

Consolidated financial statements of

Conifex Timber Inc.

December 31, 2011

Conifex Timber Inc.

December 31, 2011

Table of contents

Auditor's report.....	1
Consolidated statement of net loss and comprehensive loss	2
Consolidated balance sheet.....	3
Consolidated statement of changes in equity	4
Consolidated statement of cash flows.....	5
Notes to the consolidated financial statements.....	6-31



February 21, 2012

Independent Auditor's Report

To the Shareholders of Conifex Timber Inc.

We have audited the accompanying consolidated financial statements of Conifex Timber Inc., which comprise the consolidated balance sheet as at December 31, 2011 and the consolidated statements of net loss and comprehensive loss, changes in equity and cash flows for the year ended December 31, 2011, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Conifex Timber Inc. as at December 31, 2011 and its financial performance and its cash flows for the year ended December 31, 2011 in accordance with International Financial Reporting Standards.

Other matter

The consolidated financial statements of Conifex Timber Inc. as at December 31, 2010 and for the year then ended were audited by other auditors who expressed an audit opinion without reservation dated March 8, 2011.

PricewaterhouseCoopers LLP

Chartered Accountants

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Conifex Timber Inc.

Consolidated statement of net loss and comprehensive loss
for the year ended December 31, 2011

(thousands of Canadian dollars except earnings per share)	Note	Year ended December 31,	
		2011	2010
		\$	\$
Revenue	7	125,014	57,385
Costs and expenses			
Cost of goods sold		102,810	45,393
Freight and distribution costs		25,860	11,518
Export taxes		1,932	1,591
Selling, general and administrative	8	12,520	6,912
		143,122	65,414
Operating Loss		(18,108)	(8,029)
Interest expense - net	9	(551)	(52)
Other income (expense)		2,890	(921)
Foreign exchange loss		(65)	(286)
Accretion of convertible debenture		(1,045)	(1,037)
Write off of revaluation expense		-	(452)
		1,229	(2,748)
Loss before tax		(16,878)	(10,778)
Income taxes	10	-	-
Net loss and comprehensive loss for the period		(16,878)	(10,778)
Net loss per share, basic and diluted	11	(1.11)	(1.02)

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

Conifex Timber Inc.

Consolidated balance sheet
as at December 31, 2011

(thousands of Canadian dollars)	Note	As at December 31,	
		2011	2010
		\$	\$
Assets			
<i>Current assets</i>			
Cash	13	11,059	26,629
Cash equivalents - restricted	13	1,660	-
Trade and other receivables	14	9,450	6,011
Inventories	15	20,187	15,142
Prepaid expenses and deposits		3,727	2,455
Assets held for sale	16	929	1,629
Current assets		47,012	51,867
Goodwill	29	2,066	-
Intangible assets	17	8,483	8,607
Property, plant and equipment	18	76,524	65,693
Deposits		336	338
Total assets		134,421	126,504
Liabilities			
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables	19	12,933	6,512
Current portion of reforestation obligations	20	3,732	1,590
Employee liabilities	22	2,464	1,822
Notes payable	23	12,000	-
Current portion of long term debt	23	2,707	1,227
Current liabilities		33,836	11,150
Reforestation obligations	20	4,217	5,118
Environmental liabilities	21	2,040	1,977
Employee liabilities	22	116	111
Long term accrued liabilities	29	525	-
Convertible notes	23	6,675	5,578
Long term debt	23	5,563	5,738
Non-current liabilities		19,136	18,522
Total liabilities		52,972	29,672
Equity			
Share capital	24	118,582	117,899
Conversion option on convertible notes	23	5,170	5,187
Share-based compensation reserve		1,670	841
Deficit		(43,973)	(27,095)
Total equity		81,449	96,832
Total liabilities and equity		134,421	126,504

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

Conifex Timber Inc.

Consolidated statement of changes in equity
for the year ended December 31, 2011

(thousands of Canadian dollars)	Share capital	Conversion option on convertible notes	Share-based compensation reserve	Deficit	Total equity
	\$	\$	\$	\$	\$
Balance at December 26, 2009	31,021	4,095	277	(16,030)	19,363
Net loss for the twelve months ended December 31, 2010	-	-	-	(10,778)	(10,778)
Changes arising from Qualifying Transaction	699	-	37	(287)	449
Capital introduced during the period	85,883	-	-	-	85,883
Exercise of stock options	47	-	-	-	47
Issue of convertible notes	-	1,092	-	-	1,092
Issue of common shares for payment in kind of interest on convertible notes	249	-	-	-	249
Recognition of share-based payments	-	-	527	-	527
Balance at December 31, 2010	117,899	5,187	841	(27,095)	96,832
Net loss for the twelve months ended December 31, 2011	-	-	-	(16,878)	(16,878)
Issue of common shares upon conversion of notes	33	(17)	-	-	16
Issue of common shares upon vesting of share-based payment	401	-	(401)	-	-
Issue of common shares for payment in kind of interest on convertible notes	249	-	-	-	249
Issue of warrants on secured notes	-	-	406	-	406
Recognition of share-based payments	-	-	824	-	824
Total of other changes in equity	683	(17)	829	(16,878)	(15,383)
Balance at December 31, 2011	118,582	5,170	1,670	(43,973)	81,449

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

Conifex Timber Inc.

Consolidated statement of cash flows
as at December 31, 2011

(thousands of Canadian dollars)	Note	Year ended December 31,	
		2011	2010
		\$	\$
Cash flows from operating activities			
Net loss		(16,878)	(10,778)
Items not affecting cash:			
Amortization		6,527	2,192
Changes in mark-to-market value of lumber price derivatives		(890)	(815)
Change in reforestation obligations		1,241	(383)
Accretion of convertible notes and related financing cost		1,113	1,106
Interest on convertible notes paid by common shares		249	249
Revaluation of shares to fair value		-	452
Share Compensation		824	527
		(7,814)	(7,449)
Change in:			
Trade and other receivables		(2,381)	(733)
Prepaid expenses and deposits		(554)	(1,667)
Inventories		(4,432)	(8,644)
Accounts payable, accrued liabilities and other payables		1,555	3,476
Environmental liabilities		63	(34)
Employee liabilities		647	861
Net cash used in operating activities		(12,916)	(14,190)
Cash flows from investing activities			
Additions to intangible assets	17	(119)	(75)
Additions to property, plant and equipment	18	(12,597)	(26,412)
Acquisition of Mackenzie Assets		-	(34,460)
Acquisition of subsidiaries	29	(2,191)	-
Proceeds on disposal of assets held for sale	16	1,861	789
Net cash used in investing activities		(13,046)	(60,159)
Financing activities			
Capital introduced - share proceeds		-	85,883
Bank indebtedness on reverse asset acquisition		-	(3)
Proceeds from exercise of stock options		-	47
Net proceeds of secured notes	23	11,760	-
Net proceeds from CAF loan	23	1,522	6,965
Net repayment of CAF loan	23	(1,230)	-
Proceeds from convertible notes		-	2,009
Net cash from financing activities		12,052	94,901
Net increase (decrease) in cash and cash equivalents		(13,910)	20,552
Cash and cash equivalents, beginning of period		26,629	6,077
Cash and cash equivalents, end of period		12,719	26,629

Refer to Note 12 for discussion of non-cash transactions.

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

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

1. GENERAL INFORMATION

The primary business of Conifex in its lumber segment includes timber harvesting, reforestation, forest management, sawmilling logs into lumber and wood chips, and value added lumber finishing. Conifex's lumber products are sold in the United States, Chinese, Canadian and Japanese markets. During the year, the Company acquired a lumber marketing and distribution business and a transportation and logistics business. The primary activity in its bioenergy segment is the planned development of a bioenergy generation plant at Mackenzie, BC.

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

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

These consolidated financial statements were approved by the Board of Directors on February 22, 2012.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2.1 Basis of preparation

The consolidated financial statements of Conifex Timber Inc. have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in note 4.

2.1.2 Changes in accounting policy and disclosures

(a) New and amended standards adopted by the Company

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

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

IFRS 9, "Financial instruments", addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and further amended in October 2010. It replaces the parts of IAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. IFRS 9 also provides for new measurement guidance for financial liabilities

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

designated at fair value through profit or loss. In December 2011, the IASB deferred the mandatory effective date of IFRS 9 to annual periods beginning on or after January 1, 2015. The Company has not yet determined the impact of these standards on its financial statements.

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

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

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

2.2 Consolidation

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

The Company applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree, the fair value of any asset or liability resulting from a contingent consideration arrangement and any cash consideration paid. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

Acquisition-related costs are expensed as incurred.

Any contingent consideration to be transferred by the Company is recognized at fair value upon acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

2.3 Segment reporting

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

2.4 Foreign currency translation

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

2.5 Property, plant and equipment

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

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

Land and assets classified as held for sale are not depreciated. Buildings and fixtures and computer hardware are depreciated on a straight-line basis over its estimated useful life. Machinery, mobile and other production equipment is depreciated using the units of production basis. This method amortizes the cost of equipment over the estimated units that will be produced during its estimated useful life. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

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

Buildings and fixtures	2%
Machinery and equipment	10%-33%
Mobile equipment	20%
Computer hardware	33%

The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over their useful lives. These periods are assessed at least annually to ensure that they continue to approximate the useful lives of the related assets. The carrying amount of an asset amount is written down immediately to its recoverable amount if it is determined to be greater than its estimated recoverable amount.

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

2.6 Goodwill and intangible assets

(a) Goodwill

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. Goodwill impairment is assessed by comparing the fair value of its cash generating unit ("CGU") to the underlying carrying amount of the CGU's net assets, including goodwill. When the carrying amount of the CGU exceeds its fair value, the fair value of the CGU's goodwill is compared with its carrying amount to measure the amount of impairment loss, if any.

(b) Other intangible assets

Other intangible assets, comprised of forestry licenses and computer software, are stated at cost less accumulated amortization.

The forestry licenses are amortized on a straight line basis over 60 years. Software licenses are amortized on a straight-line basis over 3 years.

2.7 Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Assets held for sale

Assets are classified as held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell. Assets held for sale are not depreciated once they are classified as held for sale, but are tested for impairment in accordance with IAS 36 Impairment of Assets.

2.9 Financial assets – loans and receivables

The Company classifies non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. Loans and receivables are included at amortized cost using the effective interest method, less any impairment.

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

2.10 Derivative financial instruments and hedging activities

The Company utilizes derivative financial instruments solely to manage its commodity price exposures in the ordinary course of business. Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The fair values are determined by using observable market inputs for identical assets and liabilities and thus reflect the estimated amount that the Company would have paid or received if required to settle all outstanding contracts at period-end. The resulting gain or loss is recognized as a gain (loss) on derivative instruments each period unless the derivative is designated as a hedging instrument under IFRS. If the derivative is designated as a hedging instrument, any unrealized gains or losses are deferred and recognized in earnings when the related hedge transaction occurs.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

2.11 Inventories

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

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

2.12 Trade receivables

Trade receivables are amounts due from customers for products sold or services performed in the ordinary course of business. If collection is expected in one year or less they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment.

2.13 Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments and bank overdrafts.

2.14 Share capital

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

2.15 Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

2.16 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method.

Fees paid on establishment of loan facilities are capitalized and amortized over the term of the facility to which they relate.

2.17 Borrowing costs

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

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

2.18 Compound financial instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

Borrowings are classified as current liabilities if maturity dates are within 12 months of the end of the reporting period. If not, they are classified as non-current liabilities.

2.19 Current and deferred income tax

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

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

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

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

2.20 Employee benefits

(a) Retirement benefit costs

Contributions to defined contribution retirement benefits plan are recognized as an expense when employees have rendered service entitling them to the contributions.

(b) Share-based payments

The Company operates a stock option plan and a share compensation plan under which the entity receives services from directors, employees and consultants as consideration for equity instruments of the Company. The fair value of the equity instrument and the employee services received in exchange for the grant of the options or share awards is measured at the grant date.

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

2.21 Warrants

The Company measures warrants at the issue date using the Black-Scholes pricing model.

2.22 Provisions

Provisions for reforestation, environmental restoration, restructuring costs and legal claims are recognized when the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are not recognized for future operating losses.

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

2.23 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods supplied, stated net of returns and value added taxes. The Company recognizes revenue when the amount of revenue can be reliably measured, the significant risks and rewards of ownership are passed to the customer, and collectability is reasonably assured.

2.24 Interest income

Interest income is recognized using the effective interest method. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable.

2.25 Leases

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

2.26 Government grants

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

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

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

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

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

(a) Market risk

(i) Foreign exchange risk

The Company is exposed to currency risk, primarily with respect to the US dollar, as its products are sold principally in US dollars and its costs of production are incurred principally in Canadian dollars. Foreign exchange risk arises from future commercial transactions and recognized assets and liabilities. The Company does not currently use financial derivative instruments for its foreign exchange risk management program. As at December 31, 2011, the Company's US dollar denominated accounts receivable totaled US \$2,405,015 and accounts payable US \$2,799,750. The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US\$1.00 during 2011 would have decreased or increased, respectively, annual operating earnings by approximately \$678,950.

(ii) Commodity price risk

The Company is exposed to commodity price risk related to the sale of lumber and residual products and purchase of certain manufacturing inputs which are purchased primarily on the open market. From time to time, the Company enters into futures contracts on the Chicago Mercantile Exchange to reduce its exposure to risks associated with fluctuations in lumber prices. At December 31, 2011, the fair value of outstanding commodity financial instruments was \$102,441 (December 31, 2010 - \$430,090). The fair value of these instruments was determined based on market rates for instruments with similar characteristics. An increase (decrease) in the futures market price of lumber of US\$10 per thousand board feet would result in a pre-tax gain (loss) of approximately \$71,500 in relation to the lumber futures held at year end.

(iii) Interest rate risk

Exposure to interest risk arises primarily when financial assets and financial obligations bear variable interest rates. The Company currently has no exposure to interest rate risk as all borrowings bear fixed rates of interest.

(b) Credit risk

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

(c) Liquidity risk

Liquidity risk is the risk that the Company will be unable to meet its financial obligations on a current basis. The Company manages liquidity risk by regularly performing rolling cash flow forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs and commitments. Management uses cash flow forecasts to identify financing requirements which are then addressed through a combination of committed credit facilities and access to capital markets.

Repayment of amounts due within one year are typically funded by cash on hand, cash flow from operations and normal collection of current trade accounts receivable.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

3.2 Capital Management

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

The Company monitors capital on the basis of net debt to total capitalization ratio. Net debt is calculated as current and non-current borrowings including the present value of convertible notes (note 23) less cash and cash equivalents. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

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

	2011	2010
	\$	\$
Borrowings, current	14,707	1,227
Borrowings, non-current	12,238	11,316
Less: Cash and cash equivalents	(12,719)	(26,629)
Net debt	14,226	(14,086)
Shareholders' equity	81,449	96,832
Total capitalization	95,675	82,746
Net debt to capitalization	15%	n/a

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

3.3 Fair value estimation

The Company's accounts receivable, other deposits and advances, operating loans, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition.

Cash and cash equivalents and derivative instruments are measured at fair value.

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

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

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

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

The following table summarizes the Company's financial instruments at December 31, 2011 and 2010, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

	Fair Value Hierarchy Level	2011	2010
		\$	\$
Financial assets			
Held for trading			
Derivative financial instruments	Level 2	102	430
		102	430

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make critical judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could materially differ from those estimates.

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

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

5. SEASONALITY OF OPERATIONS

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

6. SEGMENT INFORMATION

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

- Lumber - The main activities of the lumber segment include timber harvesting, reforestation, forest management, manufacture of logs into finished lumber and residual products at its sawmills and distribution of its finished products.
- Bioenergy - The primary activities of the bioenergy segment will be the development of the bioenergy generation project at Mackenzie, BC as described in note 28 and the development of other opportunities in the bioenergy sector which are complementary to the Company's existing operating facilities and assets.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

Summary by segment:

	Lumber	Bioenergy	Corporate & other	Consolidated
	\$	\$	\$	\$
Year ended December 31, 2011				
Sales to external customers	125,014	-	-	125,014
Operating loss	(14,323)	(956)	(2,829)	(18,108)
Interest expense	-	-	(551)	(551)
Other income	2,890	-	-	2,890
Foreign exchange loss	-	-	(65)	(65)
Accretion of convertible debenture	-	-	(1,045)	(1,045)
Net loss (note i)	(11,433)	(956)	(4,489)	(16,878)
Amortization	6,536	-	-	6,536
Capital expenditures	10,288	6,959	-	17,247
Identifiable assets	102,849	17,339	14,234	134,422
Year ended December 31, 2010				
Sales to external customers	57,385	-	-	57,385
Operating loss	(5,539)	(489)	(2,001)	(8,029)
Interest expense	-	-	(52)	(52)
Other expense	(921)	-	-	(921)
Foreign exchange loss	-	-	(286)	(286)
Accretion of convertible debenture	-	-	(1,037)	(1,037)
Write off of revaluation expense	-	-	(452)	(452)
Net loss (note i)	(6,460)	(489)	(3,829)	(10,778)
Amortization	1,518	-	-	1,518
Capital expenditures (note ii)	54,727	9,985	-	64,712
Identifiable assets (note ii)	89,200	10,058	27,246	126,504

Note (i): Profit or losses from lumber derivatives were previously included in the corporate and other category. Current and prior periods have been restated to include profit and losses from lumber derivatives in the lumber segment.

Note (ii): Includes purchase of Mackenzie Assets in June 2010.

Revenues by geographic area were as follows:

	2011	2010
	\$	\$
China	51,858	18,366
Canada	34,183	16,482
United States	22,986	19,434
Japan	15,987	3,103
	125,014	57,385

All of the Company's operations are located in the interior region of British Columbia.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

7. REVENUE

	2011	2010
	\$	\$
Revenue		
Sale of lumber	108,902	50,777
Sale of by-product	16,112	6,608
	125,014	57,385

8. SELLING, GENERAL AND ADMINISTRATIVE

	2011	2010
	\$	\$
Salaries and benefits	3,216	1,649
Selling costs	4,179	2,026
Other administrative expenses	3,862	2,394
Legal, professional and organizational	939	777
Depreciation and amortization	324	66
	12,520	6,912

9. INTEREST EXPENSE

	2011	2010
	\$	\$
Interest income	(55)	(88)
Interest expense	606	140
	551	52

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

10. INCOME TAX

10.1 Current income taxes

	2011	2010
	\$	\$
<i>Recognized in income statement</i>		
Tax expense comprises		
Current tax expense	-	-
<i>Reconciliation of effective tax rate</i>		
Loss before taxation	(16,878)	(10,778)
Income tax expense (recovery) at corporation rate of 26.5% (2010 - 28.50%)	(4,473)	(3,072)
Expenses not deductible for tax purposes	614	648
Effect on deferred balances due to changes in income tax rates	219	314
Effect of unused tax losses and tax offsets not recognized as deferred assets	4,139	1,845
Effect of previously unrecognized deferred tax	(499)	265
Total income tax expense	-	-

10.2 Unrecognized deferred income taxes

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.

The source of unrecognized deferred income taxes is as follows:

	2010	Change		2011
	Opening balance	Related to earnings	Related to equity	Closing balance
	\$	\$	\$	\$
Deferred tax assets related to non-capital losses	4,500	1,842	-	6,342
Deferred tax assets related to temporary differences in tax and book basis	2,052	2,297	(198)	4,151
Net deferred tax assets	6,552	4,139	-	10,493

No deferred tax assets have been recognized in these financial statements due to the uncertainty as to realization.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

	2009		Change		2010
	Opening balance	Related to earnings	Related to equity		Closing balance
	\$	\$	\$		\$
Deferred tax assets related to non-capital losses	3,984	516	-		4,500
Deferred tax assets related to temporary differences in tax and book basis	(81)	1,329	804		2,052
Net deferred tax assets	3,903	1,845	804		6,552

No deferred tax assets were recognized as at December 31, 2010 due to the uncertainty as to realization.

10.3 Non-capital loss carry forwards

As at December 31, 2011, the Company has non-capital losses from the following years:

Year of loss	Non-capital loss amount
	\$
2006	43
2007	-
2008	3,612
2009	8,777
2010	5,568
2011	7,369
	25,369

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

11. NET LOSS PER SHARE

	Year ended December 31, 2011			Year ended December 31, 2010		
	Net loss	Weighted average number of Shares	Per share	Net loss	Weighted average number of Shares	Per share
	\$		\$	\$		\$
Basic loss per share	(16,878)	15,195	(1.11)	(10,778)	10,577	(1.02)
Convertible notes	-	1,246*	-	-	1,250*	-
Diluted loss per share	(16,878)	15,195	(1.11)	(10,778)	10,577	(1.02)

*The conversion of convertible notes is anti-dilutive and is therefore excluded from the weighted average number of ordinary shares for the purposes of calculating diluted earnings per share.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

12. SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash transactions

The following non-cash transactions are excluded from investing and financing transactions on the cash flow statement as they did not require the use of cash or cash equivalents during the period:

- Purchases of capital work in progress in the amount of \$2,847,346 was in accounts payable at period end
- Purchases of land in the amount of \$1,012,974 was settled with the assumption of a mortgage in a corresponding amount (note 23)
- Conversion of convertible notes in the amount of \$33,000

13. CASH AND CASH EQUIVALENTS

	2011	2010
	\$	\$
Cash at bank and in hand	11,059	26,629
Short term deposits - restricted	1,660	-
	12,719	26,629

The \$1,660,000 held in short term deposits at December 31, 2011, secures a standby letter of credit issued in the same amount by the Company to BC Hydro pursuant to the terms of the Electricity Purchase Agreement.

14. TRADE AND OTHER RECEIVABLES

	2011	2010
	\$	\$
Trade receivables	8,624	3,451
Other receivables	410	2,301
HST receivable	416	259
	9,450	6,011

All receivable balances are due within one year and do not require provision.

15. INVENTORIES

	2011	2010
	\$	\$
Logs	7,535	5,729
Lumber	8,504	5,911
Supplies	4,149	3,502
	20,188	15,142

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has been written down at December 31, 2011 by \$1,514,764 (December 31, 2010: \$658,760) and this amount is included in cost of goods sold.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

16. ASSETS HELD FOR SALE

The Company classified as "assets held for sale" certain redundant assets acquired with the purchase of the Mackenzie Assets in June 2010. Transactions within this asset category were as follows:

	2011	2010
	\$	\$
Balance at January 1	1,629	-
Acquisition of assets held for sale	-	3,950
Proceeds of disposition from sale of assets	(328)	(2,321)
Transfer of assets held for sale to property, plant and equipment	(372)	-
	929	1,629

Proceeds of disposition from the sale of assets were credited towards the carrying value of the asset class and there were no profits or losses recognized from the transactions.

In September 2011, the Company entered into an agreement under the terms of which a portion of the remaining assets held for sale will be demolished and removed. The Company will be paid for all salvaged materials. As it is difficult to estimate the expected proceeds of disposition, any gain or loss on the transaction will be recorded when the removal is completed. The removal is expected to be completed by August 2012. The consolidated statement of cash flows reports proceeds on disposal of assets held for sale in the period the proceeds are received.

17. INTANGIBLE ASSETS

	Forestry licences	Software licences	Total
	\$	\$	\$
<i>Cost</i>			
At December 31, 2010	8,550	253	8,803
Additions	-	119	119
At December 31, 2011	8,550	372	8,922
<i>Accumulated amortization</i>			
At December 31, 2010	(63)	(133)	(196)
Amortization charge for the period	(142)	(101)	(243)
At December 31, 2011	(205)	(234)	(439)
<i>Carrying amount</i>			
At December 31, 2010	8,487	120	8,607
At December 31, 2011	8,345	138	8,483

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

18. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings / equipment	Capital work in progress	Power assets	Power Capital work in progress	Total
	\$	\$		\$	\$	\$
<i>Cost</i>						
At December 31, 2010	1,548	47,472	9,775	9,737	249	68,781
Net additions	1,296	570	7,704	174	6,785	16,529
Capital put in service	-	17,332	(17,332)	-	-	-
Reclassification / transfers	-	408	-	(36)	-	372
Acquisition of subsidiaries (note 29)	-	298	-	-	-	298
Disposals	-	(84)	-	-	-	(84)
At December 31, 2011	2,844	65,996	147	9,875	7,034	85,896
<i>Accumulated depreciation</i>						
At December 31, 2010	-	(3,088)	-	-	-	(3,088)
Depreciation charge for the period	-	(6,293)	-	-	-	(6,293)
Disposals	-	9	-	-	-	9
At December 31, 2011	-	(9,372)	-	-	-	(9,372)
<i>Carrying amount</i>						
At December 31, 2010	1,548	44,384		9,737	249	65,693
At December 31, 2011	2,844	56,624		9,875	7,034	76,524

The power assets are not being depreciated as the assets are not being operated and are not in a form suitable for management's intended uses.

19. TRADE PAYABLES, ACCRUED LIABILITIES AND OTHER PAYABLES

	2011	2010
	\$	\$
Trade payables	9,142	4,172
Accruals	3,700	2,249
Other payables	91	91
	12,933	6,512

20. REFORESTATION OBLIGATIONS

	2011	2010
	\$	\$
Silviculture liability		
Current	3,732	1,590
Non-current	4,217	5,118
	7,949	6,708

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

	2011	2010
	\$	\$
Balance at beginning of year	6,708	759
Additional provisions recognized	2,400	229
Reductions arising from payment	(1,533)	(557)
Change arising from re-measurement or settlement without cost	374	(55)
Mackenzie acquisition	-	6,332
	7,949	6,708

21. ENVIRONMENTAL LIABILITIES

	2011	2010
	\$	\$
Balance at beginning of year	1,977	-
Reductions arising from payment	(92)	(34)
Change arising from re-measurement or settlement without cost	155	-
Mackenzie acquisition	-	2,011
	2,040	1,977

22. EMPLOYEE LIABILITIES

	2011	2010
	\$	\$
Non-current		
Long-term employee liability	116	111
Current		
Payroll	520	810
Deferred union payroll liability	1,944	1,012
	2,464	1,822
	2,580	1,933

The long-term employee liability relates to a contribution under employment agreements for four employees. This liability was assumed as part of the acquisition of the assets and liabilities of the Fort St. James sawmill. The amount committed to by the Company on acquisition was \$250,000 and is being repaid over a period of five years.

The deferred union payroll liability relates to deferred payroll costs for unionized employees. Under the terms of the agreement a portion of employee wages are deferred, as long as lumber selling prices are below a specified value. Deferred employee wages will be paid out once lumber selling prices increase above a specified value, upon employee retirement, or upon the expiration of the current collective agreement on June 30, 2013. The terms of the agreement remain in effect for the duration of the term.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

23. BORROWINGS

	2011	2010
	\$	\$
Non-current		
Long term debt	5,563	5,738
Convertible notes	6,675	5,578
	12,238	11,316
Current		
Current portion of long term debt	1,694	1,227
Mortgage payable	1,013	-
Notes payable	12,000	-
	14,707	1,227
Total borrowings	26,945	12,543

(a) Long-term debt

Long term debt is comprised of a secured loan facility provided under the Community Adjustment Fund ("CAF") loan program sponsored by the Northern Development Initiative Trust. The CAF loan carries a fixed interest rate of 3.75% and is repayable by twenty quarterly repayments commencing June 2011. The loan is secured by a General Security Agreement (excluding inventory and receivables) and a mortgage against certain properties. The Company drew down \$1,522,047 of the loan facility during the year ended December 31, 2011 (2010: \$ 6,964,819). The Company repaid \$1,229,863 of the CAF loan during the year ended December 31, 2011 (2010: \$nil). The CAF loan facility is fully drawn.

(b) Convertible notes

The Company issued \$10,000,000 in unsecured convertible notes in two tranches in December 2009. As the convertible notes were issued prior to a change in the Company's fiscal year end period, the first tranche of \$7,950,000 was recorded in the period ended December 26, 2009 and the second tranche of \$2,050,000 was recorded in the period ended December 31, 2010.

The key terms of the convertible notes are summarized below.

Term	5 years
Maturity date	December 15, 2014
Interest rate	2.5% from date of issuance to December 15, 2012 to be settled in common shares and 10.5% thereafter to be settled in cash
Holders' option	Convertible at the option of the holder into common shares at a conversion price of \$8 per share
Company's option	Redeemable by the Company on or after December 15, 2013 at a redemption price equal to the principal amount plus accrued and unpaid interest.

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

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

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

The convertible notes recognized in the balance sheet are calculated as follows:

	Convertible notes	Issuance costs	Equity component	Liability component
	\$	\$	\$	\$
At December 26, 2009	7,950	300	4,095	3,555
Convertible notes issued	2,050	41	1,092	916
Accretion of convertible notes	-	-	-	1,037
Accretion of issuance cost	-	-	-	70
At December 31, 2010	10,000	341	5,187	5,578
Conversion of notes	(33)	-	(17)	(16)
Accretion of convertible notes	-	-	-	1,045
Accretion of issuance cost	-	-	-	68
At December 31, 2011	9,967	341	5,170	6,675

(c) Mortgage payable

In November 2011, the Company completed an agreement to purchase certain properties it had previously been leasing in Mackenzie BC. The purchase price was settled by a combination of cash and an assumption of a mortgage held by the vendor. The mortgage is secured by the properties and repayable by eleven monthly payments commencing January 1, 2012. The interest rate is based on the prime rate offered by a major Canadian financial institution plus an adjustment.

(d) Notes payable

In December 2011, the Company issued senior secured promissory notes in the aggregate principal amount of \$12 million. The promissory notes mature on December 31, 2012, subject to early redemption by the Company as provided in the notes, and bear interest rates of 10% for the first six months and 12% for the remaining term of the loan. The notes are secured by a General Security Agreement. As additional consideration for the loan, the Company issued share purchase warrants to the holders under the terms described in note 26.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

24. SHARE CAPITAL

Authorized

Unlimited number of common voting shares without par value.

Common share activity of the Company is as follows:

	Number of common shares	Amount \$
Shares issued	2,330	247
Balance at December 31, 2009 - West Fourth Capital Consolidated on the basis of 27.5 to 1 share outstanding	2,330 (2,245)	247 -
Revaluation adjustment	-	452
Balance after consolidation and before Qualifying Transaction - West Fourth Capital	85	699
Share capital arising from Qualifying Transaction on June 3, 2010		
- Share capital of DTR	4,256	31,021
- Shares issued in DTR	10,788	85,883
Shares issued on exercise of stock options	8	47
Shares issued as payment of interest on convertible notes	31	249
Balance at December 31, 2010	15,168	117,899
Shares issued on conversion of convertible notes	4	33
Shares vested under share-based compensation plan (note 25)	44	401
Shares issued as payment of interest on convertible notes	31	249
Balance at December 31, 2011	15,247	118,582

25. STOCK OPTION PLAN AND SHARE-BASED COMPENSATION

25.1 Stock option plan

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

There were 100,000 options outstanding at December 31, 2011 with an exercise price of \$8.25 per share. The options were granted on August 20, 2010 and expire on August 20, 2020. The options are exercisable only to the extent that they have vested. The options will vest as follows: approximately 33% on the date of grant; approximately 33% on August 20, 2013 and the remaining approximately 34% on August 20, 2015.

The fair value of the options granted is estimated at the time of the grant using the Black-Scholes option pricing model. Based on a share price of \$6.50 on the day of the grant, expected life of 10 years, risk-free interest rate

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

of 3.05% and annualized volatility of 33%, the fair value of the options granted on August 20, 2010 is estimated at \$265,000 or \$2.65 per option. Expense related to the stock option plan of \$47,112 was recognized in the year ended December 31, 2011 (2010 - \$105,620).

25.2 Share-based compensation

The Company operates a share compensation program for executives and salaried employees. The Company measures the fair value of the services received as consideration for equity instruments indirectly by reference to the fair value of the equity instruments granted. The fair value is measured on the basis of an observable market price subject to a minimum price.

The following table illustrates the number and weighted average fair value ("WAFV") of, and movements in, share awards granted during the year:

	2011	2011	2010	2010
	Number	WAFV	Number	WAFV
		\$		\$
Balance at January 1	276,142	8.09	176,235	8.00
Granted during the year	199,620	9.00	124,474	8.24
Forfeited during the year	(73,604)	8.20	(24,567)	8.18
Vested during the year	(28,849)	8.00	-	-
Outstanding at December 31	373,309	8.56	276,142	8.09

The shares vest at 60% in three years, 80% in four years and 100% in five years. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period.

Expense related to the share based compensation plan of \$940,712 was recognized in the year ended December 31, 2011. (2010 - \$421,857). The compensation expense is allocated between cost of sales and selling, general and administrative expense.

26. SHARE PURCHASE WARRANTS

As additional consideration for a senior secured loan facility (note 23), the Company issued share purchase warrants entitling the holders of the promissory notes to purchase up to an aggregate of 325,000 common shares of the unissued capital stock of the Company at a price of \$9.50 per share until December 31, 2014. The warrants (and the underlying common shares) are subject to a hold period of four months and a day from the date of issue of the warrants.

The fair value of the warrants is estimated at the time of the issue using the Black-Scholes option pricing model. Based on a share price of \$7.50 on the day of the issue, expected term of 37 months, risk-free interest rate of 1.02% and annualized volatility of 35%, the fair value of the warrants issued on December 1, 2011 is estimated at \$406,537 or \$1.25 per warrant. Expense related to the issue of the share purchase warrants of \$29,039 was recognized as interest expense in the year ended December 31, 2011 (2010 - \$nil).

27. COMMITMENTS

Operating lease payments

The amount of operating lease payments charged to the statement of comprehensive loss during the period comprised:

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

	2011	2010
	\$	\$
Equipment	155	116
Land	74	45
Office equipment	71	18
Vehicles	15	32
	315	211

Operating lease commitments

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

	2011	2010
	\$	\$
Not later than 1 year	1,071	202
Later than 1 year and not later than 5 years	2,590	273
Later than 5 years	538	-
	4,199	475

28. CONTINGENCIES

Softwood Lumber Agreement

On January 18, 2011, the U.S. triggered the arbitration provision of the 2006 Softwood Lumber Agreement ("SLA") by delivering a Request for Arbitration. The U.S. claims that BC has not properly applied the timber pricing system grandparented in the SLA. The U.S. also claims that subsequent to 2006, BC made additional changes to the timber pricing system which had the effect of reducing timber prices. The claim focuses on the substantial increases in Grade 4 (non sawlog or low grade) volumes commencing in 2007. It is alleged that timber was scaled and graded as Grade 4 that did not meet the criteria for that grade and was accordingly priced too low.

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. The U.S. filed a Statement of Case with the arbitration panel on August 9, 2011. Canada delivered its response to the U.S. claim in November 2011 to which the U.S. filed a rebuttal. A hearing before the arbitration panel is expected to take place before the end of the first quarter in 2012. It is not possible at this time to predict the outcome or the value of the claim, and accordingly no provision has been recorded by the Company.

In January 2012, representatives of the Canadian and U.S. government jointly announced a two-year extension of the SLA which is now due to expire in October 2015.

Equipment purchase related to bioenergy generation project at Mackenzie BC

On January 27, 2011, the Company entered into an Equipment Design, Engineering Sale and Service Agreement with an equipment manufacturer to arrange for the manufacture and purchase of a 36 megawatt per hour steam turbine generation set (the "Turbine") and ancillary equipment and services in connection with its planned bioenergy generation project (the "Bioenergy Project") at Mackenzie BC. The total cost of the purchase is approximately U.S. \$10.5 million.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

In June 2011, Conifex finalized an Electricity Purchase Agreement (“EPA”) and a Load Displacement Agreement (“LDA”) with BC Hydro. The transactions contemplated by the EPA and LDA are subject to the EPA being accepted by the British Columbia Utilities Commission (“BCUC”) as an energy supply contract. In October 2011, the Company entered into an agreement (the “Amendment Agreement”) modifying certain terms of the EPA. The EPA specified a period of 150 days from the date that the agreement was entered into within which acceptance for filing by the BCUC was required. The Amendment Agreement extends this period by 90 days to allow for the completion of the Province’s review of BC Hydro prior to the filing of the EPA with the BCUC.

The EPA was filed with the BCUC in January 2012. As the required regulatory approval has not yet been granted, there can be no assurance that the Bioenergy Project will proceed as currently described or at all. In order to provide necessary flexibility, the Turbine acquisition agreement contains cancellation rights in favour of Conifex that may be exercised if the Bioenergy Project does not proceed. Cancellation of the agreement will subject the Company to payment of cancellation costs according to a predetermined schedule.

29. BUSINESS COMBINATIONS

On December 31, 2011, the Company completed the acquisition of a commodity lumber distribution business. Prior to the acquisition date, the vendor transferred the assets of the acquired business into a newly incorporated company named Conifex Fibre Marketing Inc. (“CFMI”). The Company acquired 100% of the share capital of CFMI on December 31, 2011.

On December 31, 2011, the Company acquired 100% of the share capital of Navcor Transportation Services Inc. (“Navcor”).

Prior to the acquisitions, the Company outsourced its marketing and logistics function to the former owners of CFMI and Navcor. The acquisitions, which include the purchase of all assets related to the vendor’s commodity lumber distribution business and employment agreements with key employees, is expected to facilitate the Company’s internalization of its sales, marketing and logistics capabilities.

The Company expects benefits of the acquisitions to include the ability to strengthen long-term relationships with customers in key markets, develop customized sales programs and diversify markets, and reduce marketing and distribution costs. The acquisitions are expected to generate incremental revenue from both the marketing and logistics businesses as CFMI and Navcor intend to further develop previously established trading relationships with third party suppliers and customers.

The aggregate goodwill of \$2,066,467 from the acquisitions is attributable to the acquired knowledge base and ability to cost effectively transition to internalization of these functions as a result of retaining key employees familiar with the Company’s products and markets; customer and supplier base; expected reduction in costs and potential generation of incremental revenue. .

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

The following table summarizes the consideration paid for CFMI and Navcor and the fair value of assets acquired and liabilities assumed.

	CFMI	Navcor	Total
	\$	\$	\$
Consideration at December 31, 2011			
Cash	1,891	300	2,191
Contingent consideration	875	-	875
Total consideration	2,766	300	3,066
Recognized amounts of identifiable assets acquired and liabilities assumed			
Inventories	614	-	614
Trade and other receivables	-	1,769	1,769
Property, plant and equipment	277	22	299
Bank overdraft	-	(447)	(447)
Trade and other payables	-	(1,235)	(1,235)
Total identifiable assets	891	109	1,000
Goodwill	1,875	191	2,066
Total	2,766	300	3,066

Acquisition related costs of \$70,257 have been charged to selling, general and administrative expense in the consolidated statement of net loss and comprehensive loss for the year ended December 31, 2011.

The contingent consideration arrangement requires the Company to pay in cash to the former owners of CFMI for a three year period a percentage of gross profit realized on sales of lumber from outside suppliers. The percentage of gross margin payable declines after the first year and is only payable on gross margin derived from a revenue source that is incremental to the Company's existing operations. The amount of contingent consideration is guaranteed to be a minimum of \$250,000 each year for the first two years. The probable undiscounted amount of all future payments that the Company could be required to make under this arrangement is between \$500,000 and \$875,000.

The fair value of the contingent consideration arrangement of \$875,000 was calculated by applying the percentage of gross profit payable each year to the estimated probable annual gross profit expected to be earned in each year. The expected gross profit was estimated based on a combination of historical results and industry norms. The fair value estimates are based on a discount rate of 2.4%. The current portion of the contingent liability is presented under trade payables, accrued liabilities and other payables and the long-term portion is presented as long-term accrued liabilities on the consolidated balance sheet.

Impairment tests for goodwill

Goodwill is allocated for impairment testing purposes to each cash-generating unit. The recoverable amount of each cash-generating unit is determined based on a value in use calculation which uses cash flow projections based on financial budgets approved annually by the directors. The Company believes that any reasonably possible change in key assumptions on which recoverable amount is based would not cause the aggregate carrying amount to exceed the aggregate recoverable amount of the cash-generating unit.

30. RELATED PARTY TRANSACTIONS

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2011

(Tabular amounts expressed in thousands except per share amounts)

(a) LJ Resources Co., Ltd.

Hebei Wenfeng Industrial Group ("Hebei") owns convertible notes and affiliates of Hebei own common shares of the Company. Hebei exercises significant influence by virtue of the shareholdings (assuming full conversion of convertible notes) of approximately 20%. Two employees of LJ Resources Co. Ltd. ("LJ") are members of the Board of Conifex. LJ is a wholly-owned subsidiary of Hebei.

The Company transacted sales of finished lumber products totaling \$3,917,639 for the period ended December 31, 2011 (2010: \$211,578) to LJ. The sales to the related party are made at terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the period end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided for any related party receivables. The outstanding accounts receivable balance from LJ at December 31 was \$ nil (2010: \$211,259).

(b) Compensation of directors and officers of the Company

Compensation of directors and officers of the Company and its subsidiaries were as follows:

	2011	2010
	\$	\$
Short-term benefits	1,461	1,002
Share-based payments	212	206
	1,673	1,208

31. EVENTS AFTER THE REPORTING PERIOD

Close of \$28.5 million private placement financing

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

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

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