

Consolidated financial statements of

Conifex Timber Inc.

December 31, 2010

Conifex Timber Inc.

December 31, 2010

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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, 2010, and the consolidated statement of net loss and comprehensive loss, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the financial statements.

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 as issued by the International Accounting Standards Board, 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, 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Deloitte & Touche LP

Chartered Accountants
Vancouver, British Columbia
March 8, 2011

Conifex Timber Inc.

Consolidated statement of net loss and comprehensive loss
for the year ended December 31, 2010

(thousands of Canadian dollars except earnings per share)		Year ended 12/31/10	Year ended 12/26/09
	Notes	\$	\$
Revenue	7	57,385	31,333
Costs and expenses			
Cost of goods sold		45,393	29,692
Freight and distribution costs		11,518	6,937
Export taxes		1,591	1,315
Selling, general and administrative	9	6,913	4,337
		65,415	42,281
Operating (Loss)		(8,030)	(10,948)
Interest (expense) income		(52)	22
Other (expense) income		(921)	755
Foreign exchange (loss)		(286)	(160)
Accretion of convertible debenture		(1,037)	-
Revaluation expense	5	(452)	-
		(2,748)	617
Loss before tax		(10,778)	(10,331)
Income taxes	10	-	-
Net loss and comprehensive loss for the year		(10,778)	(10,331)
Net loss per share, basic and diluted	11	(1.02)	(2.45)

See accompanying notes to the consolidated financial statements

Conifex Timber Inc.

Consolidated balance sheet
as at December 31, 2010

(thousands of Canadian dollars)			
	Notes	12/31/10	12/26/09
		\$	\$
Assets			
<i>Non-current assets</i>			
Intangible assets	12	8,607	2,965
Property, plant and equipment	13	65,692	9,137
Deposits		338	154
Total non-current assets		74,637	12,256
<i>Current assets</i>			
Cash	14	26,629	6,077
Inventories	15	15,142	5,449
Trade and other receivables	16	6,011	2,931
Prepaid expenses and deposits		2,455	623
Assets held for sale	6	1,630	-
Total current assets		51,867	15,080
Total assets		126,504	27,336
Liabilities			
<i>Non-current liabilities</i>			
Reforestation obligations	17	(5,118)	(586)
Environmental liabilities	6	(1,977)	-
Employee liabilities	18	(111)	(204)
Convertible notes	20	(5,578)	(3,555)
Long term debt	21	(5,738)	-
Total non-current liabilities		(18,522)	(4,345)
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables	19	(6,512)	(2,588)
Reforestation obligations	17	(1,589)	(173)
Employee liabilities	18	(1,822)	(868)
Current portion of long term debt	21	(1,227)	-
Total current liabilities		(11,150)	(3,629)
Total liabilities		(29,672)	(7,974)
Net assets		96,832	19,362
Equity			
Share capital	5, 22	117,899	31,021
Conversion option on convertible notes	20	5,187	4,095
Share-based compensation reserve		841	277
Deficit		(27,095)	(16,031)
Total equity and shareholders' funds		96,832	19,362

Commitments - Note 26
Contingencies - Note 27

See accompanying notes to the consolidated financial statements

Conifex Timber Inc.

Consolidated statement of changes in equity for the year ended December 31, 2010

(thousands of Canadian dollars)					
	Share capital	Conversion option on convertible notes	Share-based compensation reserve	Deficit	Total equity
	\$	\$	\$	\$	\$
Balance at January 1, 2009	30,046	-	-	(5,700)	24,346
Net loss for the year	-	-	-	(10,331)	(10,331)
Capital introduced during the period	975	-	-	-	975
Recognition of share-based payments	-	-	277	-	277
Issue of convertible notes	-	4,095	-	-	4,095
Balance at December 26, 2009	31,021	4,095	277	(16,031)	19,362
Net loss for the year	-	-	-	(10,778)	(10,778)
Total recognized income and expense for the period	-	-	-	(10,778)	(10,778)
Fourth share capital	247	-	-	-	247
Revaluation of Fourth shares to fair value	452	-	-	-	452
Recognition of share-based payments	-	-	37	-	37
Deficit from Fourth	-	-	-	(287)	(287)
Total 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 common shares for payment in kind of interest on convertible notes	249	-	-	-	249
Issue of convertible notes	-	1,092	-	-	1,092
Recognition of share-based payments	-	-	527	-	527
Total of other changes in equity	86,179	1,092	527	-	87,798
Balance at December 31, 2010	117,899	5,187	841	(27,095)	96,832

See accompanying notes to the consolidated financial statements

Conifex Timber Inc.

Consolidated statement of cash flows for the year ended December 31, 2010

(thousands of Canadian dollars)	Notes	Year ended 12/31/10	Year ended 12/26/09
		\$	\$
Cash provided by (used in):			
Operating activities:			
Net loss		(10,778)	(10,331)
Items not affecting cash:			
Amortization of non-current assets		2,192	1,055
Unrealized loss on lumber price derivatives		(815)	(332)
Net realizable value adjustment to inventory		127	532
Change in reforestation obligations		(383)	83
Change in environmental liabilities		(34)	-
Financing cost related to convertible notes		68	-
Accretion of convertible notes		1,037	-
Share compensation		527	277
Interest on convertible notes paid by common shares		249	-
Revaluation of shares to fair value		452	-
		(7,356)	(8,716)
Cash generated from (used in) operating working capital:			
Trade and other receivables		(733)	(1,482)
Prepaid expenses and deposits		(1,667)	(230)
Inventories		(8,771)	(2,952)
Accounts payable, accrued liabilities and other payables		3,476	1,816
Employee liabilities		861	798
		(14,190)	(10,765)
Investing activities:			
Additions to intangible assets		(75)	(60)
Additions to property, plant and equipment		(26,412)	(1,905)
Acquisition of Assets	6	(34,460)	-
Proceeds on disposal of assets held for sale		789	-
		(60,159)	(1,964)
Financing activities			
Capital introduced - share proceeds	4	85,883	975
Bank indebtedness on reverse asset acquisition		(3)	-
Proceeds from exercise of stock options		47	-
Proceeds from CAF loan	21	6,965	-
Proceeds from convertible notes		2,009	7,650
		94,901	8,625
Net increase (decrease) in cash		20,552	(4,104)
Cash, beginning of period		6,077	10,181
Cash, end of period		26,629	6,077

See accompanying notes to the consolidated financial statements

Non-cash transactions

Proceeds from the sale of assets held for sale in the amount of \$1.532 million had not been received at year end and are excluded from the consolidated statement of cash flows.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2010

(Tabular amounts expressed in thousands except per share amounts)

1. General information

Conifex Timber Inc. ("Conifex" or the "Company") is a limited company incorporated in Canada. The principal activities of the Company and its subsidiaries are described in Note 8.

The Company is a publicly listed company, and its shares are listed on the TSX Venture Exchange (the "TSX-V") in Canada.

The registered office of the Company is located at 1000 Cathedral Place, 925 West Georgia Street, Vancouver, British Columbia ("BC") V6C 3L2.

The Company, formerly West Fourth Capital Inc. ("Fourth") was incorporated under the Canada Business Corporations Act on May 17, 2007. Fourth, which was a capital pool company pursuant to the policies of the TSX-V, completed a "Qualifying Transaction" in accordance with the TSX-V policies governing capital pool companies. The Qualifying Transaction was affected by way of a reverse asset acquisition of DTR Wood Acquisitionco Ltd. ("DTR"), a non-public operating company, incorporated October 22, 2004 under the British Columbia Business Corporations Act. The transaction was completed on June 3, 2010, resulting in DTR becoming a wholly-owned subsidiary of Fourth. Fourth subsequently changed its name to Conifex.

On June 3, 2010, the Company, through its wholly-owned subsidiary, Conifex Mackenzie Forest Products Inc. ("Mackenzie") (formerly 0869550 B.C. Ltd.) acquired certain idled sawmill and other assets located in or near Mackenzie, British Columbia. Mackenzie commenced manufacturing operations at one of its two sawmills on a one-shift basis on November 1, 2010.

The Company's fiscal year end is December 31. Prior to the qualifying transaction, DTR's fiscal year end was the 52 or 53 weeks ending the last Saturday of December and customarily consisted of four 13-week quarters, with every sixth year including 53 weeks.

2. Basis of preparation

On August 27, 2010, the British Columbia Securities Commission granted the Company exemptive relief from the requirement to prepare its financial statements in accordance with Canadian generally accepted accounting principles in order to use International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The exemptive relief order applies to the preparation of the Company's annual financial statements for years ending on or after January 1, 2010 and interim financial statements for interim periods ending on or after the completion of the Qualifying Transaction.

The consolidated financial statements are prepared in accordance with IFRS under the historical cost basis. The principal accounting policies adopted are set out below and have been applied consistently to the period presented in these consolidated financial statement.

3. Significant accounting policies

3.1 Basis of consolidation

Pursuant to the Qualifying Transaction, these consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiaries. The comparative amounts included in the consolidated financial statements are those of DTR. The consolidated financial statements are issued under the name of the legal parent (the "Company"), but are deemed a continuation of the legal subsidiary ("DTR").

Subsidiary undertakings are those 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. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Conifex Timber Inc.

Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

3.1 Basis of consolidation (continued)

Where necessary, adjustments are made to the results of subsidiaries to bring their accounting policies into line with those used by the parent company. Inter-company transactions, balances, income and expense are eliminated on consolidation, where appropriate.

3.2 Business combinations

Acquisitions of businesses are accounted for using the purchase method. The cost of the business combination is measured as the aggregate of the fair values (at the date of exchange) of assets given and liabilities incurred or assumed, and equity instruments issued by the Company in exchange for control of the acquiree. Acquisition-related costs are generally recognized in profit or loss as incurred. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 *Business Combinations* are recognized at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, which are recognized and measured at fair value less costs to sell.

3.3 Revenue recognition

Revenues are derived from the sale of lumber and by-products. Revenue is recognized from product sales when the significant risks and rewards of ownership are passed to the customer, the sales price is fixed and determinable, and collectability is reasonably assured. Amounts charged to customers for shipping and handling are recognized as revenue and shipping and handling costs and lumber export taxes incurred by the Company are recorded in costs and expenses.

3.4 Government grants

Government grants are not recognized until there is reasonable assurance that the Company will comply with the conditions attaching to them and that the grants will be received.

Government grants for assets are recorded as a reduction to the cost basis of the related asset in the period necessary to match them with the costs for which they are intended to compensate, on a systematic basis.

Government grants for expenses are recorded as a reduction to the related expense in the period necessary to match them with the costs for which they are intended to compensate, on a systematic basis.

3.5 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.

3.6 Interest revenue

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

3.7 Foreign currency translation

Transactions in foreign currencies are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences are recognized in profit or loss in the period in which they arise.

Conifex Timber Inc.

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(Tabular amounts expressed in thousands except per share amounts)

3.8 Leasing

Operating lease payments are recognized as an expense when due over the lease term.

3.9 Assets held for sale

Assets classified as held for sale are reported at the lower of their previous carrying amount and estimated fair market value net of estimated costs of disposal. 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.

3.10 Property, plant and equipment

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

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.

Depreciation is charged to the income statement in one of two methods. For assets whose estimated useful life is independent of production; buildings and fixtures and computer hardware, a straight-line method is followed where the asset is depreciated over its useful life. For machinery and equipment and mobile equipment whose useful life is directly linked to production, a units of production method is used. The units of production method takes the expected production over the useful life of the asset and expenses depreciation based on the production in the period.

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

Buildings and fixtures (straight-line)	2%
Machinery and equipment	10%-33%
Mobile equipment	20%
Computer hardware (straight-line)	33%

Land is not depreciated.

3.11 Intangible assets

Intangible assets 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.

3.12 Cash

Cash comprises cash balances. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash for the purpose of the statement of cash flows.

3.13 Inventories

Logs and lumber are valued at the lower of average cost and net realizable value. The cost of logs and lumber is defined as 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. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost for completion and sale of the item.

Supplies are valued at the lower of average cost and replacement cost.

Conifex Timber Inc.

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(Tabular amounts expressed in thousands except per share amounts)

3.14 Other financial assets

Other receivables that have fixed or determinable payments that are not quoted on an active market are classified as loans and receivables. 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.

3.15 Reforestation obligations

Obligations associated with reforestation are recorded as liabilities when those obligations are incurred, with the amount of the liabilities initially measured at fair value.

3.16 Impairment

The Company's property, plant and equipment and intangibles are reviewed at each reporting date to assess impairment. Where indication of impairment exists, the asset's recoverable amount is estimated, and if found to be lower than its carrying value, it is written down to the recoverable amount. The impairment loss is taken to the Company's income statement. The recoverable amount is the higher of an asset's (or cash generating unit's) net selling price and its value-in-use (i.e. the net present value of its future cash flows, discounted at a pre-tax interest rate that reflects the borrowing costs and risks for the asset).

An impairment loss is reversed if estimates for the recoverable amount change, but only to the extent that its carrying amount after reversal does not exceed the net asset value that would arise had there been no impairment loss.

3.17 Income tax

Income tax on the profit and loss for the period comprises current and deferred tax.

Current 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 tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. 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.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3.18 Significant judgments and key estimates

The preparation of financial statements in conformity with IFRS requires management to make 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. 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. Key estimates include valuation of inventory, depreciation and amortization, income taxes, provision for accrued liabilities, environmental and reforestation obligations, share based compensation, allocation of the purchase price of Mackenzie assets, going concern, impairment and contingencies. Actual results may differ from these estimates.

Conifex Timber Inc.

Notes to the consolidated financial statements

December 31, 2010

(Tabular amounts expressed in thousands except per share amounts)

3.18 Significant judgments and key estimates (continued)

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

3.19 Share-based payments

Equity-settled share-based payments to employees are measured at the fair value of the equity instrument at the grant date. The fair value determined at the grant date is expensed over the vesting period based on the Company's estimate of equity instruments that will eventually vest.

3.20 Derivative financial instruments

The Company enters into derivative financial instruments to manage its exposure to price risk associated with the change in market rates. Gains and losses resulting from changes in the market value of these contracts are recorded as a gain (loss) on derivative instruments each period unless they meet specified criteria to qualify as hedging instruments under IFRS. If these contracts meet the criteria for hedging instruments, any unrealized gains or losses are deferred and recognized in earnings when the related hedge transaction occurs.

3.21 Borrowing costs

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

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

3.22 Changes in accounting policy

Amendment IAS 39, *Financial Instruments - Recognition and Measurement*, is effective for the year ended December 31, 2010. The application of this standard amends the principles that affect a hedged risk. The adoption of this standard had no impact on the financial statements.

Amendment IFRS 7, *Financial Instrument Disclosures*, is effective for the year ended December 31, 2010. The application of this revised standard impacts the presentation and format of the primary statements and notes and these disclosures have been revised accordingly in the 2010 financial statements.

The following standards have been issued but are not yet effective:

		Effective for annual periods beginning on or after
IAS 24	(Revisions) Related party disclosures – which clarifies the definition of a related party	January 1, 2011
IFRS 9	(New standard) Financial Instruments – which introduces certain new requirements for the classification and measurement of financial assets	January 1, 2013
IFRIC 19	New Interpretation Accounting for situations where financial liabilities are settled using equity instruments	July 1, 2010

The Company is currently evaluating the impact of the adoption of these standards on its consolidated financial statements.

Conifex Timber Inc.

Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

4. Completion of DTR equity financing

During April and May of 2010, DTR issued 10,787,878 subscription receipts at \$8.25 per subscription receipt, for gross proceeds of \$88,999,994 through a brokered and non-brokered private placement. On June 3, 2010, each DTR subscription receipt was exchanged for one DTR common share. In connection with this offering, DTR incurred offering and other transaction costs totaling \$3,116,924 which have been recorded as a reduction to share capital.

	Number of common shares	Amount \$
Balance, December 31, 2009	4,256	31,021
Shares issued	10,788	85,883
Balance, December 31, 2010	15,044	116,904

5. Reverse asset acquisition

The Qualifying Transaction between the Company and DTR was completed on June 3, 2010. The Company received 15,043,660 Class A voting common shares of DTR in exchange for 15,043,660 post-consolidated common shares issued by the Company. Prior to the completion of the Qualifying Transaction, the Company had 2,330,000 common shares and 233,000 options outstanding. All of the outstanding shares and options were consolidated on a 27.5 to 1 basis. The aggregate of 84,727 post-consolidated common shares were recorded at an estimated fair value of \$698,998 (\$8.25 per share) and the resulting increase in share capital of \$451,846 was recognized through deficit and as "revaluation expense."

Options to purchase shares outstanding immediately prior to the Qualifying Transaction were replaced with replacement options to purchase an equivalent number of common shares of the Company, on economically equivalent terms and conditions. All of DTR's convertible subordinated notes were acquired from each DTR noteholder, in exchange for notes having substantially similar terms.

The acquisition of the shares of DTR has been accounted for as a reverse asset acquisition.

6. Acquisition of Mackenzie Assets

On March 24, 2010, the Company and Abitibi-Consolidated Company of Canada ("Abitibi") entered into an Asset Purchase Agreement ("APA"), as amended, for the acquisition of certain sawmill and other assets located in or near Mackenzie, British Columbia. The Company completed the acquisition on June 3, 2010.

Total consideration paid included cash of \$33.5 million plus \$1 million for net working capital and assumed long-term liabilities. This transaction has been accounted for as an asset acquisition.

The acquisition was financed through the proceeds of the private placement (Note 4). The purchase price including transaction costs has been allocated to the fair value of the assets acquired and related liabilities arising from the transaction based upon management's best estimates of fair value of tangible and intangible assets, assets held for sale and certain liabilities.

The assets acquired include manufacturing facilities, timber harvesting rights, power generation assets, a paper mill and working capital. The paper mill will not be operated and is recorded as an asset held for sale. The Company assumed certain liabilities of Abitibi including reforestation, environmental and certain employee related liabilities.

Conifex Timber Inc.

Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

6. Acquisition of Mackenzie Assets (continued)

The purchase price is allocated as follows:

	\$
Prepaid expenses	349
Inventories	1,049
Assets held for sale	3,950
Intangible assets	5,700
Power assets	9,701
Other property, plant and equipment	22,502
Accrued liabilities and other payables	(447)
Reforestation obligation	(6,332)
Environmental liabilities	(2,012)
Cash consideration	34,460

During the current period, the Company sold a portion of the assets held for sale and the carrying value of the remaining assets held for sale has been reduced by the total proceeds of disposition of \$2.3 million.

7. Revenue

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
Revenue		
Sale of lumber	50,180	27,584
Sale of by-product	7,205	3,749
	57,385	31,333

8. Segment information

For management purposes, the Company is organized into business units based on their products and services and has two reportable segments as follows:

- 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.
- The main activities of the bioenergy generation segment will include the upgrade and further development of the power related assets acquired as part of the Mackenzie Asset purchase, subsequent operation of the cogeneration facility to export renewable energy to the BC Hydro power grid and to provide steam for the lumber kilns, and the pursuit of opportunities in the bioenergy sector which are complementary to the Company's existing operating facilities and assets. The Company intends to begin the development phase of the cogeneration plant project at Mackenzie B.C. upon completion of certain agreements with BC Hydro as described in Note 28.

Conifex Timber Inc.

Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

8. Segment Information (continued)

Summary by segment:

Year ended December 31, 2010	Lumber \$	Bioenergy \$	Consolidated \$
Sales	57,385	-	57,385
Net loss	(10,290)	(488)	(10,778)
Total assets	116,518	9,986	126,504
Total liabilities	28,958	-	28,958
Year ended December 26, 2009			
Sales	31,333	-	31,333
Net loss	(10,331)	-	(10,331)
Total assets	27,336	-	27,336
Total liabilities	7,974	-	7,974

Revenues by geographic area were as follows:

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
Canada	16,482	10,363
United States	19,434	14,866
Asia	21,469	6,104
	57,385	31,333

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

9. Selling, general and administrative

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
Salaries and benefits	1,649	1,198
Selling costs	2,026	1,253
Other administrative expenses	2,394	1,186
Legal, professional and organizational	778	661
Depreciation and amortization	66	39
	6,913	4,337

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(Tabular amounts expressed in thousands except per share amounts)

10. Income tax expense

10.1 Current income taxes

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
<i>Recognized in income statement</i>		
Tax expense comprises		
Current tax expense	-	-
<i>Reconciliation of effective tax rate</i>		
Loss before taxation	(10,778)	(10,331)
Income tax expense (recovery) at corporation rate of 28.5% (2009 - 30%)	(3,072)	(3,099)
Expenses not deductible for tax purposes	648	69
Effect on deferred balances due to changes in income tax rates	314	(678)
Effect of unused tax losses and tax offsets not recognized as deferred assets	1,845	3,708
Effect of previously unrecognized deferred tax	265	-
Total income tax expense	-	-

10.2 Unrecognized deferred income taxes

The sources of unrecognized deferred income taxes are as follows:

	Dec. 26, 2009	Change		Dec. 31, 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 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, 2010

(Tabular amounts expressed in thousands except per share amounts)

10.2 Unrecognized deferred income taxes (continued)

	Dec. 31,	Change		Dec. 26,
	2008	Related to	Related to	2009
	Opening	earnings	equity	Closing
	balance			balance
	\$	\$	\$	\$
Deferred tax assets related to non-capital losses	1,261	2,723	-	3,984
Deferred tax assets related to temporary differences in tax and book basis	205	(286)	-	(81)
Net deferred tax assets	1,466	2,437	-	3,903

No deferred tax assets were recognized as at December 26, 2009 due to the uncertainty as to realization.

10.3 Non-capital loss carry forwards

As at December 31, 2010, 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
	18,000

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 Dec. 31, 2010			Year ended Dec. 26, 2009		
	Net loss	Weighted average number of Shares	Per share	Net loss	Weighted average number of Shares	Per share
	\$		\$	\$		\$
Basic loss per share	(10,778)	10,577	(1.02)	(10,331)	4,212	(2.45)
Convertible notes	-	1,250*	-	-	-	-
Diluted loss per share	(10,778)	10,577	(1.02)	(10,331)	4,212	(2.45)

*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.

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December 31, 2010

(Tabular amounts expressed in thousands except per share amounts)

12. Intangible assets

	Forestry licences	Software licences	Total
	\$	\$	\$
<i>Cost</i>			
At December 26, 2009	2,850	183	3,033
<i>Additions</i>			
Acquisition of Mackenzie Assets	5,700	-	5,700
At December 31, 2010	8,550	253	8,803
<i>Accumulated amortization</i>			
At December 26, 2009	-	(68)	(68)
Amortization charge for the period	(63)	(65)	(128)
At December 31, 2010	(63)	(133)	(196)
<i>Carrying amount</i>			
At December 26, 2009	2,850	115	2,965
At December 31, 2010	8,487	120	8,607

13. Property, plant and equipment

	Buildings and land	Machinery/ equipment	Power assets	Capital work in progress	Total
	\$	\$	\$	\$	\$
<i>Cost</i>					
At December 26, 2009	1,498	7,638	-	1,025	10,161
Additions	2,883	14,820	285	8,751	26,739
Acquisition Mackenzie	3,926	18,575	9,701	-	32,202
Disposals	-	(322)	-	-	(322)
At December 31, 2010	8,307	40,711	9,986	9,776	68,780
<i>Accumulated depreciation</i>					
At December 26, 2009	(68)	(957)	-	-	(1,024)
Depreciation charge for the period	(84)	(2,302)	-	-	(2,386)
Disposals	-	322	-	-	322
At December 31, 2010	(152)	(2,936)	-	-	(3,088)
<i>Carrying amount</i>					
At December 26, 2009	1,430	6,682	-	1,025	9,137
At December 31, 2010	8,155	37,775	9,986	9,776	65,692

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.

14. Cash

All cash is available for use by the Company at December 31, 2010 (and at December 26, 2009).

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Notes to the consolidated financial statements

December 31, 2010

(Tabular amounts expressed in thousands except per share amounts)

15. Inventories

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Logs	5,729	1,630
Lumber	5,911	1,938
Supplies	3,502	1,881
	15,142	5,449

Inventory expensed in the period ended December 31, 2010 was \$44,734,679 (December 26, 2009 - \$29,160,456). Inventory is valued at the lower of average cost and net realizable value at the end of each period. Net realizable value is estimated based on prevailing selling prices for finished lumber at period end. Log and lumber inventory has been written down at December 31, 2010 by \$658,760 (December 26, 2009 - \$531,642) and this amount is included in cost of goods sold.

16. Trade and other receivables

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Trade receivables	3,451	1,797
Other receivables	2,301	1,081
HST receivable	259	53
	6,011	2,931

Included in the above are \$Nil receivables due after more than one year.

17. Reforestation obligations

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Silviculture liability		
Current	1,589	173
Non-current	5,118	586
	6,707	759

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Balance at beginning of year	759	675
Additional provisions recognized	229	215
Reductions arising from payment	(558)	(63)
Reductions arising from re-measurement or settlement without cost	(55)	(68)
Mackenzie (Note 6)	6,332	-
	6,707	759

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Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

18. Employee liabilities

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Non-current		
Long-term employee liability	111	204
Current		
Payroll	810	351
Deferred union payroll liability	1,012	517
	1,822	868
	1,933	1,072

The long-term employee liability relates to a contribution under employment agreements for four employees. This liability was set-up 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 or upon employee retirement. The terms of the agreement remain in effect for the duration of the term of the current collective agreement which expires June 30, 2013.

19. Trade payables, accrued liabilities and other payables

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Trade payables	4,172	1,420
Accruals	2,249	985
Other payables	91	91
Related party payables	-	92
	6,512	2,588

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20. Convertible notes

In November 2009, DTR arranged for \$10,000,000 of convertible note financing as follows:

		\$
December 17, 2009	Convertible subordinated notes issued	7,950
	Less: issuance costs	(300)
	Equity component	(4,095)
<hr/>		<hr/>
December 26, 2009		3,555
December 30, 2009	Convertible subordinated notes issued	2,050
	Less: issuance costs	(41)
	Equity component	(1,093)
	Accretion of issuance costs	70
	Accretion of convertible notes	1,037
<hr/>		<hr/>
December 31, 2010		5,578

Term	5 years
Maturity date	December 15, 2015
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 convertible notes contain two components: liability and equity elements. The equity element is presented in equity under the heading of "conversion option on convertible notes". The effective interest rate of the liability element on initial recognition is 22.5% and represents the estimated rate of borrowings on equivalent unsecured financing upon issuance. The note discount equal to the value of the option is accreted over the term of the note.

On December 15, 2010, the Company paid interest due on the convertible notes by issuing 31,151 common shares as payment in kind and cash payments for fractional shares. At December 31, 2010, interest has been accrued and the note discount has been accreted.

On June 3, 2010, as part of the Qualifying Transaction, all of DTR's convertible subordinated notes were acquired by the Company from each DTR noteholder, in exchange for notes having substantially similar terms.

21. Long-term debt

In August of 2009, the Company was approved for a secured loan facility of \$8,500,000 under the Community Adjustment Fund ("CAF") loan program sponsored by the Northern Development Initiative Trust. In November of 2010, the amount of the secured loan facility was amended to \$8,594,876. The CAF loan carries a fixed interest rate of 3.75% with twenty quarterly repayments to commence June 1, 2011. The loan is secured by a General Security Agreement (excluding inventory and receivables) and a mortgage against specific properties. Under the agreement, funds are drawn down based upon a fixed percentage of related capital expenditure dollars spent on the capital expenditure program currently underway at the Company's Fort St. James mill. The Company drew down \$ 6,964,819 of this loan facility during the year ended December 31, 2010. Interest has been capitalized in the amount of \$96,161 (2009 - \$ nil).

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Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

21. Long-term debt (continued)

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Current portion - repayments of principal due between June 1, 2011 and December 31, 2011	1,227	-
Repayments of principal due between January 1, 2012 and March 1, 2016	5,738	-
	<u>6,965</u>	<u>-</u>

22. 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, December 31, 2009 - West Fourth Capital	2,330	247
Consolidated on the basis of 27.5 to 1 share outstanding	(2,245)	-
Revaluation adjustment Note 5	-	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 (Note 4)	10,788	85,883
Shares issued on exercise of stock options	8	47
Shares issued as payment of interest on convertible notes (Note 20)	31	249
Balance, December 31, 2010	<u>15,168</u>	<u>117,899</u>

23. Stock option plan and share-based compensation

23.1 Stock option plan

The Company has a stock option plan applicable to directors, officers and consultants, under which 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 September 30, 2010 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

Conifex Timber Inc.

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23.1 Stock option plan (continued)

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 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 \$105,620 was recognized in the year ended December 31, 2010 (December 26, 2009 - \$nil).

23.2 Share-based compensation

The Company operates a share compensation program for executives and salaried employees. The program has set aside 174,994 shares with a fair value of \$8 per share at the grant date and 101,148 shares with a fair value of \$8.25 per share at the grant date, at a total value of \$2,234,412 for executive and salaried employees. The shares vest at 60% in three years, 80% in four years and will be 100% vested in five years and are expensed over the vesting period.

The total number of shares recognized as an expense during the period from January 1, 2010 to December 31, 2010 was 52,135 for a recorded expense of \$421,857 (2009 total - \$276,552). The expense is allocated between cost of sales and selling, general and administrative expense.

24. Financial instruments

24.1 Capital management

The Company's objective when managing capital is to maintain a strong balance sheet that ensures adequate liquidity and sustains future development of the business. The capital structure of the Company consists of net debt (convertible notes - Note 20 and CAF loan – Note 21 offset by cash and bank balances) and equity (comprising issued capital, deficit and reserves). The Company's current principal sources of funds are cash flow from operations, cash on hand and its available credit facility under the CAF loan. The Company is seeking to secure additional credit facilities in 2011. The Company's principal uses of funds consist of operating and capital expenditures and repayment of debt.

As part of its overall strategy, the Company may acquire businesses or additional assets from time to time as such opportunities arise. As a result, the Company may require substantial additional capital resources. The Company expects such additional capital resources will be generated from debt financing and / or the issuance of equity securities.

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24.2 Categories of financial instruments and fair values

The following tables include both the current and non-current financial instrument balances:

Categories of financial instruments and their fair values

				Dec. 31, 2010	Dec. 26, 2009	
	Loans and receivables	Held for trading	Financial assets and liabilities at amortized cost	Total carrying amount	Fair value	Fair value
	\$	\$	\$	\$	\$	\$
Financial assets						
Trade and other receivables	6,011	-	-	6,011	6,011	2,931
Cash	26,629	-	-	26,629	26,629	6,077
Total financial assets	32,640	-	-	32,640	32,640	9,008
Financial liabilities						
Trade and other payables	-	-	6,421	6,421	6,421	2,497
CAF loan	-	-	6,965	6,965	6,925	-
Convertible notes	-	-	5,578	5,578	8,511	3,555
Total financial liabilities	-	-	18,964	18,964	21,857	6,052

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Included in trade and other receivables are derivative instruments of \$432,425 carried at fair value and classified as Level 2 financial instruments. Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability either directly (i.e., as prices) or indirectly (i.e., derived from prices).

Management has determined that the fair value of non-derivative financial assets is in accordance with generally accepted pricing models based on observable current market transactions.

24.3 Interest rate risk

The Company's exposure to interest rates on financial assets is analyzed below:

				Dec. 31, 2010	Dec. 26, 2009			
	Effective interest rate	Floating interest rate	Fixed interest rate			Non- interest bearing	Total	Total
	%	\$	<1 year	1-5 years	>5 years	\$	\$	\$
Financial assets								
Trade and other receivables	-	-	-	-	-	6,011	6,011	2,931
Cash	0.1	26,629	-	-	-	-	26,629	6,077
Total financial assets		26,629	-	-	-	6,011	32,640	9,008

Financial liabilities are either non-interest bearing or carry fixed rate of interest.

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24.4 Foreign currency risk

Certain of the Company's sales transactions are denominated in foreign currencies, principally the U.S. dollar and, accordingly, the Company is exposed to currency risk associated with changes in foreign currency exchange rates. Accordingly, fluctuations in foreign exchange costs may affect the carrying value of the underlying accounts receivable. As at December 31, 2010, the Company's accounts receivable denominated in U.S. dollars totaled US\$4,054,967. The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US\$1.00 during 2010 would have decreased or increased, respectively, annual operating earnings by approximately \$274,244. The Company does not currently use financial derivative instruments for its foreign exchange risk management programme.

24.5 Equity price risk

The Company has no equity price risk as the Company has no equity investments.

24.6 Credit risk

Credit risk arises from cash and deposits with banks, short-term investments and accounts receivable. Management reviews the credit worthiness of new customers and lumber sales are conducted under standard industry terms and conditions. The Company regularly reviews the collectibility of accounts receivable and makes provisions where the collectibility is uncertain. The Company does not have significant credit risk as cash and deposits are held with a major Canadian bank.

24.7 Price risk

The Company uses derivative financial instruments to reduce its exposure to risks associated with fluctuations in lumber prices. At December 31, 2010, the fair value of outstanding commodity financial instruments was \$432,425 (December 26, 2009 - \$207,326). The fair value of these instruments was determined based on market rates for instruments with similar characteristics.

25. 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.

Compensation of directors and officers of the Company

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

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
Short-term benefits	1,002	632
Share-based payments	206	52
	1,208	684

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26. Commitments

Operating lease payments

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

	Year ended Dec. 31, 2010	Year ended Dec. 26, 2009
	\$	\$
Equipment	116	77
Land	45	-
Office equipment	18	13
Vehicles	32	26
	<u>211</u>	<u>116</u>

Operating lease commitments

	Dec. 31, 2010	Dec. 26, 2009
	\$	\$
Not longer than 1 year	202	156
Longer than 1 year and not longer than 5 years	273	245
	<u>475</u>	<u>401</u>

Capital commitments

At December 31, 2010, the Company had capital commitments totaling \$6.8 million to complete an ongoing capital expenditure project and to acquire certain property and become payable in 2011.

27. Contingencies

Reassessment of property transfer tax

In July 2010, the Company was reassessed property transfer tax in the amount of \$151,160 related to the acquisition of the Fort St. James assets in 2008. The Company has appealed the Minister's decision. There has been no provision made for the reassessment in the consolidated financial statements.

28. Events after the reporting period

28.1 Sale of redundant assets

On January 7, 2011, the Company entered into an Equipment Purchase and Sale Agreement to sell certain Equipment classified as "assets held for sale" for proceeds of U.S. \$325,000.

28.2 Softwood Lumber Agreement

On January 18, 2011, the US triggered the arbitration provision of the Softwood Lumber Agreement ("SLA") 2006 by delivering a Request for Arbitration. The US claims that BC has not applied the timber pricing system grand parented in SLA 2006. The US also claims that, post 2006, BC made additional changes to the timber pricing system which contributed to the under pricing of timber. The claim focuses on the substantial increases

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28.2 Softwood Lumber Agreement (continued)

in Grade 4 log volumes commencing in 2007. It is also alleged that the failure to apply the market pricing system wrongly reduced the prices of Grade 1 and Grade 2 sawlogs. 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 Province of BC and BC industry. It is not possible at this time to predict the outcome or the value of the claim. The impact, if any, will be accounted for when the outcome is determinable.

28.3 Equipment purchase related to bioenergy generation project at Mackenzie B.C.

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 36MW steam turbine generation set and ancillary equipment and services in connection with its planned bioenergy generation project (the "Bioenergy Project") at Mackenzie B.C. The total cost of the purchase is approximately U.S. \$10.5 million. The Bioenergy Project is expected to generate approximately 230 GWh of net energy per year.

Conifex is in discussions with BC Hydro in connection with a proposed energy purchase agreement and with respect to establishing energy savings arrangements at its Mills. Such agreement and arrangements, if completed, will be subject to regulatory approval.

As no agreement has yet been reached, and as any such agreement would be subject to regulatory approval, 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 and agreed upon schedule.

29. Approval of financial statements

The financial statements were approved by the board of directors and authorized for issue on March 8, 2011.