982. In the case of previous disputes, the preliminary duties levied were subject to significant adjustments in the periods following the initial application. In the absence of any additional information, we have accrued CVD, and will accrue ADD, at the weighted average "all others" rate designated by the USDOC. These rates are subject to change based on administrative reviews and appeals available to us. Changes to the rates may be material and our results may be adjusted as new information becomes available. Any adjustments resulting from a change in the final CVD and ADD rates will be made prospectively.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors is included in the Company's annual information form dated March 28, 2017, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

While the severe forest fire season in British Columbia to date has had no material financial impact on our operations, a continuation of the current hot and dry weather in the B.C. Interior could increase the risks of material disruption to our fibre procurement efforts, operations and transportation.

See also the discussion of risks related to the softwood lumber dispute described above under "Recent Developments in Second Quarter 2017."

OUTSTANDING SECURITIES

As at August 9, 2017, the Company had 26,432,791 issued and outstanding common shares, 100,000 options granted, 1,147,663 long-term incentive plan awards, and 1,060,000 warrants.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2017, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

ADDITIONAL INFORMATION

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