CONIFEX

CONIFEX TIMBER INC.
SECOND QUARTER 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 9, 2018

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, 2018 relative to the quarters ended March 31, 2018 and June 30, 2017. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the quarters ended June 30, 2018 and 2017, as well as the 2017 annual MD&A and the December 31, 2017 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." EBITDA represents earnings before finance costs, taxes, and depreciation and amortization. The Company discloses EBITDA as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, EBITDA is not a substitute 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 United States dollar.

FORWARD-LOOKING STATEMENTS

This interim MD&A contains certain forward-looking information that reflects our current views and/or expectations 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 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 products, such as anti-dumping duties or countervailing duties on softwood lumber; our expectations for U.S. dollar benchmark prices; potential acquisition of businesses or assets or commitments to additional capital projects; 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 Power Plant power production; our use of proceeds of financing operations; our expectations about discussions with United Steelworkers concerning renewal of the collective labour agreement; our expectations about the IFRS amendments; and the anticipated benefits, cost and timing of operations of our El Dorado Mill.

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 our 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 5, 2018 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

Commencement of Commercial Operations at El Dorado Mill

We commenced shipment of residual products from our recently commissioned sawmill complex in El Dorado, Arkansas (the "El Dorado Mill") in November 2017, and commenced modest lumber shipments in late December. We offset revenues generated from the El Dorado Mill in the fourth quarter of 2017 and the first quarter of 2018 to capitalized commissioning and start-up costs and have not included such revenues in operating results.

Commercial operations at the El Dorado Mill have been recorded in our operating results from April 2018. The El Dorado Mill produced Southern Yellow Pine ("SYP") lumber at an annual run rate of 100 million board feet in the second quarter of 2018, equivalent to approximately 56% of two-shift capacity of 180 million board feet. As a result, the El Dorado Mill began making modest contributions to operating income and EBITDA in the second quarter of 2018.

SUMMARY OF OPERATING RESULTS

Selected Financial Information

(millions of dollars except share and per share amounts and exchange rate information, unaudited)	Q2 2018	Q1 2018	YTD 2018	Q2 2017	YTD 2017
Sales by Segment					
Lumber	195.2	123.3	318.5	111.7	205.2
Bioenergy	5.1	7.5	12.6	4.7	11.6
	200.3	130.8	331.1	116.4	216.8
Operating Earnings by Segment					
Lumber	16.1	6.7	22.9	7.1	8.9
Bioenergy	1.4	2.0	3.4	0.9	2.2
Corporate and other unallocated items	(1.5)	(1.7)	(3.3)	(1.6)	(3.2)
	16.0	7.0	23.0	6.4	7.9
EBITDA by Segment					
Lumber	19.3	7.3	26.5	10.8	15.9
Bioenergy	2.4	3.6	6.0	1.8	4.6
Corporate and other unallocated items	(0.9)	(1.6)	(2.4)	(2.4)	(4.2)
	20.8	9.3	30.1	10.2	16.3
Net income	9.2	2.5	11.7	4.2	2.8
Net income per share - basic and diluted	0.35	0.10	0.44	0.16	0.12
Shares outstanding - weighted average (millions)	26.5	26.4	26.5	26.3	24.4
Average exchange rate - US$/Cdn$ (1)	0.775	0.791	0.783	0.744	0.750
Reconciliation of EBITDA to Net Income					
Net income	9.2	2.5	11.7	4.2	2.8
Add: Finance costs	2.6	1.6	4.2	1.7	4.3
Amortization	5.5	4.5	10.0	4.3	9.2
Deferred income tax expense	3.5	0.7	4.2	-	-
EBITDA (2)	20.8	9.3	30.1	10.2	16.3

(1) Source: Bank of Canada, www.bankofcanada.ca.
(2) The Company's EBITDA calculation represents earnings before finance costs, taxes, and depreciation and amortization.

Our revenues totaled $200.3 million in the second quarter of 2018, an improvement of 53% over the prior quarter and 72% over the same quarter last year. Our revenue growth over the comparative quarters was mainly attributable to an increase in our lumber segment revenues. The commencement of commercial operations in April 2018 at our El Dorado Mill contributed approximately 8% of total revenues and modest operating income and EBITDA to current quarter results.

Second quarter lumber segment operating earnings of $16.1 million represented increases of 140% over the previous quarter and 126% over the second quarter of 2017. Lumber segment operating results included countervailing ("CV") and anti-dumping ("AD") duties expense of $8.2 million in the second quarter of 2018, $6.3 million in the first quarter of 2018 and $4.6 million in the second quarter of 2017. The bioenergy segment contributed operating earnings of $1.4 million in the current quarter compared to $2.0 million in the previous quarter and $0.9 million in the same quarter last year. Corporate costs of $1.5 million were generally consistent with each of the comparative quarters. Operating earnings were $23.0 million for the first six months of 2018 compared to $7.9 million for the first six months of 2017.

Net income for the second quarter of 2018 was $9.2 million, or $0.35 per share, compared to net income of $2.5 million or $0.10 per share in the previous quarter and $4.2 million or $0.16 per share in the second quarter of 2017. Year to date net income was $11.7 million, or $0.44 per share compared to $2.8 million or $0.12 per share for the same period last year. Net income for the first half of 2018 included realized and unrealized losses on derivative financial instruments of $3.7 million and deferred income tax expense of $4.2 million compared to a gain on derivative financial instruments of $0.3 million and no income tax expense for the first six months of 2017. The losses from lumber futures contracts were generally attributable to the steady rise of commodity lumber prices throughout the first five months of 2018 and the fourth quarter of 2017.

EBITDA was $20.8 million in the second quarter of 2018 compared to $9.3 million in the first quarter of 2018 and $14.8 million in the second quarter of 2017. Compared to the previous quarter, lumber segment EBITDA improved by $12.0 million and bioenergy segment EBITDA declined by $1.2 million. Compared to the second quarter of 2017, lumber segment EBITDA improved by $3.9 million and bioenergy segment EBITDA by $0.6 million. EBITDA was $30.1 million for the six month period ended June 30, 2018 compared to $16.3 million for the six month period ended June 30, 2017.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, other than statistical and exchange rate information and lumber prices, unaudited)	Q2 2018	Q1 2018	YTD 2018	Q2 2017	YTD 2017
Sales -Lumber - Conifex produced	106.0	70.2	176.2	70.8	127.5
- Lumber - wholesale	72.2	42.1	114.3	28.6	56.9
- By-products	11.2	6.3	17.5	7.2	12.7
- Logistics services	5.8	4.7	10.5	5.1	8.1
Total Sales	195.2	123.3	318.5	111.7	205.2
EBITDA	19.3	7.3	26.5	10.8	15.9
Amortization	4.5	2.9	7.3	3.4	6.7
Gain (loss) on derivative financial instruments	(1.3)	(2.3)	(3.7)	0.3	0.3
Operating income	16.1	6.7	22.9	7.1	8.9
Statistics (in millions, other than exchange rate and lumber prices)					
Production - WSPF lumber (MMfbm)	132.4	123.7	256.1	131.6	255.2
Production - SYP lumber (MMfbm)	25.0	-	25.0	-	-
Shipments - WSPF lumber (MMfbm)	133.8	112.7	246.5	128.5	239.2
Shipments - SYP lumber (MMfbm)	23.8	-	23.8	-	-
Shipments - wholesale lumber (MMfbm)	86.2	55.1	141.3	38.4	79.4
Average exchange rate - US$/Cdn$ (1)	0.775	0.791	0.783	0.744	0.750
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$598	$513	$556	$388	$368
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (3)	$772	$649	$711	$522	$491
Average SYP 2x4 #2 lumber price (US$) (4)	$574	$540	$557	$455	$456
Average SYP 2x4 #2 lumber price (Cdn$) (3)	$741	$683	$712	$612	$608

(1) Source: Bank of Canada, www.bankofcanada.ca
(2) Source: Random Lengths Publications Inc. - Western Spruce / Pine / Fir, per thousand board feet.
(3) Average SPF 2x4 #2&Btr and SYP 2x4 #2 lumber prices (US$) divided by average exchange rate.
(4) Source: Random Lengths Publications Inc. - Southern Yellow Pine Westside, per thousand board feet.

The U.S. Census Bureau reported privately-owned housing starts averaged a seasonally adjusted annualized rate of approximately 1.26 million units over the second quarter of 2018, a level which was 8% higher than the same quarter last year and approximately 4% lower than the first quarter of 2018. Single-family housing starts accounted for 71% of total second quarter 2018 U.S. housing starts, a level generally comparable to the previous quarter and an increase in units of 9% over the second quarter of 2017. 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$598 during the second quarter of 2018, an improvement of 17% over the previous quarter and 54% over the second quarter of 2017.[1] Several industry analysts have attributed the continued strength in the U.S. dollar benchmark price to steady demand in the U.S. market, shipment constraints due to transportation challenges in the first quarter of 2018 and imposition of CV and AD duties on U.S. destined shipments. Average benchmark prices for SYP remained elevated by historical standards and averaged US$574 during the second quarter of 2018, an improvement of 26% over the second quarter of 2017[2].

The U.S. dollar averaged US$0.775 for each Canadian dollar during the second quarter of 2018, which represented a weakening of the Canadian dollar of 2% compared to the previous quarter and strengthening of 4% compared to the same quarter last year.[3] Canadian dollar-denominated benchmark WSPF prices, which averaged $772 in the second quarter of 2018, improved by 19% or $123 over the previous quarter and 40% or $250 over the second quarter of 2017.

The U.S. and China remained our principal markets and accounted for over 70% of total lumber shipments in each of the comparative quarters while shipments to Japan remained steady at approximately 7%. Shipments to other offshore markets averaged 5% of our total volumes in the comparative quarters. The balance of our lumber shipments were directed to the domestic Canadian market.

Revenues from Conifex produced lumber were $106.0 million in the second quarter of 2018 and represented an increase of 51% over the previous quarter. The addition of sales from our El Dorado Mill contributed to approximately 21% of the increase with the balance mainly attributable to a 19% increase in shipment volumes and 10% improvement in unit sales realizations from our B.C. mills. Lumber shipments, which were hampered by 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 50% over the second quarter of 2017 was largely due to improvements in sales realizations of 23% and shipment volumes of 4% from our B.C. mills and the addition of revenues from the El Dorado Mill.

Wholesale lumber revenues, which represented 37% of total lumber segment revenues in the second quarter of 2018, increased by 71% from the previous quarter and 152% from the second quarter of 2017. Approximately 80% of the revenue growth was attributable to higher shipment volumes with the balance due to improved sales realizations.

Increases in revenues from wood chips and other residuals of 78% over the previous quarter and 56% over the second quarter of 2017 were largely due to the addition of shipments from our El Dorado Mill and increased shipments and improved pricing from our B.C. mills.

The increase in revenues from provision of third party logistics services of 23% over the previous quarter and 14% over the same quarter last year was generally attributable to revitalized seasonal demand in certain sectors.

[1] As quoted in Random Lengths Publications Inc.

[2] As quoted in Random Lengths Publications Inc.

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

Lumber production at our B.C. mills totalled approximately 132 million board feet during the second quarters of 2018 and 2017 and represented annualized operating rates of 98% compared to 92% in the previous quarter. Productivity in the first quarter of 2018 was hampered by winter conditions at our B.C. mills. Our El Dorado Mill produced approximately 25 million board feet of lumber which represented an annualized operating rate of 56% based on two-shift production capacity of 180 million board feet.

Unit log costs increased by 1% over the previous quarter and 15% over the same quarter last year at our B.C. mills. The higher log costs were mainly attributable to higher market based stumpage and purchased log costs.

An improvement of 10% in unit cash conversion costs over the previous quarter at our B. C. mills was mainly attributable to higher operating rates and lower energy and weather related maintenance costs. Overall unit cash conversion costs in the second quarter of 2018 were adversely impacted by the lower operating rate and elevated unit costs at the El Dorado Mill, where reliability and productivity improvements remain our focus. Commercial operations at our El Dorado Mill have been recorded in our operating results commencing April 2018, prior to which revenues generated at the mill were offset to capitalized commissioning and start-up costs.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were 9% higher than the previous quarter due to the weaker Canadian currency and increased costs of expediting shipments during the recent period of transportation challenges.

We expensed CV and AD duty deposits of $8.2 million, or $52 per thousand board feet, in the second quarter of 2018 compared to $6.3 million, or $56 per thousand board feet, in the previous quarter. CV duty deposits of $4.6 million were expensed in the second quarter of 2017.

We recorded realized and unrealized losses on lumber futures contracts of $1.3 million in the second quarter of 2018 and $2.3 million in the first quarter of 2018 and gains of $0.3 million in the second quarter of 2017.

The lumber segment recorded operating income of $16.1 million in the second quarter of 2018 compared to $6.7 million in the previous quarter and $7.1 million in the second quarter of 2017. Compared to the previous quarter, lumber segment operating results benefited from increased shipment volumes, improved sales realizations from higher benchmark lumber prices and a weaker Canadian currency, and growth in revenues from residuals, and were impeded by higher CV and AD duty deposits expense and higher overall unit manufacturing costs due to relatively low operating rates at the El Dorado Mill. Compared to the second quarter of 2017, improvements in gross sales realizations, shipment volumes and revenues from residuals were somewhat offset by higher softwood lumber duties expense and higher unit log and cash conversion costs.

Lumber segment EBITDA was $19.3 million in the second quarter of 2018 compared to $7.3 million in the previous quarter and $10.8 million in the second quarter of 2017. Lumber segment EBITDA was $26.5 million for the six months ended June 30, 2018 and $15.9 million for the six months ended June 30, 2017.

Bioenergy Segment

(millions of dollars, other than statistical information, unaudited)	Q2 2018	Q1 2018	YTD 2018	Q2 2017	YTD 2017
Electricity sales under EPA - GWh	51.5	50.5	102.0	51.0	97.3
Electricity revenues	5.1	7.5	12.6	4.7	11.6
EBITDA	2.4	3.6	6.0	1.8	4.6
Amortization	1.0	1.6	2.6	0.9	2.4
Operating income	1.4	2.0	3.4	0.9	2.2

Our Mackenzie power generation plant (the "Mackenzie Power Plant") sold 51.5 gigawatt hours of electricity under our Electricity Purchase Agreement with BC Hydro ("EPA") in the second quarter of 2018, which represented approximately 94% of targeted operating rates. Current quarter electricity revenues were 32% lower than the first quarter of 2018 due to lower seasonal rates coupled with slightly reduced rates during the dispatch period. Electricity revenues were 9% higher than the same quarter last year due primarily to a relatively shorter dispatch period during the current quarter.

Cash operating costs were generally consistent with the second quarter of 2017 and improved by 31% from the first quarter of 2018. The cost improvement was primarily due to elimination of variable costs during the dispatch period and higher weather related seasonal costs during the winter months. Amortization expense was lower compared to the previous quarter as idled components are not depreciated during the dispatch period.

Bioenergy segment EBITDA was $6.0 million for the first six months of 2018, an improvement of 30% over the same period last year.

Dispatch Notice

Our EPA with BC Hydro, similar to electricity purchase agreements with other independent power producers, provides BC Hydro with the option to "turn down" electricity purchased from us during periods of low demand by issuing a "dispatch order". In January 2018, BC Hydro issued a dispatch order with respect to, among others, the Mackenzie Power Plant advising of a dispatch period of 112 days, encompassing the mid-May to early September 2018 period. Last year, the Mackenzie Power Plant, among others, was dispatched for 122 days encompassing the months of April, June, July and August. 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.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $1.5 million in the second quarter of 2018, $1.7 million in the first quarter of 2018 and $1.6 million in the second quarter of 2017. Corporate costs of approximately $3.3 million were generally consistent for the first six months of 2018 and 2017.

Interest Expense and Finance Costs

Finance costs related to debt issuance are amortized over the remaining term of the respective credit facility. Borrowing costs attributable to the development of the El Dorado Mill were recorded as capital costs in 2017 and the first quarter of 2018.

Interest and finance costs totalled $2.6 million in the second quarter of 2018, $1.6 million in the previous quarter and $1.7 million in the second quarter of 2017. The increase in interest and finance costs over the previous quarter was primarily attributable to expensing borrowing costs related to the El Dorado development. Year to date interest and finance costs were $4.2 million for 2018 compared to $4.4 million for 2017.

Gain or Loss on Derivative Financial Instruments

We utilize derivative financial instruments to manage commodity lumber price exposure 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. Conifex does not presently use derivatives for trading or speculative purposes. Due to lumber market conditions characterized by steadily rising prices in the first five months of 2018, we recorded losses from lumber derivative instruments of $1.3 million in the second quarter of 2018 and $2.3 million in the previous quarter. We recorded gains from lumber derivative instruments of $0.3 million in the second quarter of 2017.

The term loan for our power business consists of a floating rate tranche and a fixed rate tranche. Our 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 approximately $0.2 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 on our statement of net income results from the revaluation of U.S. dollar-denominated working capital balances 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$0.775 at June 30, 2018, US$0.791 at March 31, 2018 and US$0.744 at June 30, 2017.[4] We recorded foreign exchange translation gains of $0.6 million in the second quarter of 2018 and $0.1 million in the first quarter of 2018. We recorded a foreign exchange translation loss of $0.8 million for the second quarter of 2017.

Foreign exchange differences for foreign operations with a functional currency that differs from the Company's presentation currency are recognized as Other Comprehensive Income (or Loss) and reflected in the statement of changes in equity. We recorded a gain of $1.0 million in the second quarter of 2018 related to foreign exchange differences for our El Dorado operations resulting from a weakening of the Canadian dollar relative to the U.S. dollar at the end of the quarter.

Income tax

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts used for income tax purposes. As at June 30, 2018, the Company recognized deferred income tax liabilities of $7.6 million and deferred income tax assets of $0.2 million. We recorded deferred income tax expense of $3.5 million in the second quarter of 2018 and $0.7 million in the previous quarter. There was no income tax expense recorded in the second quarter of 2017.

[4] 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 2018**	**Q4 2017**	**Q2 2017**
Cash	24.0	16.9	24.8
Cash - restricted	9.1	9.3	10.3
Operating working capital	71.5	69.7	60.7
Operating loans	(1.6)	(1.6)	(1.6)
Current portion of long-term debt	(5.7)	(5.9)	(4.2)
Net current assets	97.3	88.4	90.0
Long-term assets related to Mackenzie Power Plant	112.4	113.9	116.2
Long-term assets - lumber segment and corporate	199.3	193.0	160.3
	409.0	395.3	366.5
Non-interest bearing long-term liabilities	30.2	23.4	21.5
Long-term debt - Mackenzie Power Plant term loan	60.0	62.5	66.9
Revolving credit facility	90.7	94.2	83.1
Long-term debt - other	5.2	5.6	-
Shareholders' equity	222.9	209.6	195.0
	409.0	395.3	366.5
Ratio of current assets to current liabilities	2.9	2.8	3.3
Net debt to capitalization	39%	41%	38%
Net debt to capitalization (1)	25%	29%	24%

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

We believe that we maintained conservative current assets to current liabilities ratios of approximately 2.9:1 at June 30, 2018 and December 31, 2017 and 3.3:1 at June 30, 2017.

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, and bank advances, less cash. Total capital is calculated as the sum of net debt and equity.

Net debt at June 30, 2018 was $141.0 million and represented a modest reduction from net debt of $143.7 million at December 31, 2017. The net debt to capitalization ratio was 39% at June 30, 2018 compared to 41% at December 31, 2017. Excluding the effects of borrowings by Conifex Power Limited Partnership, the net debt to capitalization ratio was 25% compared to 29% at December 31, 2017.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	Q2 2018	Q1 2018	YTD 2018	Q2 2017	YTD 2017
Cash generated from (used in)					
Operating activities	36.2	1.9	38.1	25.9	21.4
Financing activities	(14.1)	0.7	(13.4)	(1.6)	31.9
Investing activities	(9.0)	(8.8)	(17.8)	(13.5)	(41.1)
Increase (decrease) in cash	13.1	(6.2)	6.9	10.8	12.2

Operating Activities
We operate in a cyclical industry.

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 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 Canadian 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 in our industry.

We generated cash from operations before working capital changes of $31.1 million in the first six months of 2018 compared to $17.4 million in the first six months of 2017. Changes in non-cash working capital provided cash of $7.0 million in the first six months of 2018 and $4.0 million in the same period last year.

Financing Activities
Financing activities consumed net cash of $13.4 million in the first six months of 2018. Cash outflows included net repayments of our revolving credit facility of $3.6 million and term loan of $2.8 million and the payment of finance expenses of $6.4 million.

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 public offering and private placement of common shares 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.

Investing Activities
Investing activities consumed cash of $17.8 million in the first six months of 2018 and mainly consisted of $5.1 million on capital improvements at our B.C. mills, $1.1 million on major maintenance items at the Mackenzie Power Plant and $11.6 million related to the El Dorado Mill. Lumber segment capital expenditures for our B.C. mills were primarily related to the upgrade of infrastructure to support waterborne transport of logs at Mackenzie and maintenance of business projects. Expenditures related to the El Dorado Mill largely comprised remaining payments on previously accrued capital commitments and capitalization of start-up costs in the first quarter of 2018.

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 Mackenzie Power Plant and $37.3 million on our capital project at our El Dorado Mill. Lumber segment capital expenditures for our B.C. mills were primarily related to the completion of the upgrade of a log line at the Mackenzie Site II sawmill.

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, 2018, we had total liquidity of $61.9 million, compared to $49.2 million at December 31, 2017 and $63.0 million at June 30, 2017. Liquidity at June 30, 2018 was comprised of unrestricted cash of $24.0 million and unused availability under our revolving credit facilities of $37.9 million. Availability under the revolving 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.

We were required to begin depositing cash on account of softwood lumber duties imposed by the U.S. in April 2017. We expect future cash flow will be adversely impacted by the CV and AD duty 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 help 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 through 2018. We expect the El Dorado Mill and the recently acquired Cross City Mill and Glenwood Mill to provide additional reliable sources of cash flow with productivity and other operational improvements continuing to progress through the balance of the 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 as at June 30, 2018 were comprised of standby letters of credit totalling $12.7 million posted by Conifex Power Limited Partnership, and operating leases for vehicles, equipment and machinery. The standby letters of credit are issued to BC Hydro and to the Agent for our term loan to support certain contractual agreements.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(millions of dollars, except share and per share amounts, statistical and exchange rate information and lumber price	2018 Q2	2018 Q1	2017 Q4	2017 Q3	2017 Q2	2017 Q1	2016 Q4	2016 Q3
Sales - lumber segment	195.2	123.3	124.5	114.2	111.7	93.5	94.4	99.2
Sales - electricity	5.1	7.5	8.2	6.1	4.7	6.8	7.6	4.9
Operating income	16.0	7.0	14.7	8.8	6.4	1.5	6.7	3.3
Net income (loss)	9.2	2.5	8.0	6.2	4.2	(1.4)	5.1	1.4
Net income (loss) per share - basic and diluted	0.35	0.10	0.30	0.23	0.16	(0.06)	0.24	0.07
EBITDA (1)	20.8	9.3	17.5	12.1	10.2	6.1	11.8	8.5
Shares outstanding - weighted average (millions)	26.5	26.4	26.4	26.4	26.3	22.5	21.2	21.2
Statistics (in millions, other than exchange rate and lumber prices)								
Production - WSPF lumber (MMfbm)	132.4	123.7	129.9	133.4	131.6	123.7	118.7	136.2
Production - SYP lumber (MMfbm)	25.0	-	-	-	-	-	-	-
Shipments - WSPF lumber (MMfbm)	133.8	112.7	138.2	135.3	128.5	110.7	124.4	132.3
Shipments - SYP lumber (MMfbm)	23.8	-	-	-	-	-	-	-
Shipments - wholesale lumber (MMfbm)	86.2	55.1	45.4	37.6	38.4	41.0	40.5	39.6
Electricity production - GWh	51.5	50.5	55.2	55.2	51.0	46.3	53.0	37.6
Average exchange rate - US$/Cdn$ (2)	0.775	0.791	0.787	0.798	0.744	0.756	0.750	0.766
Average WSPF 2x4 #2&Btr lumber price (US$) (3)	$598	$514	$464	$406	$388	$348	$316	$321
Average WSPF 2x4 #2&Btr lumber price (Cdn$)(4)	$772	$650	$590	$509	$522	$460	$421	$418
Average SYP 2x4 #2&Btr lumber price (US$) (5)	$574	$540	$438	$382	$455	$456	$432	$410
Average SYP 2x4 #2&Btr lumber price (Cdn$)(4)	$741	$683	$557	$478	$612	$603	$576	$535
Reconciliation of EBITDA to Net Income (Loss)								
Net income (loss)	9.2	2.5	8.0	6.2	4.2	(1.4)	5.1	1.4
Add: Finance costs	2.6	1.6	1.6	1.6	1.7	2.6	2.1	2.3
Amortization	5.5	4.5	4.8	4.3	4.3	4.9	4.6	4.8
Deferred income tax expense	3.5	0.7	3.1	-	-	-	-	-
EBITDA	20.8	9.3	17.5	12.1	10.2	6.1	11.8	8.5

(1) The Company's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization.
(2) Source: Bank of Canada, www.bankofcanada.ca.
(3) Source: Random Lengths Publications Inc. – Western Spruce / Pine / Fir, per thousand board feet
(4) Average SPF 2x4 #2&Btr and SYP 2x4 #2 lumber prices (US$) divided by average exchange rate.
(5) Source: Random Lengths Publications Inc. – Southern Yellow Pine Westside, per thousand board feet.

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 softwood lumber duty deposit rates on shipments to the U.S., 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 at our Canadian mills to ensure adequate supply of fibre 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 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 interest charges, are fixed in nature, quarterly operating results in the bioenergy segment are expected to reflect the variability in revenues.

OUTLOOK

Operations and Lumber Market Outlook

We expect the U.S. market to continue its gradual recovery in both the housing and repair and remodelling sectors. We expect benchmark prices for WSPF and SYP to remain at reasonably elevated levels to reflect solid softwood lumber demand and the continued imposition of trade sanctions on Canadian softwood lumber exports to the U.S. The extent to which the anticipated increase in U.S. softwood lumber demand translates into higher selling prices will also be influenced by supply side responses from Canadian and other suppliers into the U.S. market. We expect the uncertainty created by the softwood lumber trade dispute and possible supply chain disruptions from potential equipment and labor shortages will contribute to price volatility in the North American market.

We expect our sales volume to China and Japan will remain steady and intend to continue to develop sales into other export markets. We expect to sustain the year-over-year gains in sales realizations achieved in 2017 in our key export markets.

At our B.C. mills, we expect to sustain the more typical operating rates and normalized shipment patterns restored during the second quarter of 2018. We expect continued log cost inflation in our operating areas in the interior region of B.C. due to forecast heightened lumber prices which will contribute to higher market based stumpage and purchased log costs. We expect unit cash conversion costs to remain relatively consistent.

We will continue to focus on productivity improvements at the El Dorado Mill and our recently acquired Cross City Mill and the ramp up of production at our recently acquired Glenwood Mill following its recent commissioning of a second continuous dry kiln.

SUBSEQUENT EVENTS

Conifex’s Collective Agreement with the United Steelworkers (USW)

Conifex’s collective labour agreement with the USW union, which represents our hourly employees at the Fort St. James and Mackenzie mills, expired on June 30, 2018. Conifex anticipates entering into discussions with the USW during the third quarter of 2018. Although we have not experienced any work stoppages in the past and do not expect any work stoppages now, there can be no assurance that we will be able to negotiate an acceptable collective agreement with our employees. Any new collective labour agreement is expected to be retroactive to July 1, 2018.

Acquisition of Sawmills in the US South and Completion of Related Financings

On July 9, 2018, we completed the acquisition of all the outstanding membership interests of Suwannee Lumber Holding Company LLC, Suwannee Timber Management LLC and Caddo River Forest Products LLC (collectively, the “BW Group”) pursuant to a Securities Purchase Agreement (the “SPA”) with BW SLC Holdings LLC and the minority shareholders of Caddo River Forest Products LLC (together, the “Vendors”). The total purchase price under the transaction was (i) cash consideration of US$153.1 million plus US$19.8 million, representing the estimated net working capital of the BW Group at closing, (ii) $60.3 million through the issuance of 9,273,291 common shares of the Company (the “Shares”) to the Vendors at a price of $6.50 per Share, and (iii) 3.5 million warrants to purchase Shares for a period of five years (subject to extension in certain circumstances for a one-year period) at an exercise price of $8.78 per Share.

The cash portion of the purchase price was paid by Conifex using the net proceeds from our recently completed $64.8 million offering of subscription receipts (the “Subscription Receipts”) and borrowings under the Company’s new syndicated US$225.0 million senior secured credit facility (the “New Credit Facility”) led by a leading US commercial bank, along with a syndicate of other lenders. A total of 10,806,332 Shares were issued to the holders of the Subscription Receipts.

The New Credit Facility consists of a US$165.0 million term loan facility and a US$60.0 million revolving credit facility with a term of five years. Availability under the revolving credit facility is determined by a borrowing base tied to eligible accounts receivable and inventory. In addition to financing a part of the purchase price of the BW Group, a portion of the New Credit Facility was utilized to repay and retire the Company’s existing revolving credit facility.

The New Credit Facility is secured by substantially all of the Company’s and its subsidiaries’ lumber segment assets.

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

Appointment to Management Team

Brett Bray was appointed to the new position of Vice President, US Operations and will be responsible for leading the operations at our three U.S. South mills. Mr. Bray previously was the General Manager of the Glenwood Mill and played a key role in the successful completion of a major capital project and commencement of commercial operations at the site. Mr. Bray also has previous leadership experience with other sawmills in the U.S. South and in the pulp sector.

TRANSACTIONS BETWEEN RELATED PARTIES

Related party transactions consist of renumeration of directors and other key management personnel with whom we have entered into employment agreements in the normal course. Further information is contained in our management information circulars in respect of our annual general meetings of shareholders, which are filed on SEDAR at www.sedar.com.

CRITICAL ACCOUNTING ESTIMATES

There were no significant changes to the Company’s critical accounting estimates during the quarter ended June 30, 2018. Conifex’s critical accounting estimates are described in its MD&A for the year ended December 31, 2017, filed under the Company’s profile on SEDAR at www.sedar.com.

ADOPTION OF NEW ACCOUNTING STANDARDS

Effective January 1, 2018, we adopted IFRS 15, *Revenue from Contracts with Customers,* using the full retrospective method. The new standard for revenue replaces IAS 18, *Revenue,* IAS 11, *Construction Contracts,* and the related interpretations. The standard provides a new framework to determine the timing of revenue recognition and the measurement of revenue. The adoption of this standard had no significant impact on our condensed consolidated interim financial statements.

Effective January 1, 2018, we adopted IFRS 9, *Financial Instruments.* IFRS 9 supersedes IAS 39, *Financial Instruments: Recognition and Measurement.* The new standard includes amended guidance for the classification and measurement of financial assets. It also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management and contains a new impairment model which could result in earlier recognition of losses. The adoption of IFRS 9 had no significant impact on our condensed consolidated interim financial statements.

ACCOUNTING STANDARDS ISSUED AND NOT APPLIED

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

We expect our consolidated financial statements will be impacted by the recognition of new assets and liabilities for our operating leases. We are in the process of assessing the quantitative impact of adoption of this new standard on our consolidated financial statements. As of December 31, 2017, the future aggregate minimum lease payments under non-cancellable operating leases were $7.35 million.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors is included in the Company’s annual information form dated March 5, 2018, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

OUTSTANDING SECURITIES

As at August 9, 2018, the Company had 46,600,175 issued and outstanding common shares, 100,000 options granted, 1,361,174 long-term incentive plan awards, and 3,500,000 warrants.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the period covered by this report, there have been no changes that have materially affected, or are reasonably likely to materially affect Conifex’s internal controls over financial reporting.

ADDITIONAL INFORMATION

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