CONIFEX

CONIFEX TIMBER INC.
FIRST QUARTER 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of May 3, 2016

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 March 31, 2016 relative to the quarters ended December 31, 2015 and March 31, 2015. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the quarters ended March 31, 2016 and 2015 as well as the 2015 annual MD&A and the December 31, 2015 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 or disposals. "Adjusted EBITDA margin" is defined as adjusted EBITDA as a percentage of sales. The Company discloses EBITDA and has disclosed 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 expectations, 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 export tax rate 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; 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 of the benefits and effects of the timber harvesting cooperation agreement; the expected improved liquidity from the repayment of our operating loans; use of proceeds of financing operations; and the anticipated benefits, cost, timing and completion dates for projects.

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 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 29, 2016 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.

SIGNIFICANT DEVELOPMENTS IN FIRST QUARTER OF 2016

Amendment of senior secured revolving asset based credit facility

In January 2016, we completed the renewal of our revolving asset based credit facility for a further three-year term. The amendment increased our borrowing availability to $35 million and extended the maturity date of the facility to January 29, 2019.

Exercise of payment-in-kind note

In February 2016, the holder of the $30 million payment-in-kind note ("PIK Note") exercised its option to convert the PIK Note to acquire a Conifex subsidiary, which holds a forest licence in British Columbia with an annual allowable cut of 200,000 m3. The redemption of the PIK Note resulted in a net gain on the sale of assets of approximately $29.0 million in the first quarter of 2016.

After giving effect to the discharge of the PIK Note, the Company held forest licences with annual allowable cut totaling 1,372,500 m3. For additional information with respect to our annual allowable cut, see "Subsequent Events" below. Our net debt to capitalization ratio improved to 49% at March 31, 2016 from 60% at December 31, 2015. The net debt to capitalization ratio, excluding non-recourse borrowings by Conifex Power Limited Partnership, improved to 28% at March 31, 2016 from 42% at December 31, 2015.

SUMMARY OF OPERATING RESULTS

Selected Financial Information

(millions of dollars except share and per share amounts and exchange rate information, unaudited)	Q1 2016	Q4 2015	Q1 2015
Sales by Segment			
Lumber	91.8	92.7	85.3
Bioenergy	7.7	7.8	-
	99.5	100.5	85.3
Operating Earnings (Loss) by Segment			
Lumber	1.2	0.5	2.0
Bioenergy	2.6	2.4	-
Corporate and other unallocated items	(0.8)	(1.3)	(0.9)
	3.0	1.6	1.1
Adjusted EBITDA by Segment			
Lumber	4.5	4.1	4.7
Bioenergy	4.2	4.1	-
Corporate and other unallocated items	(1.8)	(0.9)	1.0
	6.8	7.3	5.7
Net income (loss)	28.5	(0.3)	1.6
Net income (loss) per share - basic	1.35	(0.01)	0.08
Net income (loss) per share - diluted (1)	1.24	(0.01)	0.08
Shares outstanding - weighted average (millions)	21.1	21.1	21.0
Average exchange rate - US$/Cdn$ (2)	0.727	0.749	0.806
Reconciliation of adjusted EBITDA to Net Income (Loss)			
Net income (loss)	28.5	(0.3)	1.6
Add: Finance costs	2.5	2.6	1.3
Amortization	4.8	5.0	2.8
EBITDA (3)	35.8	7.3	5.7
Less: Gain on sale of asset	(29.0)	-	-
Adjusted EBITDA (4)	6.8	7.3	5.7

(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, and gains or losses from asset sales or disposals.

Revenues totalling $99.5 million in the first quarter of 2016 were generally consistent with the previous quarter and an improvement of 17% over the same quarter last year. The revenue growth over the first quarter of 2015 was attributable to an 8% increase in lumber segment revenues and the contribution from electricity sales which commenced in May 2015.

Operating income improved to $3.0 million compared to $1.6 million in the previous quarter and $1.1 million in the same quarter last year. The bioenergy segment contributed operating earnings of $2.6 million in the current quarter and $2.4 million in the previous quarter.

We reported a net gain on the sale of assets of $29.0 million resulting from the redemption of the PIK Note in the first quarter of 2016. Net income for the first quarter of 2016 was $28.5 million, or $1.35 per basic and $1.24 per diluted share, compared to net loss of $0.3 million or $0.01 per share in the previous quarter and net income of $1.6 million or $0.08 per basic and diluted share in the first quarter of 2015. Net earnings were impacted by a foreign exchange translation loss of $1.1 million in the first quarter of 2016 and foreign exchange translation gains of $0.4 million in the previous quarter and $1.9 million in the first quarter of 2015. Excluding the net gain on the sale of assets and foreign exchange translation gains and loss, net income improved by $1.3 million over the previous quarter and by $0.9 million over the first quarter of 2015.

The current quarter increase of finance costs of $1.2 million and depreciation and amortization expense of $2.0 million over the first quarter of 2015 is primarily attributable to the commencement of operations of the Mackenzie power generation plant.

Adjusted EBITDA was $6.8 million in the first quarter of 2016 compared to $7.3 million in the fourth quarter of 2015 and $5.7 million in the first quarter of 2015. Current quarter adjusted EBITDA included a foreign exchange translation loss of $1.1 million compared to foreign exchange translation gains of $0.4 million and $1.9 million in the prior and comparative quarters. In the current quarter, adjusted EBITDA benefited from slightly improved lumber segment results and lower corporate costs compared to the prior quarter and the contribution of bioenergy segment adjusted EBITDA of $4.2 million compared to the first quarter of 2015.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, other than statistical and exchange rate information and lumber prices, unaudited)	**Q1 2016**	**Q4 2015**	**Q1 2015**
Sales -Lumber - Conifex produced	57.0	58.9	53.8
- Lumber - wholesale	25.1	23.9	22.1
- By-products	6.5	6.8	6.4
- Logistics services	3.2	3.1	3.0
Total Sales	91.8	92.7	85.3
Adjusted EBITDA	4.5	4.1	4.7
Amortization and other	3.3	3.6	2.7
Operating income	1.2	0.5	2.0
Statistics (in millions, other than exchange rate and lumber prices)			
Lumber production (MMfbm)	135.8	131.1	119.4
Lumber shipments - Conifex product (MMfbm)	127.0	139.4	112.8
Lumber shipments - Wholesale (MMfbm)	40.7	38.6	34.8
Average exchange rate - US$/Cdn$ (1)	0.727	0.749	0.806
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$272	$262	$309
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (3)	$373	$350	$384
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$245-$303	$240-$274	$276-$340

(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 1.13 million units over the first quarter of 2016, a level which was consistent with the previous quarter and represented an increase of approximately 16% over the first quarter of 2015. Single-family housing starts accounted for 70% of total first quarter 2016 U.S. housing starts and marked an increase in units of 5% over the previous quarter and 23% over the first quarter of 2015. Lumber consumption per unit in single-family housing starts is generally considered to be two to three times greater than in multi-family units.

Housing starts in the U.S. remain a key indicator of North American lumber prices, although growth in demand from export markets, most notably China, has played an increasingly important role in influencing domestic prices over the last several years. Prices for the bell-weather WSPF #2 & Btr product averaged $272 during the first quarter of 2016, an improvement of 4% over the previous quarter and a decline of 12% from the first quarter of 2015.[1] Industry analysts have cited declining exports to China, the weaker Canadian dollar, and increased production due to a number of mill restarts as key factors for the lower U.S. dollar benchmark prices during the last six months compared to the first quarter of 2015.

The U.S. dollar strengthened against the Canadian dollar during the first quarter of 2016 and averaged US$0.727, an appreciation of 3% over the previous quarter and 10% over the same quarter last year.[2] Canadian dollar-denominated benchmark lumber prices averaged $373 in the first quarter of 2016, $350 in the previous quarter and $384 in the first quarter of 2015.

The U.S. and China remained our principal markets and accounted for approximately 76% of total lumber shipments in each of the comparative quarters while shipments to Japan remained steady at approximately 8%. Shipments to other offshore markets expanded to 7% of total volumes during the current and previous quarters compared to 2% in the same quarter last year. The balance of lumber shipments were directed to the Canadian market.

Revenue from Conifex produced lumber was $57.0 million in the first quarter of 2016. The decline of 3% from the previous quarter was attributable to 9% lower shipment volumes which were somewhat offset by a 6% improvement in sales realizations. The higher sales realizations reflected stronger benchmark lumber prices and the benefit of a weaker Canadian dollar. The growth in revenue of 6% over the first quarter of 2015 was largely due to an increase of 13% in shipment volumes partially offset by a 6% decline in sales realizations. The lower sales realizations in the current quarter were due primarily to the decline in benchmark prices and wider discounts on low grade products somewhat offset by a weaker Canadian currency.

Wholesale lumber revenues were $25.1 million, an increase of 5% over the previous quarter and 14% over the same quarter last year. The growth over the prior quarter was primarily attributable to higher shipment volumes. The improvement over the same quarter last year was due to 17% higher shipment volumes somewhat offset by lower sales realizations due to variation in product mix.

Revenues from wood chips and other by-products and from provision of third party logistics services were generally consistent in each of the comparative quarters.

Lumber production totalled 136 million board feet during the first quarter of 2016 and represented an annualized operating rate of 103% (excluding production capacity attributed to the idled Mackenzie Site I sawmill) compared to 100% in the previous quarter and 91% in the same quarter last year. Hourly productivity improved by 6% over the previous quarter and 13% over the first quarter last year. The higher operating rates were mainly attributable to production efficiencies from capital upgrades completed in the second half of 2015, enhanced maintenance protocols and improved log quality.

The two main elements of our lumber manufacturing costs are log costs and conversion costs. Log costs typically account for the majority of the costs. Cash conversion costs exclude depreciation and amortization expense. Unit manufacturing costs were consistent in the first quarter of 2016 and the fourth quarter of 2015 and improved by 8% compared to the first quarter of 2015.

[1] As quoted in Random Lengths Publications Inc.

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

Unit log costs were consistent in the first quarter of 2016 and the previous quarter and 11% lower than the first quarter of last year. The year-over-year improvement was primarily due to a successful fall and winter logging season which resulted in lower unit delivery costs, largely due to improvements in our supply chain management systems.

High operating rates and production efficiencies permit us to lower our average cost by spreading fixed costs over more units. Unit cash conversion costs improved by 2% over the previous quarter as improved productivity more than offset higher energy, labour and maintenance costs. Unit cash conversion costs improved by 3% over the first quarter of 2015 as improved productivity offset generally higher operating costs.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were generally consistent in each of the comparative quarters.

The Softwood Lumber Agreement with the United States expired on October 12, 2015. The agreement provides for a one-year standstill after expiry that prevents the United States from initiating new trade actions against Canada with respect to the importation of softwood lumber. Canadian lumber is currently being shipped without a duty, tax or quota. The export tax rate on shipments to the U.S. was 15% for the first 12 days of the fourth quarter of 2015. There was no export tax on shipments to the U.S. in the first quarter of 2015 due to stronger average lumber prices as reflected by the Random Lengths Framing Lumber Composite Price.

We recorded a positive inventory valuation adjustment of $0.4 million in the first quarter of 2016 compared to a positive adjustment of $1.3 million in the previous quarter and negative adjustment of $0.7 million in the same quarter last year.

Our Mackenzie mill delivers feedstock to the Mackenzie power generation plant at a fixed price. Current quarter lumber segment operating results were hampered by costs related to the supply of incremental fuel from third parties due to the sustained performance of the plant at above target operating rates.

The lumber segment recorded operating income of $1.2 million in the first quarter of 2016 compared to $0.5 million in the previous quarter and $2.0 million in the first quarter of 2015. Compared to the previous quarter, current quarter lumber segment operating results benefited from higher sales realizations due to higher benchmark lumber prices, a slightly weaker Canadian dollar and modestly lower unit cash conversion costs, partially offset by lower shipments of Conifex produced lumber, a negative variance in inventory valuation, and extra costs related to the supply of incremental feedstock for the power plant. Compared to the first quarter of 2015, current quarter operating results benefited from higher lumber shipments, lower unit log costs and, to a lesser degree, improved unit cash conversion costs, partially offset by lower lumber sales realizations and higher feedstock costs for the power plant.

Lumber segment adjusted EBITDA was $4.5 million in the first quarter of 2016 compared to $4.1 million in the previous quarter and $4.7 million in the first quarter of 2015.

Bioenergy Segment

The Mackenzie power generation plant (the “Mackenzie Plant”) commenced commercial operations in May 2015. The ramp up and optimization of the boiler, turbine and related equipment continued throughout the balance of 2015. Despite some typical challenges related to operating a newly commissioned facility, including unplanned outages and the learning curve associated with operator familiarization of a new plant, average hourly electricity production achieved 103% of operating target during the eleven month period since commercial operations began.

Average hourly electricity production achieved 115% and 106% of operating target during the first quarter of 2016 and the previous quarter, respectively. As at March 31, 2016, the Mackenzie Plant has operated continuously since a four day major maintenance shutdown was taken in early November 2015. Despite the planned outage, there were several more operating days in the fourth quarter of 2015 than in the current quarter. The Mackenzie Plant sold approximately 55 gigawatt hours of electricity under our 20-year Electricity Purchase Agreement ("EPA") with BC Hydro in the first quarter of 2016 and in the fourth quarter of 2015.

Although electricity revenues under the EPA are based upon a fixed base price per megawatt hour, the application of a "time of delivery" factor to the unit price adds a seasonal effect to quarterly revenues. We expect the seasonal effect will produce variances in revenues of up to 30% between the strongest and weakest quarters. The effective power rate is highest during the first and fourth quarters of each year and lowest in the second quarter. As a major portion of the costs of production, as well as depreciation and interest expense, are fixed, quarterly operating results in the bioenergy segment are expected to reflect the fluctuation in revenues.

Segment operating results were similar to the prior quarter. In the first quarter of 2016, revenues from electricity sales were $7.7 million, while operating costs, including depreciation expense of $1.6 million, were $5.1 million and resulted in bioenergy segment operating income of $2.6 million. In the previous quarter, revenues were $7.8 million, while operating costs, including depreciation expense of $1.7 million, were $5.4 million and resulted in bioenergy segment operating income of $2.4 million. Interest on the power project term loan was approximately $1.3 million for each quarter resulting in bioenergy segment adjusted EBITDA of $4.2 million in the current quarter and $4.1 million in the previous quarter. Adjusted EBITDA margin, defined as adjusted EBITDA as a percentage of sales, was approximately 54%.

Operating costs were higher than budgeted due primarily to costs related to outside service contractors, recruitment and training of additional personnel as we transition from third party service providers, enhanced workplace safety standards and additional regulatory work. Some of these extra costs are non-recurring and we continue to focus on normalizing costs.

The EPA with BC Hydro provides for a one-time option to increase our electricity deliveries by 10% for the duration of the contract term. Subsequent to the current quarter end, in April 2016, we notified BC Hydro that we would be exercising the option with increased deliveries to commence in May 2016.

The EPA 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. The "turn down" most commonly occurs during the spring freshet when the abundance of water in rivers and reservoirs makes less expensive electricity available from other sources. In April 2016, BC Hydro issued a dispatch order to, among others, our power plant advising us of a dispatch period of 61 days from May 1, 2016 to June 30, 2016. During the dispatch period, we will only produce electricity to fulfill volume commitments under the Load Displacement Agreement. We will continue to be paid revenues based upon a reduced rate and on volumes that are generally reflective of recent average hourly megawatt production. As the reduced rate is intended to compensate for a large portion, but not all, of our fixed costs, we expect operating results to be somewhat lower than projected in the second quarter of 2016. The application of a time of delivery factor generally produces the lowest quarterly revenues of the year in the second quarter. We are working on modifying our operating plan to regain some of the revenue shortfall over the second half of 2016.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $0.8 million in the first quarter of 2016, $1.3 million in the previous quarter and $0.9 million in the first quarter of 2015.

Finance Costs

Finance costs are comprised of interest expense and amortization of costs related to debt issuance and accretion of convertible notes and senior secured notes. Finance costs totalled $2.5 million in the first quarter of 2016, $2.6 million in the previous quarter and $1.3 million in the first quarter of 2015. The increase during the last six months compared to the first quarter of 2015 is primarily attributable to the addition of interest expense on the power project term loan of approximately $1.3 million per quarter. We ceased capitalizing interest on the power project term loan in May 2015.

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. Gain 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 $0.1 million in the first quarter of 2016 and $0.3 million in the previous quarter, and a loss of $0.1 million in the first quarter of 2015.

The term loan provided under the power project financing consists of a floating rate tranche and a fixed rate tranche. Conifex Power Limited Partnership has 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. A loss of $0.3 million on the interest rate swap instruments was recorded as interest expense in the first quarter of 2016 and in the fourth quarter of 2015 and a loss of $0.3 million was recorded as capital costs during the first quarter of 2015.

Foreign Exchange Translation Gain

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 mortgage 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 rate of exchange prevailing at the reporting date. 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$0.770 at March 31, 2016, US$0.722 at December 31, 2015 and US$0.789 at March 31, 2015.[3] The foreign exchange translation loss was $1.1 million in the first quarter of 2016 compared to foreign exchange translation gains of $0.4 million in the previous quarter and $1.9 million in the first quarter of 2015.

Income tax

At December 31, 2015, the Company had unused non-capital tax losses carried forward totalling $32.1 million and unrecognized deferred tax assets totalling $13.6 million. As previously noted, the redemption of the PIK Note resulted in a gain on the sale of assets of approximately $29.0 million in the first quarter of 2016. As a result of a tax election which was filed in 2015 to increase the tax basis of the asset, no current income tax should arise on the PIK Note redemption in 2016. The tax effects of the transaction are fully reflected in the tax balances at December 31, 2015.

Although the Company expects to realize the full benefit of the loss carry forwards and unrecognized deferred tax assets, 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 summarizes the Company's financial position as at the end of each of the comparative quarters:

(millions of dollars, unaudited)	Q1 2016	Q4 2015	Q1 2015
Cash	7.4	9.9	10.1
Cash - restricted	10.4	8.5	2.0
Operating working capital	59.7	51.9	46.5
Operating loans	(23.8)	(18.3)	(18.6)
Current portion of convertible notes	(11.8)	(11.8)	-
Current portion of mortgage	(11.2)	(12.0)	-
Current portion of long-term debt	(4.0)	(4.3)	(7.0)
Net current assets	26.7	23.9	33.0
Long-term assets related to power project	122.7	124.2	132.1
Long-term assets - lumber segment and corporate	106.0	109.2	85.1
	255.4	257.3	250.2
Non-interest bearing long-term liabilities	22.3	20.7	13.7
Long-term debt - power project construction loan	73.5	75.8	73.0
Payment-in-kind notes (1)	-	30.0	-
Long-term debt - other	24.6	24.4	39.4
Shareholders' equity	135.0	106.4	124.1
	255.4	257.3	250.2
Ratio of current assets to current liabilities	1.3	1.3	1.5
Net debt to capitalization	49%	60%	50%
Net debt to capitalization (2)	28%	42%	28%

(1) The PIK Note was redeemed in February 2016.
(2) Excluding borrowings by Conifex Power Limited Partnership, which are non-recourse to our other operations.

The ratio of current assets to current liabilities at March 31, 2016 and December 31, 2015 was 1.3:1 compared to 1.5:1 at March 31, 2014. The ratio was positively impacted by higher cash and working capital balances and negatively impacted by increased borrowings on the operating loans, the addition of the mortgage in connection with the El Dorado property, and the reclassification of the convertible notes from long-term debt to current.

We manage capital with the objective to maintain a strong balance sheet that ensures 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, the mortgage, and PIK Note, less cash. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

Net debt at March 31, 2016 of $131.2 million was $27.0 million lower than at December 31, 2015 due primarily to the redemption of the PIK Note. The net debt to capitalization ratio improved to 49% from 60% at the end of the previous quarter.

Excluding the effects of borrowings by Conifex Power Limited Partnership, net debt was $52.5 million and the net debt to capitalization ratio was 28% compared to $76.8 million and 42%, respectively, at December 31, 2015. We expect further improvement in the net debt to capitalization ratio in the second quarter of 2016 as the proceeds from a timber harvesting cooperation agreement were used to repay a portion of the senior secured notes and operating loans (see Subsequent Event below).

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	**Q1 2016**	**Q4 2015**	**Q1 2015**
Cash generated from (used in)			
Operating activities	0.7	4.0	(2.5)
Financing activities	(0.3)	(2.0)	10.8
Investing activities	(1.1)	2.6	(8.1)
Increase (decrease) in cash	(0.7)	4.6	0.2

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

Working capital levels fluctuate throughout 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 the payment of payables 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 $8.6 million and consumed cash of $7.9 million in incremental working capital in the first quarter of 2016. The change in non-cash working capital included an increase in log inventories of $7.0 million, an increase in lumber inventories of $3.2 million and an increase in accounts payable of $2.7 million. The increase in log inventories was due to the seasonal build-up of logs in anticipation of curtailed log deliveries during the spring months.

We generated cash from operations before working capital changes of $7.4 million and used cash of $3.4 million in incremental working capital in the fourth quarter of 2015. The change in non-cash working capital was largely comprised of increases in accounts receivables and prepaid expenses of $4.9 million, in accounts payable of $4.2 million, and a reduction in inventories of $6.6 million due to lower log inventories and higher than typical lumber shipments.

We generated cash from operations before working capital changes of $7.3 million and used cash of $9.8 million in incremental working capital in the first quarter of 2015. Increases in log inventories and lumber inventories of $8.6 million and $4.3 million, respectively, were partially offset by a reduction of $4.0 million in accounts receivable and prepaid expense balances.

Financing Activities
Financing activities consumed net cash of $0.3 million in the first quarter of 2016 and were primarily comprised of net proceeds from operating loans of $5.4 million, debt repayments of $2.9 million, and the payment of finance expenses of $3.0 million.

Financing activities consumed net cash of $2.1 million in the fourth quarter of 2015 and included net proceeds from operating loans of $1.5 million, debt repayments of $2.2 million and payment of finance expenses of $1.4 million.

Financing activities provided net cash of $10.8 million in the first quarter of 2015 and included net proceeds from operating loans of $6.9 million and from our construction loan of $5.8 million, debt repayments of $0.5 million and the payment of finance expenses of $1.4 million.

Investing Activities
Investing activities consumed cash of $1.0 million in the first quarter of 2016 and consisted of $0.5 million on capital improvements in the lumber segment, $0.2 million related to the power generation plant and $0.3 million in pre-development costs related to the El Dorado assets.

Investing activities provided cash of $2.6 million in the fourth quarter of 2016 and were comprised of expenditures of $2.4 million in the lumber segment and $0.5 million related to the Mackenzie Plant, offset by receipt of interim insurance proceeds of $5.5 million.

Investing activities during the first quarter of 2015 totalled $8.1 million and were comprised of $2.6 million of lumber segment capital expenditures and $5.5 million of expenditures related to the power generation project. Lumber segment capital expenditures were concentrated on the installation of extensive dust mitigation equipment at the Fort St. James and Mackenzie Site II sawmills.

Liquidity

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

Total liquidity comprises unrestricted cash and available credit under our revolving credit facilities. At March 31, 2016, we had total liquidity of $18.7 million, compared to $22.6 million at December 31, 2015 and $20.0 million at March 31, 2015. Liquidity at March 31, 2016 was comprised of unrestricted cash of $7.4 million and unused availability under our revolving working capital facilities of $11.3 million. Our investment in operating working capital was at a seasonal peak at the end of March 31, 2016 due to the build in log inventories. Liquidity is expected to improve considerably in the second quarter of 2016 as log inventories are drawn to seasonal lows. The receipt of proceeds of $20.0 million from the completion of the timber harvesting cooperation agreement in April 2016, which was applied to repay $5.7 million of senior secured notes and our revolving credit facility, also provides additional liquidity (see Subsequent Event below).

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 2016.

In the future, we may make acquisitions of businesses or assets or commitments to additional capital projects. To achieve any such long-term goals of expanding our assets and earnings, including through acquisitions, 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 March 31, 2016 were comprised of standby letters of credit totalling $18.75 million posted by 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)	2016 Q1	2015 Q4	2015 Q3	2015 Q2	2015 Q1	2014 Q4	2014 Q3	2014 Q2
Sales - lumber segment	91.8	92.7	80.0	79.2	85.3	95.2	90.9	99.6
Sales - electricity	7.7	7.8	5.9	2.6	-	-	-	-
Operating income (loss)	3.0	1.6	(4.5)	(9.8)	1.1	0.6	1.5	4.4
Net income (loss)	28.5	(0.3)	(5.6)	(13.0)	1.6	-	1.1	2.0
Net income (loss) per share - basic	1.35	(0.01)	(0.26)	(0.62)	0.08	-	0.05	0.10
Net income (loss) per share - diluted (1)	1.24	(0.01)	(0.26)	(0.62)	0.08	-	0.05	0.10
Adjusted EBITDA (2)	6.8	7.3	1.5	(6.8)	5.7	4.1	5.3	6.2
Shares outstanding - weighted average (millions)	21.1	21.1	21.1	21.0	21.0	20.9	20.9	20.9
Statistics (in millions, other than exchange rate and lumber prices)								
Lumber production (MMfbm)	135.8	131.1	112.3	118.1	119.4	116.9	125.6	134.9
Lumber shipments - Conifex produced (MMfbm)	127.0	139.4	107.6	116.0	112.8	134.0	130.4	146.4
Lumber shipments - wholesale (MMfbm)	40.7	38.6	42.6	39.7	34.8	40.4	41.9	43.3
Electricity production - GWh	54.9	54.5	46.2	24.3	-	-	-	-
Average exchange rate - US$/Cdn$ (3)	0.727	0.749	0.764	0.813	0.806	0.881	0.918	0.917
Average WSPF 2x4 #2&Btr lumber price (US$) (4)	$272	$262	$271	$269	$309	$340	$357	$336
Average WSPF 2x4 #2&Btr lumber price (Cdn$)(5)	$373	$350	$355	$331	$384	$386	$389	$366
Reconciliation of Adjusted EBITDA to Net Income (Loss)								
Net income (loss)	28.5	(0.3)	(5.6)	(13.0)	1.6	-	1.1	2.0
Add: Finance costs	2.5	2.6	2.6	2.1	1.3	1.4	1.4	1.5
Amortization	4.8	5.0	4.5	4.1	2.8	2.7	2.8	2.7
EBITDA (6)	35.8	7.3	1.5	(6.8)	5.7	4.1	5.3	6.2
Less: Gain on sale of asset	(29.0)	-	-	-	-	-	-	-
Adjusted EBITDA	6.8	7.3	1.5	(6.8)	5.7	4.1	5.3	6.2

(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, and depreciation and amortization, and gains or losses from sales or disposals of assets.
(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 factors, including fluctuations in lumber prices and prices of certain commodities related to by-product revenue and manufacturing inputs, changes in the export tax rate, 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 higher, during the fourth quarter of each year due to planned curtailments related to seasonal holidays.

OUTLOOK AND STRATEGIC CAPITAL EXPENDITURES

Lumber Market Outlook

We currently expect the U.S. market to continue its gradual recovery in both the housing and repair and remodelling sectors in 2016. We agree with forecasts calling for an approximate 6% increase in North American lumber consumption, and expect Canadian dollar denominated benchmark prices will average at least 5% higher than in 2015. The extent to which the anticipated increase in U.S. housing demand translates into higher selling prices will be influenced by potential increased supply from higher shipment volumes from Canadian and other suppliers into the U.S. market. The uncertainty related to the recent expiry of the Softwood Lumber Agreement may increase market volatility.

Although Chinese demand for lumber is forecast to decline in 2016, we currently expect our sales volume to China will remain similar to first quarter 2016 levels and anticipate a slight improvement in pricing in the second quarter. We expect steady demand but limited growth in the Japanese lumber market through the balance of the year.

Strategic Capital Expenditures

In the short-term, we expect modest capital expenditure outlays on maintenance of business types of projects for our lumber and bioenergy segments as well as a number of small high return projects in our lumber segment in 2016. Beyond the short-term, we are evaluating a number of larger scale capital projects including consideration of certain capital expenditures to modify and strengthen our fibre procurement operations at Mackenzie, partly to provide additional affordable feedstock for the Mackenzie Plant.

SUBSEQUENT EVENT

Completion of Coordinated Harvesting Cooperation Agreement

On April 12, 2016, we announced the completion of a timber harvesting cooperation agreement with a regional lumber manufacturer to conduct coordinated joint timber harvesting operations on certain portions of Conifex's harvesting areas in the Mackenzie Timber Supply Area. Conifex believes that the coordinated harvesting operations will enhance fibre optimization between the two companies, improve supply chain efficiencies, and contribute to more stable harvest levels in the Mackenzie Timber Supply Area. Conifex also believes that this innovative arrangement with the harvesting partner can provide additional volumes of affordable feedstock to its power generation unit at Mackenzie through increased utilization of lower quality wood and harvest residuals.

Pursuant to the agreement, the harvesting partner paid Conifex $20 million to acquire half of the shares of a Conifex subsidiary which holds a forest licence having a 300,000 cubic metre annual harvest of timber.

Conifex used the net proceeds from the transaction to repay $5.7 million of the senior secured notes and repay advances on our operating loans. We expect the improved liquidity will further support working capital requirements and fund high-return capital projects at our BC harvesting and manufacturing operations.

CRITICAL ACCOUNTING ESTIMATES

There were no significant changes to the Company's critical accounting estimates during the quarter ended March 31, 2016. Conifex's critical accounting estimates are described in its MD&A for the year ended December 31, 2015, filed under the Company's profile on SEDAR at www.sedar.com.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors is included in the Company's annual information form dated March 29, 2016, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

OUTSTANDING SECURITIES

As at May 3, 2016, the Company had the following outstanding securities: (i) 21,142,347 common shares; (ii) 100,000 options; (iii) 1,347,058 long-term incentive plan awards; (iv) 1,060,000 warrants; and (v) subordinated convertible promissory notes in the aggregate principal amount of $12 million, which notes are convertible into a maximum of 1,929,260 common shares of the Company.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended March 31, 2016, there were no changes in the Company's internal controls over financing 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.