

Interim consolidated financial statements of

# **Conifex Timber Inc.**

(Formerly West Fourth Capital Inc.)

June 30, 2010  
(Unaudited)

# Conifex Timber Inc.

June 30, 2010

## Table of contents

Interim consolidated statement of comprehensive loss .....	1
Interim consolidated balance sheet .....	2
Interim consolidated statement of changes in equity.....	3
Interim consolidated statement of cash flows .....	4
Notes to the interim consolidated financial statements.....	5-23

# Conifex Timber Inc.

## Interim consolidated statement of comprehensive loss period ended June 30, 2010 (unaudited)

(thousands of Canadian dollars except earnings per share)		Three months ending		Six months ending	
	Notes	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
		\$	\$	\$	\$
<b>Revenue</b>	6	12,604	8,408	24,680	8,575
<b>Costs and expenses</b>					
Cost of goods sold		10,353	6,937	19,239	11,848
Freight and other distribution costs		2,336	2,068	4,771	2,068
Export taxes		269	357	737	357
Selling, general and administrative	8	1,482	930	2,821	1,624
		14,441	10,292	27,567	15,897
<b>Operating Income (Loss)</b>		(1,837)	(1,884)	(2,887)	(7,321)
Interest and investment income/(expense)		211	309	(22)	326
Realized and unrealized foreign exchange gain/(loss)		(42)	(37)	(123)	(37)
Gain/(loss) on lumber price derivatives		282	(76)	-	(76)
Accretion of convertible debenture		(519)	-	(519)	-
Write off of revaluation expense	3	(452)	-	(452)	-
		(520)	196	(1,116)	213
Loss before tax		(2,356)	(1,688)	(4,003)	(7,108)
Current tax	9	-	-	-	-
<b>Net loss and comprehensive loss for the period</b>		(2,356)	(1,688)	(4,003)	(7,108)
<b>Net loss per share, basic and diluted</b>	10	(0.31)	(0.40)	(0.67)	(1.71)

See accompanying notes to the unaudited interim consolidated financial statements

# Conifex Timber Inc.

## Interim consolidated balance sheet as at June 30, 2010 (unaudited)

(thousands of Canadian dollars)		June 30,	December 26,
	Notes	2010	2009
		\$	\$
<b>Assets</b>			
<i>Non-current assets</i>			
Intangible assets	11	8,649	2,965
Property, plant and equipment	12	45,629	9,137
Deposits		167	155
<b>Total non-current assets</b>		<b>54,445</b>	<b>12,256</b>
<i>Current assets</i>			
Cash	13	52,016	6,077
Inventories	14	10,038	5,449
Trade and other receivables	15	2,694	2,932
Prepaid expenses and deposits		3,021	623
Assets held for sale	4	3,500	-
<b>Total current assets</b>		<b>71,269</b>	<b>15,080</b>
<b>Total assets</b>		<b>125,714</b>	<b>27,336</b>
<b>Liabilities</b>			
<i>Non-current liabilities</i>			
Reforestation obligations	16	(6,264)	(586)
Environmental liabilities		(1,500)	-
Employee liabilities	17	(181)	(204)
Convertible notes	19	(5,025)	(3,555)
Long term debt	20	(2,269)	-
<b>Total non-current liabilities</b>		<b>(15,239)</b>	<b>(4,345)</b>
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables	18	(4,514)	(2,497)
Reforestation obligations	16	(1,339)	(173)
Employee liabilities	17	(1,556)	(869)
Income tax payable		(91)	(91)
<b>Total current liabilities</b>		<b>(7,500)</b>	<b>(3,630)</b>
<b>Total liabilities</b>		<b>(22,740)</b>	<b>(7,974)</b>
<b>Net assets</b>		<b>102,974</b>	<b>19,362</b>
<b>Equity</b>			
Share capital	21	117,650	31,021
Conversion option on convertible notes	19	5,187	4,095
Contributed surplus		457	277
Deficit		(20,320)	(16,031)
<b>Total equity and shareholders' funds</b>		<b>102,974</b>	<b>19,362</b>

Commitments and Contingencies - Note 26 and 27

See accompanying notes to the unaudited interim consolidated financial statements

# Conifex Timber Inc.

## Interim consolidated statement of changes in equity period ended June 30, 2010 (unaudited)

(thousands of Canadian dollars)					
	Share capital	Conversion option on convertible notes	Contributed surplus	Deficit	Total equity
	\$	\$	\$	\$	\$
<b>Balance at January 1, 2009</b>	<b>30,046</b>			<b>(5,700)</b>	<b>24,346</b>
Net loss for the period January 1, 2009 to June 27, 2009				(7,109)	(7,109)
Capital introduced during the period	975				975
Contributed surplus during the period			138		138
<b>Balance at June 27, 2009</b>	<b>31,021</b>	<b>-</b>	<b>138</b>	<b>(12,809)</b>	<b>18,350</b>
Net loss for the period June 28, 2009 to December 26, 2009				(3,222)	(3,222)
Issue of convertible notes		4,095			4,095
Contributed surplus during the period			139		139
<b>Balance at December 26, 2009</b>	<b>31,021</b>	<b>4,095</b>	<b>277</b>	<b>(16,031)</b>	<b>19,362</b>
Net loss for the six months ended June 30, 2010				(4,003)	(4,003)
<b>Total recognized income and expense for the period</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(4,003)</b>	<b>(4,003)</b>
Fourth share capital	247	-	-	-	247
Revaluation of Fourth shares to fair value	452	-	-	-	452
Contributed surplus from Fourth	-	-	37	-	37
Deficit from Fourth	-	-	-	(287)	(287)
<b>Total arising from Qualifying Transaction</b>	<b>699</b>	<b>-</b>	<b>37</b>	<b>(287)</b>	<b>449</b>
Capital introduced during the period	85,883	-	-	-	85,883
Exercise of stock options	47	-	-	-	47
Issue of convertible notes	-	1,093	-	-	1,093
Equity-settled employee benefits	-	-	143	-	143
<b>Total of other changes in equity</b>	<b>85,930</b>	<b>1,093</b>	<b>143</b>	<b>-</b>	<b>87,166</b>
<b>Balance at June 30, 2010</b>	<b>117,650</b>	<b>5,187</b>	<b>457</b>	<b>(20,320)</b>	<b>102,974</b>

See accompanying notes to the unaudited interim consolidated financial statements

# Conifex Timber Inc.

## Interim consolidated statement of cash flows period ended June 30, 2010 (unaudited)

(thousands of Canadian dollars)		For three months ending		For six months ending	
	Notes	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
		\$	\$	\$	\$
<b>Operating activities</b>					
Operating loss before changes in working capital	23	(471)	(2,179)	(1,554)	(4,495)
Decrease/(increase) in trade and other receivables		1,253	(2,487)	238	(2,454)
Decrease/(increase) in prepaid expenses and deposits		(2,355)	680	(2,061)	(5)
Decrease/(increase) in inventories		1,603	2,252	(3,813)	(4,844)
(Decrease)/increase in trade payables, accrued liabilities and other payables		(1,557)	(1,156)	1,569	285
Increase/(decrease) in reforestation obligation		(34)	(12)	-	-
Increase in employee liabilities		403	692	665	980
<b>Net cash flows used in operating activities</b>		<b>(1,158)</b>	<b>(2,209)</b>	<b>(4,957)</b>	<b>(10,533)</b>
<b>Investing activities</b>					
Interest and investment income (loss)		211	-	(22)	17
Purchase of intangible assets		(15)	(1)	(15)	(54)
Purchase of property, plant and equipment		(2,434)	(155)	(4,812)	(749)
Acquisition of Mackenzie Assets		(34,460)	-	(34,460)	-
Purchase of short-term investments		-	(187)	-	(187)
<b>Net cash flows used in investing activities</b>		<b>(36,698)</b>	<b>(343)</b>	<b>(39,310)</b>	<b>(973)</b>
<b>Financing activities</b>					
Capital introduced - share proceeds		85,883	975	85,883	975
Bank indebtedness on reverse asset acquisition		(3)	-	(3)	-
Proceeds from exercise of stock options		47	-	47	-
Proceeds from CAF loan		2,269	-	2,269	-
Proceeds from conversion option on convertible notes		-	-	2,009	-
Loan proceeds		-	750	-	750
<b>Net cash flows from financing activities</b>		<b>88,196</b>	<b>1,725</b>	<b>90,206</b>	<b>1,725</b>
<b>Net increase in cash</b>		<b>50,340</b>	<b>(827)</b>	<b>45,939</b>	<b>(9,781)</b>
Cash, beginning of period		1,676	1,227	6,077	10,181
<b>Cash, end of period</b>		<b>52,016</b>	<b>400</b>	<b>52,016</b>	<b>400</b>

See accompanying notes to the unaudited interim consolidated financial statements

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 1. General information

Conifex Timber Inc. ("Conifex" or the "Company") and its subsidiaries are in the business of acquiring and operating forest product facilities in Canada.

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 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 has not commenced operations.

The Company's fiscal year end will be 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. Accounting policies

#### (a) 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"). 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 interim financial statements are prepared in accordance with IFRS and in accordance with International Accounting Standard ("IAS") 34 Interim Financial Reporting under the historical cost basis. The principal accounting policies adopted are set out below.

The accounting policies set out below have been applied consistently to the period presented in these consolidated interim financial statements.

#### (b) Basis of consolidation

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

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 2. Accounting policies (continued)

#### (b) *Basis of consolidation (continued)*

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 interim financial statements of subsidiaries are included in the consolidated interim financial statements from the date that control commences until the date that control ceases.

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.

#### (c) *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, plus any costs directly attributable to the business combination. 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.

#### (d) *Revenue recognition*

Revenue from the sale of goods shall be recognized when all the following conditions are met:

- the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
- the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

#### (e) *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.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 2. Accounting policies (continued)

(f) *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.

(g) *Interest revenue*

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

(h) *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.

(i) *Leasing*

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

(j) *Asset classified as held for sale*

Assets classified as held for sale are reported at estimated fair market value net of estimated costs of disposal.

(k) *Property, plant and equipment*

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses, if any, that have been recognized in equity. 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:

Land	0%
Buildings and fixtures (straight-line)	2%
Machinery and equipment	10%-33%
Mobile equipment	20%
Computer hardware (straight-line)	33%

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 2. Accounting policies (continued)

(l) *Intangible assets*

Intangible assets are stated at cost less accumulated amortization.

The forestry license is considered to have an indefinite useful life based on legislation governing its replaceability and is not being amortized, but is tested annually for impairment.

Amortization of the software license is charged to the income statement on a straight-line basis over the estimated useful life of 3 years.

(m) *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.

(n) *Inventories*

Logs and lumber are valued at the lower of average cost and net realizable value. 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.

(o) *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.

(p) *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.

(q) *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.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 2. Accounting policies (continued)

#### (r) *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.

#### (s) *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, going concern, impairment and contingencies. Actual results may differ from these estimates.

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.

#### (t) *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

#### (t) *Share-based payments*

on a straight-line basis over the vesting period based on the Company's estimate of equity instruments that will eventually vest.

#### (u) *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.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 2. Accounting policies (continued)

(v) *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.

(w) *Changes in accounting policy*

#### Operating Segments

Effective December 28, 2009, the Company adopted a new accounting standard (IFRS 8 *Operating Segments*) that was issued by the International Accounting Standards Board ("IASB"). IFRS 8 was revised and now requires disclosure of information about segment assets. This accounting policy change was adopted on a prospective basis with no restatement of prior period financial statements. The change has been reflected in Note 7.

Revised IAS 23, *Borrowing Costs*, is effective for the year ended December 31, 2010. IAS 23 removes the option to expense borrowing costs and requires an entity to capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The adoption of this standard did not have a material impact on the financial statements.

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 did not have a material 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

A detailed analysis of the possible applicability and potential effect of the pronouncements included above has not yet been performed.

# Confifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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### 2. Accounting policies (continued)

*(w) Changes in accounting policy (continued)*

The significant accounting policies adopted in these financial statements are set out in Note 2.

### 3. Reverse asset acquisition

The Qualifying Transaction between the Company and DTR was completed on June 3, 2010. 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 "write-off of 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.

### 4. 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 liabilities.

The acquisition was financed through the proceeds of the private placement (Note 5). The purchase price including transaction costs has been allocated on a preliminary basis to the fair value of the assets acquired and related liabilities arising from the transaction based on values agreed to in the APA and on management's best estimates and taking into account all available information to June 30, 2010. The purchase price allocation is preliminary and subject to adjustment in accordance with further refinement of fair value allocations.

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 unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 4. Acquisition of Mackenzie Assets (continued)

The purchase price is allocated on a preliminary basis as follows:

	\$
Prepays	349
Inventories	1,049
Asset held for sale	3,500
Intangible assets	5,700
Power assets	10,000
Property, plant and equipment	22,654
Accrued liabilities and other payables	(447)
Reforestation obligation	(6,845)
Environmental liabilities	(1,500)
	<u>34,460</u>

### 5. Completion of 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 has been recorded as a reduction to share capital.

### 6. Revenue

	Three months ended		Six months ended	
	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
	\$	\$	\$	\$
Revenue				
Sale of lumber	10,591	7,259	21,344	7,259
Sale of by-product	2,013	1,149	3,336	1,316
	<u>12,604</u>	<u>8,408</u>	<u>24,680</u>	<u>8,575</u>

### 7. Segment information

The Company's main business activities are the purchase and harvesting of logs; the manufacturing of logs into finished lumber and residual products at its sawmill and the distribution of its finished products. The Company manages its business as a single operating segment. All of the Company's operations are located in the interior region of British Columbia.

The Company acquired assets related to heat and power generation including a power boiler and steam turbine generator. The power related assets have been recorded at an estimated fair value of \$10 million (note 4). Future wood biomass converting and power related activities are expected to be segregated into a separate operating segment when the scope of these activities have been defined and the assets become operational.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 8. Selling, general and administrative

	Three months ended		Six months ended	
	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
	\$	\$	\$	\$
Salaries and benefits	474	391	812	740
Selling costs	312	277	737	280
Other administrative expenses	544	98	894	307
Legal, professional and organizational	134	148	341	270
Depreciation and amortization	19	16	36	26
	<b>1,482</b>	<b>930</b>	<b>2,821</b>	<b>1,624</b>

### 9. Income tax expense

#### (a) Current income taxes

	Three months ended		Six months ended	
	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
	\$	\$	\$	\$
<i>Recognized in income statement</i>				
Tax expense comprises				
Current tax expense	-	-	-	-
<i>Reconciliation of effective tax rate</i>				
Loss before taxation	(2,356)	(1,688)	(4,003)	(7,109)
Income tax expense at corporation rate of 28.5% (2009 - 30%)	(672)	(506)	(1,141)	(2,133)
Expenses not deductible for tax purposes	51	16	190	16
Change in future tax rates	211	370	211	370
Losses not recognized in current period	410	120	740	2201
Total income tax expense	-	-	-	454

As at June 30, 2010, the Company has non-capital losses of approximately \$14.6 million. The non-capital losses are available to offset future taxable income and expire in 2028 and 2029.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 9. Income tax expense (continued)

#### (b) Unrecognized deferred income taxes

	Opening balance	Charged to income	June 30, 2010 Closing balance
	\$	\$	\$
Temporary differences			
Fixed assets	(276)	475	199
Convertible notes	-	130	130
Deferred payroll - union	-	129	129
Reforestation obligation	-	190	190
Unrealized foreign exchange	-	2	2
CEC	195	770	965
	(81)	1,696	1,616
Unused tax losses and credits			
Tax losses	3,984	(326)	3,658
	3,903	1,370	5,274

No deferred tax asset has been recognized in these financial statements due to the uncertainty as to its realization.

	Opening balance	Charged to income	December 26, 2009 Closing balance
	\$	\$	\$
Temporary differences			
Fixed assets	10	(286)	(276)
CEC	195	-	195
	205	(286)	(81)
Unused tax losses and credits			
Tax losses	1,261	2,723	3,984
	1,466	2,438	3,903

No tax asset was recognized in 2009 due to the uncertainty as to its realization.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 10. Net earnings (loss) per share

	Three months June 30, 2010			Three months June 30, 2009		
	Net loss	Shares	Per share	Net loss	Shares	Per share
	\$		\$	\$		\$
Basic loss per share	(2,356)	7,603	(0.31)	(1,688)	4,204	(0.40)
Convertible notes	-	1,250*	-	-	-	-
Diluted loss per share	(2,356)	7,603	(0.31)	(1,688)	4,204	(0.40)

  

	Six months June 30, 2010			Six months June 30, 2009		
	Net loss	Shares	Per share	Net loss	Shares	Per share
Basic loss per share	(4,003)	5,939	(0.67)	(7,109)	4,167	(1.71)
Convertible notes	-	1,250*	-	-	-	-
Diluted loss per share	(4,003)	5,939	(0.67)	(7,109)	4,167	(1.71)

\*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.

### 11. Intangible assets

	Forestry licences	Software licences	Total
	\$	\$	\$
At December 26, 2009	2,850	183	3,033
Additions	-	15	15
Acquisition of Mackenzie Assets	5,700	-	5,700
At June 30, 2010	8,550	198	8,748
<i>Amortization</i>			
At December 26, 2009	-	(69)	(69)
Amortization charge for the period	-	(31)	(31)
At June 30, 2010	-	(99)	(99)
<i>Carrying amount</i>			
At December 26, 2009	2,850	115	2,964
At June 30, 2010	8,550	99	8,648

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 12. Property, plant and equipment

	Land	Buildings/ fixtures	Machinery/ equipment	Mobile equipment	Computer hardware	Power Assets	Capital work in progress	Total
	\$	\$		\$	\$	\$	\$	\$
<i>Cost</i>								
At December 26, 2009	121	1,377	6,671	874	93	-	1,025	10,161
Additions	-	57	5,769	-	11	-	4,801	10,638
Acquisition Mackenzie	1,927	3,639	16,688	400	-	10,000	-	32,654
Disposals/transfers			(322)				(5,826)	(6,148)
At June 30, 2010	2,048	5,074	28,806	1,274	104	10,000	-	47,306
<i>Accumulated depreciation</i>								
At December 26, 2009	-	(68)	(725)	(196)	(35)	-	-	(1,024)
Depreciation charge for the period	-	(26)	(812)	(121)	(15)	-	-	(975)
Disposals			322					322
At June 30, 2010	-	(93)	(1,216)	(318)	(50)	-	-	(1,677)
<i>Carrying amount</i>								
At December 26, 2009	121	1,310	5,946	678	58	-	1,025	9,137
At June 30, 2010	2,048	4,981	27,590	956	54	10,000	-	45,629

### 13. Cash

	June 30, 2010	December 26, 2009
	\$	\$
Bank balances	52,016	6,077

All cash is available for use by the Company at June 30, 2010 (and at December 26, 2009)..

### 14. Inventories

	June 30, 2010	December 26, 2009
	\$	\$
Logs	1,850	1,631
Lumber	5,050	1,938
Supplies	3,138	1,881
	10,038	5,449

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 15. Trade and other receivables

	June 30, 2010	December 26, 2009
	\$	\$
Trade receivables	1,779	1,797
Other receivables	883	1,081
GST receivable	32	53
	<u>2,694</u>	<u>2,932</u>

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

### 16. Reforestation obligation

	June 30, 2010	December 26, 2009
	\$	\$
Silviculture liability		
Current	1,339	173
Non-current	6,264	586
	<u>7,604</u>	<u>759</u>

### 17. Employee liabilities

	June 30, 2010	December 26, 2009
	\$	\$
Non-current		
Long-term employee liability	181	204
Current		
Payroll	891	352
Deferred union payroll liability	665	517
	<u>1,556</u>	<u>869</u>
	<u>1,737</u>	<u>1,073</u>

The long-term employee liability relates to a contribution under employment agreements for four staff. 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 will be paid over five years.

The deferred union payroll liability relates to deferred payroll costs for unionized employees, agreed upon prior to commencement of operations on March 2, 2009. 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 will remain in effect for the duration of the term of the subsequent collective agreement following the 2003-2009 collective agreement.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 18. Trade payables, accrued liabilities and other payables

	June 30, 2010	December 26, 2009
	\$	\$
Trade payables	1,246	1,724
Accruals	3,268	751
Related party payables	-	23
	<u>4,514</u>	<u>2,497</u>

### 19. Convertible notes

In November 2009, DTR arranged for \$10,000,000 of convertible note financing. These notes have a five year term and carry an interest rate of 2.5% from issue to December 15, 2012 to be settled in common shares and 10.5% thereafter to be settled in cash. The convertible notes mature on December 15, 2014 and are convertible at the option of the holder into common shares at a conversion price of \$8 per share. The notes may be redeemed by the Company on or after December 15, 2013 at a redemption price equal to the principal amount plus accrued and unpaid interest. The holder's conversion option is valued separately from the convertible note at the estimated fair market value of the option at the date of issuance using a discount rate of 22.5% representing the estimated rate of borrowings on equivalent unsecured financing. The note discount equal to the value of the option is accreted over the term of the note. The convertible notes were issued as follows:

- On December 17, 2009 DTR issued \$7,950,000 of convertible subordinated notes, less issuance costs of \$300,000. The holder's conversion option has been valued at \$4,094,752. At June 30, 2010, interest has been accrued and the note discount has been accreted.
- On December 30, 2009, DTR issued \$2,050,000 of convertible subordinated notes less issuance costs of \$40,560. The holder's conversion option has been valued at \$1,092,678. At June 30, 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 Fourth from each DTR noteholder, in exchange for notes having substantially similar terms.

### 20. Long-term debt

In August of 2009, the Company was approved for a secured loan of \$8,500,000 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% with twenty quarterly repayments to commence June 1, 2011. The amount of funds advanced under the program is based upon a fixed percentage of related capital expenditure dollars spent. The Company drew down \$ 2,269,184 of this facility during the period in connection with the capital project at the Fort St. James planer mill. In accordance with the Company's borrowing cost accounting policy (note 2 (u)), the interest has been capitalized. The loan is secured by a General Security Agreement (excluding inventory and receivables) and a mortgage against specific properties.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 21. Share capital

#### Authorized

Unlimited number of common voting shares without par value.

#### Issued and fully paid

During the period, DTR completed equity financing as described in Note 5.

	Number of common shares	Amount \$
Balance, December 31, 2009	4,256	31,021
Shares issued	10,788	85,883
Balance, June 30, 2010	15,044	116,904

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.

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 Consolidated on the basis of 27.5 to 1 share outstanding	2,330	247
	(2,245)	-
Adjustment to estimated fair value		452
Balance after consolidation and before Qualifying Transaction - West Fourth Capital	85	699
Share capital arising from Qualifying Transaction on June 3, 2010	15,044	116,904
Shares issued on exercise of stock options	8	47
Balance, June 30, 2010	15,137	117,650

### 22. Stock option plan and share-based compensation

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. Under the plan, an option's maximum term is five years from the grant date. Options under this plan vest upon issuance. As at June 30, 2010, the Company had no options outstanding.

The Company also operates a share compensation program for executives and salaried employees. The program has also set aside 200,000 shares, with an agreed value of \$8 per share at the grant date, at a total value of \$1,600,000 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 on a straight-line basis over the vesting period.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 22. Stock option plan and share-based compensation (continued)

The total number of shares recognized as an expense during the period from March 28, 2010 to June 30, 2010 was 9,028 for a recorded expense of \$72,221 and from December 27, 2009 to March 27, 2010, 8,881 shares for a recorded expense of \$71,046 (2009 - \$276,552).

### 23. Notes to the consolidated statement of cash flows

*Reconciliation of loss from operations to operating loss before changes in working capital and provisions*

	Three months ended		Six months ended	
	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
	\$	\$	\$	\$
Operating activities				
Net loss from operations	(2,356)	(1,688)	(4,003)	(7,108)
Adjustments for:				
Depreciation and amortization of non-current assets	496	332	1,005	438
Interest and investment income	(211)	-	22	(17)
Loss on lumber price derivatives	(282)	-	-	-
Net realizable value adjustment to inventory	805	(894)	273	2,054
Financing cost related to convertible notes	34	-	34	0
Revaluation of shares to fair value	452	-	452	-
Accretion of convertible debenture	519	-	519	-
Share compensation	72	71	143	138
Operating loss before changes in working capital	(471)	(2,179)	(1,554)	(4,495)

#### *Non-cash transactions*

During the periods presented, the Company had not entered into any non-cash transactions:

### 24. Financial instruments

#### (a) *Capital risk management*

The capital structure of the Company consists of net debt (convertible notes - Note 17 and CAF loan - Note 18 offset by cash and bank balances) and equity (comprising issued capital, deficit and reserves). Management has concluded that this will be sufficient to address liquidity risk and to support their assessment that the business is a going concern.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 24. Financial instruments (continued)

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

#### Categories of financial instruments and their fair values

					June 30, 2010	December 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	2,694	-	-	2,694	2,694	2,932
Cash	52,016	-	-	52,016	52,016	6,077
<b>Total financial assets</b>	<b>54,710</b>	<b>-</b>	<b>-</b>	<b>54,710</b>	<b>54,710</b>	<b>9,008</b>
Financial liabilities						
Trade and other payables	-	-	4,514	4,514	4,514	2,497
CAF loan	-	-	2,269	2,269	2,269	-
Convertible notes	-	-	5,025	5,025	5,025	3,555
<b>Total financial liabilities</b>	<b>-</b>	<b>-</b>	<b>11,808</b>	<b>11,808</b>	<b>11,808</b>	<b>5,279</b>

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 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 \$nil 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 and liabilities is in accordance with generally accepted pricing models based on observable current market transactions.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 24. Financial instruments (continued)

#### (c) Interest rate risk

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

	Effective interest rate	Floating interest rate	Fixed interest rate			Non-interest bearing	June 30,	December 26,
			<1 year	1-5 years	>5 years		2010	2009
							Total	Total
%	\$	\$	\$	\$	\$	\$		
<b>Financial assets</b>								
Trade and other receivables	-	-	-	-	-	2,694	2,932	
Cash	0.1	52,016	-	-	-	52,016	6,077	
<b>Total financial assets</b>		<b>52,016</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,694</b>	<b>9,008</b>	
<b>Financial liabilities</b>								
Trade and other payables	-	-	-	-	-	4,514	2,497	
CAF loan	3.75	-	-	2,269	-	2,269	-	
Convertible notes	6.50	-	-	5,025	-	5,025	3,555	
<b>Total financial liabilities</b>		<b>-</b>	<b>-</b>	<b>7,294</b>	<b>-</b>	<b>4,514</b>	<b>6,052</b>	

#### (d) 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 June 30, 2010, the Company's accounts receivable denominated in U.S. dollars totaled US\$596,417. The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US\$1.00 during the second quarter of 2010 would have decreased or increased, respectively, second quarter operating earnings by approximately \$88,000. The Company does not currently use financial derivative instruments for its foreign exchange risk management programme.

#### (e) Equity price risk

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

#### (f) 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.

#### (g) Price risk

The Company uses derivative financial instruments to reduce its exposure to risks associated with fluctuations in lumber prices. At June 30, 2010, the fair value of outstanding commodity financial instruments was \$nil (December 26, 2009 - \$207,326). The fair value of these instruments was determined based on market rates for instruments with similar characteristics.

# Conifex Timber Inc.

## Notes to unaudited interim consolidated financial statements

June 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

### 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 and its subsidiaries were as follows:

	Three months ended		Six months ended	
	June 30, 2010	June 27, 2009	June 30, 2010	June 27, 2009
	\$	\$	\$	\$
Short-term benefits	214	204	420	422
Share-based payments	26	23	65	47
	<b>240</b>	<b>227</b>	<b>485</b>	<b>469</b>

### 26. Operating lease arrangements

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

	June 30, 2010	December 26, 2009
	\$	\$
Equipment	28	122
Land	6	
Office equipment	5	47
Vehicles	8	29
	<b>46</b>	<b>198</b>

#### *Operating lease commitments*

	June 30, 2010	December 26, 2009
	\$	\$
Not longer than 1 year	6	22
Longer than 1 year and not longer than 5 years	649	380
Longer than 5 years	37	-
	<b>692</b>	<b>402</b>

### 27. Contingencies

The Company continues to defer payroll costs for unionized employees, as disclosed in Note 13. Payroll costs will continue to be deferred as long as lumber selling prices are below a specified value. To June 30, 2010, payroll costs of \$665,045 have been deferred and there is uncertainty as to when these amounts will be paid.