



## **CONIFEX TIMBER INC.** **FIRST QUARTER 2011**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

**Dated as of May 20, 2011**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the quarter ended March 31, 2011 relative to the quarters ended December 31, 2010 and March 31, 2010, the Company's financial condition and future prospects. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements of Conifex and accompanying notes for the quarters ended March 31, 2011 and 2010, as well as the 2010 annual MD&A and the 2010 audited consolidated financial statements and notes thereon which are filed on SEDAR at [www.sedar.com](http://www.sedar.com). The financial information contained in this interim MD&A has been prepared in accordance with International Financial Reporting Standards ("IFRS") and in accordance with International Accounting Standard 34 Interim Financial Reporting.*

*In this interim MD&A, reference is made to "EBITDA". EBITDA represents earnings before interest, taxes, depreciation and amortization, as well as before deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures and other investments. The Company discloses EBITDA as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.*

*Unless otherwise noted, all monetary references in this interim MD&A are in Canadian dollars.*

*References in this interim MD&A to "Conifex" and the "Company" mean Conifex Timber Inc., together with its subsidiaries, unless the context otherwise requires.*

### **FORWARD-LOOKING STATEMENTS**

*Certain statements in this interim MD&A may constitute "forward-looking statements". Forward-looking statements are statements that address or discuss activities, events or developments that the Company expects or anticipates may occur in the future. When used in this interim MD&A, words such as "estimates", "expects", "plans", "anticipates", "projects", "will", "intends", "believes", "should", "could", "may" and other similar terminology are intended to identify such forward-looking statements. Forward-looking statements reflect the current expectations and beliefs of the Company's management. Because forward-looking statements involve known and unknown risks, uncertainties and other factors, actual results, performance or achievements of the Company or industry may be materially different from those implied by such forward-looking statements. Forward-looking statements involve significant uncertainties, should not be read as a guarantee of future performance or results, and will not necessarily be an accurate indication of whether or not such results will be achieved. A number of factors could cause*

*actual results to differ materially from the results discussed in the forward-looking statements, including those matters described under "Risks and Uncertainties". Accordingly, readers should exercise caution in relying upon forward-looking statements and the Company undertakes no obligation to publicly revise them to reflect subsequent events or circumstances, except as required by law.*

## **SIGNIFICANT DEVELOPMENTS**

During the first quarter of 2011, the Company completed its capital expenditure project at Fort St. James and added a second shift at Fort St. James and at Mackenzie at the end of March. Conifex also announced the initiation of a bioenergy cogeneration project at Mackenzie. This project represents the first significant undertaking in the Company's bioenergy segment.

### **Completion of capital expenditure program at Fort St. James and start-up of second shift**

The Company completed its \$30 million capital expenditure project at Fort St. James during the first quarter of 2011. Although the project was completed on budget, final completion of several project components took a couple of months longer than originally anticipated. The year-long project did not require significant curtailment of production but planer productivity was adversely impacted during the last quarter of 2010 and the first quarter of 2011 due to the disruptive nature of the major construction activity on site.

One of the key objectives of the project was to increase the planer speed to better match the hourly output of the finishing operations to the hourly output of the sawmill. Considerable progress has been made towards the achievement of this objective and a second sawmill shift was added at the end of March 2011.

The addition of the second shift brings the total production potential at this site to approximately 310 million board feet per year. With the structural improvements largely in place to achieve this potential, management and operations personnel will focus on improving processes, skills and training to further increase efficiencies and output from the manufacturing and finishing operations.

One of the early successes arising from the completion of the project is the increased percentage of higher quality lumber the mill currently produces. Japan is one of the major markets for the premium grades of lumber. The Company expects the financial benefits of the improved product mix to become more fully evident when shipments to Japan resume normal seasonal volumes.

### **Start-up of second shift at Mackenzie**

The Company commenced operations on a one-shift basis at one of its two sawmill complexes at Mackenzie BC in November of 2010. The Company added a second shift at the Site II sawmill in late March 2011. The production potential of the Site II sawmill complex on a two-shift basis is approximately 220 million board feet per year.

The production potential of the currently idled Site I sawmill complex as it is presently constituted is approximately 215 million board feet per year. The total production potential of the Company's three sawmill assets is approximately 745 million board feet on an annualized basis. The Company will achieve an operating rate of approximately 70% when both of its currently operating mills reach their combined production capacity of approximately 530 million

board feet per year. This compares to an operating rate of approximately 34% during the first quarter of 2011 and 26% in the previous quarter.

### **Announcement of bioenergy project at Mackenzie BC and related agreement**

In early March 2011 the Company announced the initiation of a bioenergy cogeneration project at its Mackenzie sawmill site, currently scheduled for commercial production of electricity in the third quarter of 2012 (the "Bioenergy Project"). The Bioenergy Project is currently estimated to cost approximately \$50 million to complete. The planned capital expenditures are to be utilized for the upgrade of the existing power island infrastructure and the purchase of a 36 megawatt per hour steam turbine generator set to replace the existing 13.8 megawatt per hour turbine.

The power produced by the cogeneration plant will meet the Company's own electricity needs at Mackenzie and the balance of the power produced will be sold to BC Hydro. The cogeneration plant is currently expected to produce approximately 230 gigawatt hours ("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 Mackenzie mills. Such agreements and arrangements, if completed, will be subject to regulatory approval.

As previously reported, the Company entered into arrangements with a manufacturer for the manufacture and purchase of a 36 megawatt per hour steam turbine generation set (the "Turbine") and ancillary equipment and services at a total estimated cost of U.S. \$10.5 million. As no agreement has yet been reached with BC Hydro, there can be no assurance that the Bioenergy Project will proceed as currently described or at all. In order to provide the necessary flexibility, the Turbine acquisition agreement contains cancellation rights in favour of Conifex that may be exercised if the Bioenergy Project does not proceed.

### **Other notable developments**

#### Additions to management team and establishment of regional office

During the first quarter of 2011, the Company added personnel in key management positions and established a regional office in Prince George BC to support the increased scope of forestry and manufacturing operations in its lumber segment and the further development of initiatives in its bioenergy segment.

Personnel additions included the previously announced appointment of Kevin Horsnell as Chief Operating Officer and the appointment of Arnold Federink as General Manager of the Mackenzie operations. All of the Company's senior management personnel are based in the regional office with the exception of the CEO and CFO, who are based in Vancouver BC.

## SUMMARY OF OPERATING RESULTS AND FINANCIAL POSITION

### CONSOLIDATED OPERATING RESULTS

	Q1	Q4	Q1
(millions of dollars except share and per share amounts)	2011	2010	2010
Sales -Lumber	18.6	16.2	10.9
- By-products	2.6	2.0	1.2
<b>Total Sales</b>	<b>21.2</b>	<b>18.2</b>	<b>12.1</b>
Operating loss	(3.8)	(2.7)	(1.0)
Net loss	(3.6)	(3.9)	(1.6)
Net loss per share - basic and diluted	(0.24)	(0.26)	(0.39)
EBITDA*	(1.3)	(2.2)	(0.9)
Shares outstanding - end of period (millions)	15.2	15.2	4.3
Shares outstanding - weighted average (millions)	15.2	15.1	4.3

#### Statistics

Lumber shipments (MMfbm)**	62.5	53.5	37.4
Lumber production (MMfbm)	63.5	49.1	39.5
Average exchange rate - US\$/Cdn\$ (1)	1.0142	0.987	0.961
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$ 297	\$ 268	\$ 268
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)	\$ 293	\$ 272	\$ 279
Price range: WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$287 - \$321	\$233 - \$308	\$218 - \$293

\* EBITDA represents earnings before interest, taxes, depreciation and amortization, as well as before deductions for non-cash charges related to employee compensation and changes in the balance sheet carrying value of convertible debentures and other investments. The company discloses EBITDA as it is a measure used by analysts and the Company's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.

\*\*Shipment volumes from prior periods have been adjusted.

(1) Source: Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

(2) Source: Random Lengths Publications Inc.

### Reconciliation of EBITDA to Net Loss

	Q1	Q4	Q1
(millions of dollars)	2011	2010	2010
Net loss	(3.6)	(3.9)	(1.6)
Add:			-
Depreciation and amortization	1.4	1.0	0.5
Deferred union payroll liability	0.3	0.2	0.2
Share based compensation	0.3	0.3	0.1
Accretion of convertible debentures	0.3	0.3	-
<b>EBITDA*</b>	<b>(1.3)</b>	<b>(2.2)</b>	<b>(0.9)</b>

\*May not total exactly due to rounding.

### Overview

The Fort St. James and Mackenzie Site II sawmill complexes operated on a one-shift basis throughout the first quarter of 2011. Operating results from the previous quarter reflect one-shift

operations at Fort St. James throughout the period and the commencement of one-shift manufacturing operations at Mackenzie in November of 2010. The first quarter of 2010 results reflect operations at the Fort St. James location on a one-shift basis. Operating rates were approximately 34%, 26% and 21% respectively based on the current total estimated production capacity.

For the quarter ended March 31, 2011 the Company recorded a net loss of \$3.6 million or \$0.24 per share and negative EBITDA of \$1.3 million on sales of \$21.2 million. Negative EBITDA was comprised of \$1 million from the lumber segment, \$0.2 million from the bioenergy segment and \$0.1 million from corporate costs and other items. Overall EBITDA improved by \$0.9 million and net loss by \$0.3 million over the previous quarter. Net loss for the first quarter of 2010 was \$1.6 million and negative EBITDA was \$0.9 million.

The advantage of higher lumber prices in select items during the most recent quarter compared to the first and fourth quarters of 2010 was largely offset by the appreciation of the Canadian currency. Unit manufacturing costs during the last two quarters were adversely impacted by production inefficiencies related to the construction activity at Fort St. James and the start-up of the Site II sawmill complex, as well as low overall operating rates.

At March 31, 2011, the Company had \$9.5 million cash on hand, a decrease of \$17.1 million from December 31, 2010. Approximately \$12.5 million of the decrease was attributable to the seasonal build-up of log inventories to support increased production levels throughout the break-up period and to an increase in finished lumber inventories committed to export orders.

## REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

### Operating Results by Business Segment

(millions of dollars)	Q1 2011	Q4 2010	Q1 2010
<b>Revenue</b>			
Lumber	21.2	18.2	12.6
Bioenergy	-	-	-
	21.2	18.2	12.6
<b>Net Loss</b>			
Lumber	(2.9)	(1.7)	(0.9)
Bioenergy	(0.2)	(0.2)	-
Corporate costs and other items	(0.5)	(2.0)	(0.7)
	(3.6)	(3.9)	(1.6)
<b>EBITDA</b>			
Lumber	(1.0)	(0.4)	(0.4)
Bioenergy	(0.2)	(0.2)	-
Corporate costs and other items	(0.1)	(1.6)	(0.5)
	(1.3)	(2.2)	(0.9)

### Lumber Segment

#### Overview

Lumber prices during the first quarter of 2011 were largely shaped by the supply and demand for targeted products by specific markets. Thus the notable improvement in the average price of

the traditionally bellwether WSPF 2x4 #2 & Btr (“WSPF”) compared to the previous quarter and the first quarter of 2010 was not necessarily indicative of a general trend in higher prices.

Although prices for WSPF averaged US\$297<sup>1</sup> during the first quarter of 2011 and represented an 11% improvement over the first and fourth quarters of 2010, comparable price increases were not achieved across the wider dimensions of #2 & Btr products. Generally speaking, average prices during the most recent quarter for 2x6 and wider dimensions remained unchanged or were at a discount to prices achieved in the first and fourth quarters of 2010 after taking into consideration the impact of the stronger Canadian dollar.

The increase in price of 2x4 was indicative of the considerable demand for the product, most notably from China. In contrast, average prices during the first quarter of 2011 for 2x10 and 2x12 were lower by 6% and 19% respectively compared to the first quarter of 2010. Demand in the most recent quarter for the wider dimension products typically consumed by the North American construction market remained soft. Demand for these products last March was underpinned by government incentives that were available to U.S. homebuyers at that time.

Lumber sales revenues during the most recent quarter were adversely impacted by the steady strengthening of the Canadian dollar over its U.S. counterpart by 3 cents over the previous quarter and by 5 cents over the first quarter of 2010.

The export tax remained at 15% throughout the first quarter of 2011.

The Company recorded a net loss of \$2.9 million in its lumber segment on sales of \$21.2 million for the first quarter of 2011 compared to a net loss of \$1.7 million on sales of \$18.2 million for the previous quarter and a net loss of \$0.9 million on sales of \$12.6 million for the same quarter last year. EBITDA in this segment was negative \$1 million for the first quarter of 2011 compared to negative \$0.4 million for the first and fourth quarters of 2010.

Operating results continued to be negatively impacted by the segment’s low overall operating rates. The segment is currently incurring fixed costs capable of supporting near capacity operations.

### Sales

Lumber shipments totalled 62.5 million board feet during the first quarter of 2011, an increase of 17% over the previous quarter and 67% over the first quarter of 2010. The increase in shipment volumes was largely attributable to the commencement of shipments from the Mackenzie mill in December 2010.

Revenue from lumber shipments totalled \$18.6 million during the first quarter of 2011, an increase of almost 15% over the previous quarter and approximately 70% over the first quarter of 2010. As the unit sales price realizations from each of the three quarters were similar, the increase in revenue was due mostly to the increase in volume.

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<sup>1</sup> Prices as quoted in Random Lengths Publications Inc.

The table below shows the percentage of net lumber revenue earned from and volume shipped to each geographic market.

	Q1 2011	Q4 2010	Q1 2010
<b>By Revenue (net of freight)</b>			
Canada	23%	21%	27%
USA	34%	25%	47%
Export	43%	54%	26%
	100%	100%	100%
<b>By Shipment Volume</b>			
Canada	23%	18%	21%
USA	33%	26%	48%
Export	44%	56%	31%
	100%	100%	100%

Shipments to export markets, primarily China and Japan, represented 44% of total first quarter 2011 shipment volumes. Compared to the actual board footage shipped during the first quarter of 2011, the Company shipped 11% more volume to export markets during the fourth quarter of 2010 and 59% less volume to export markets during the first quarter of 2010. The increase in volume shipped to the North American market in the most recent quarter compared to the previous quarter reflects seasonal slowdowns in the Asian markets, diversion of specific products to the U.S. market to achieve higher prices, and temporary logistical constraints on export shipments.

The Company expects that shipments to Asia will represent the largest portion of shipments in 2011 as Chinese demand has been strong and the timing of a sustainable recovery in the U.S. housing sector is uncertain. The production by the Company of a higher proportion of premium grades of lumber will also increase future shipments to Japan although there is uncertainty regarding the timing of this demand.

Revenue from chips and other residuals in the first quarter of 2011 totalled \$2.6 million and represented 12% of total revenue. The increase of 30% over the fourth quarter of 2010 and 217% over the first quarter of 2010 was mainly attributable to volume increases.

#### Production and Operations

Lumber production totalled 63.5 million board feet during the first quarter of 2011, an increase of 29% over the previous quarter and 60% over the first quarter of 2010. The increase in production is largely due to the commencement of one-shift manufacturing operations at Mackenzie in November 2010.

Cost of goods sold in the first quarter of 2011 was \$18.1 million, an increase of \$3.3 million over the previous quarter. Unit manufacturing costs between the two quarters were similar once the effects of idled facility costs during the previous quarter and increased depreciation during the more recent quarter are removed. Costs in both quarters were adversely impacted by low operating rates of approximately 34% and 26% respectively and production inefficiencies due to disruptions from the construction activity at Fort St. James and the start-up of the Site II operations. Additional costs were also incurred in the more recent quarter as both operating sites made preparations for additional shifts.

About 60% of the \$9.2 million increase in cost of goods sold in the current quarter over the first quarter of 2010 is attributable to the increase in production volume, with the balance of the increase attributable to increased depreciation, variation in inventory valuation, production inefficiencies and costs absorbed ahead of increased production volumes.

Freight and distribution costs on a per unit basis were 12% lower in the current quarter compared to both the first and fourth quarters of 2010. The decrease was due to the stronger Canadian currency as international freight movements are typically priced in U.S. dollars and to an increased volume of sales transacted on a "free on board" mill basis.

Selling, general and administrative expenses related to the lumber segment increased by \$0.4 million or 18% over the fourth quarter of 2010 and by \$1.3 million or 200% over the first quarter of 2010. Approximately 60% of the increase over the first quarter of 2010 is attributable to selling and shipping costs related to increased shipment volumes. The balance of the increase is attributable to the additions of the Mackenzie operations, a regional office and a corporate office and increased administrative and compensation costs.

### **Bioenergy Segment**

Activities in the bioenergy segment during the first quarter of 2011 included work on project structuring, engineering and design in preparation for the Company's Bioenergy Project at Mackenzie BC. The Company also committed to a major equipment purchase in connection with this project as previously mentioned.

The Company is actively exploring a variety of other opportunities in the bioenergy sector with a focus on those that will allow the Company to capitalize on its existing infrastructure and by-product fibre suitable for use as bioenergy feedstock.

The net loss in this segment for the first quarter of 2011 and the fourth quarter of 2010 arises from costs related to holding idled facilities such as insurance and property tax and to professional fees related to activities undertaken in the bioenergy segment.

### **Corporate costs and other items**

The only significant change in corporate costs and other items from the first quarter of 2011 to the previous quarter was a mark to market adjustment of lumber price derivatives of positive \$0.7 million in the more recent quarter compared to a negative \$0.7 million adjustment in the previous quarter.

## FINANCIAL POSITION AND LIQUIDITY

### SELECTED CASH FLOW ITEMS

(millions of dollars)	Q1 2011	Q4 2010	Q1 2010
<b>Operating Activities</b>			
Cash used before working capital changes	(2.2)	(3.3)	(0.8)
Non - cash working capital change	(12.1)	1.0	(3.2)
Cash used in operating activities	(14.3)	(2.3)	(4.0)
<b>Investing Activities</b>			
Additions to property, plant, equipment	(3.6)	(8.4)	(2.4)
Proceeds on disposal of assets held for sale	0.8	(1.5)	-
Cash used in investing activities	(2.8)	(9.9)	(2.4)
<b>Financing Activities</b>			
Proceeds from loans	-	2.7	-
Proceeds from convertible notes	-	-	2.0
Cash provided from financing activity	-	2.7	2.0
<b>Change in cash</b>	<b>(17.1)</b>	<b>(9.5)</b>	<b>(4.4)</b>

Cash used in operating activities totalled \$14.3 million during the first quarter of 2011 compared to \$2.3 million in the previous quarter and \$4 million in the first quarter of 2010. The most substantial change in non-cash working capital in the most recent quarter was an increase of inventories of \$12.5 million. Log inventories were built up to provide the volume required to support increased production levels at both locations during the seasonal break-up period. Finished lumber inventories were also higher due to an increase in the volume of goods in transit between the mill sites and the dock to fulfill orders committed to export shipments. An increase in accounts receivable of \$3.5 million due to higher lumber and residual shipments was offset by a corresponding increase in accounts payable.

Investment activities during the first quarter of 2011 included additions to capital assets of \$7 million of which \$3.4 million remained in accounts payable at March 31, 2011. Capital purchases included \$6 million related to the recently completed capital expenditure program at Fort St. James and \$0.8 million related to the Bioenergy Project at Mackenzie. A portion of the pool of assets held for sale was sold in January 2011 for net proceeds of \$0.3 million. The Company also collected proceeds from assets sold in a prior period. Additions to property, plant and equipment totalled \$8.4 million during the previous quarter and \$2.4 million in the first quarter of 2010.

Related to its capital expenditures, in April 2011 the Company drew down the remaining \$1.5 million available from its previously approved credit facility under the Community Adjustment Fund ("CAF") loan program sponsored by Northern Development Initiative Trust.

Financing activities during the fourth quarter of 2010 consisted of proceeds from the CAF loan of \$2.7 million. During the first quarter of 2010, the Company received proceeds of \$2 million from the issue of convertible debentures.

The net decrease in cash for the first quarter of 2011 was \$17.1 million and compares to a net decrease in cash of \$9.5 million for the previous quarter and \$4.4 million for the first quarter of 2010. At March 31, 2011, the Company had cash on hand of \$9.5 million.

## LIQUIDITY

The Company's current principal sources of funds are cash flow from operations and cash on hand. The Company is seeking to secure additional credit facilities in 2011. The Company's principal uses of funds consist of operating and capital expenditures.

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 sale of equity securities.

The Company's working capital levels fluctuate throughout the year and are affected by changes in operating rates, changing sales patterns, seasonality and the timing of receivables and the payment of payables and expenses. The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the winter months to ensure adequate supply of fibre to its mills during the spring months. Changes in sales volume and price can affect the level of receivables and influence overall working capital levels. The significant increase in shipments to export markets has increased the level of in transit finished goods inventory typically held by the Company. The Company believes its management practices with respect to working capital conform to common industry practices.

## SELECTED QUARTERLY FINANCIAL INFORMATION

<b>Quarterly Earnings Summary</b>	<b>2011</b>		<b>2010</b>		<b>2009</b>			
(millions of dollars except share and per share amounts)	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Sales -Lumber	18.6	16.2	12.9	10.7	10.9	9.8	10.8	7.4
- By-products	2.6	2.0	1.6	1.9	1.2	1.0	1.1	1.0
<b>Total Sales</b>	<b>21.2</b>	<b>18.2</b>	<b>14.5</b>	<b>12.6</b>	<b>12.1</b>	<b>10.8</b>	<b>11.9</b>	<b>8.4</b>
Operating loss	(3.8)	(2.7)	(2.4)	(1.8)	(1.0)	(2.5)	(1.1)	(1.9)
Net loss	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)	(1.0)	(1.7)
Net loss per share - basic and diluted	(0.24)	(0.26)	(0.19)	(0.31)	(0.39)	(0.52)	(0.24)	(0.40)
EBITDA	(1.3)	(2.2)	(1.8)	(0.8)	(0.9)	(1.7)	(0.4)	(1.1)
Shares outstanding - end of period (millions)	15.2	15.2	15.1	15.1	4.3	4.3	4.3	4.3
Shares outstanding - weighted average (millions)	15.2	15.1	15.1	7.6	4.3	4.3	4.3	4.2
<b>Statistics</b>								
Lumber shipments (MMfbm)*	62.5	53.5	44.4	34.3	37.4	39.9	43.3	31.6
Lumber production (MMfbm)	63.5	49.1	39.3	41.3	39.5	32.8	36.5	36.0
Average exchange rate - US\$/Cdn\$ (1)	1.0142	0.987	0.962	0.973	0.961	0.947	0.912	0.858
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$ 297	\$ 268	\$ 222	\$ 266	\$ 268	\$ 205	\$ 191	\$ 174
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)	\$ 293	\$ 272	\$ 230	\$ 273	\$ 279	\$ 216	\$ 209	\$ 203

\* Shipment volumes from prior periods have been adjusted.

(1) Source: Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

(2) Source: Random Lengths Publications Inc.

<b>Reconciliation of EBITDA to Net Loss</b> (millions of dollars)	<b>2011</b>		<b>2010</b>		<b>2009</b>			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Net loss	(3.6)	(3.9)	(2.9)	(2.4)	(1.6)	(2.2)	(1.0)	(1.7)
Add:								
Depreciation and amortization	1.4	1.0	0.5	0.5	0.5	0.3	0.3	0.3
Deferred union payroll liability	0.3	0.2	0.2	-	0.2	0.2	0.2	0.2
Share based compensation	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Accretion of convertible debentures	0.3	0.3	0.3	0.5	-	-	-	-
Revaluation of Fourth shares to fair value	-	-	-	0.5	-	-	-	-
<b>EBITDA*</b>	<b>(1.3)</b>	<b>(2.2)</b>	<b>(1.8)</b>	<b>(0.8)</b>	<b>(0.9)</b>	<b>(1.7)</b>	<b>(0.4)</b>	<b>(1.1)</b>

\*May not total exactly due to rounding.

The Company's financial results are impacted by a variety of market related factors including fluctuation in lumber prices, price fluctuations in commodities associated with revenue derived from by-products and movements in foreign exchange rates. Quarterly trends are also impacted by the seasonal nature of activities such as logging operations and construction and remodelling activity. Other more company specific factors that influence quarterly trends include operating rates and transactions of a non-recurring nature.

The Fort St. James mill commenced operations on a one-shift basis in March 2009 and shipments in April 2009.

The Mackenzie Assets were acquired in June of 2010. Manufacturing operations started at the Site II sawmill and planer mill on a one-shift basis in November of 2010 and a small volume of lumber was shipped in December of 2010 from this location. Shutdown costs directly related to the non-operational assets are included in the results of the third and fourth quarter of 2010.

## **SOFTWOOD LUMBER AGREEMENT**

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

As the arbitration is a state-to-state international dispute under the SLA, Canada is preparing a defence to the claim with the assistance of the BC provincial government and the BC lumber industry. It is not possible at this time to predict the outcome or the value of the claim, and accordingly no provision has been recorded by the Company.

## **OUTLOOK AND STRATEGY**

### **Lumber segment**

With the completion of several key initiatives during the most recent quarter, the Company is positioned to achieve positive EBITDA given a reasonable lumber price environment. The

major capital expenditure program at Fort St. James has been completed. Both operating mills moved to a two-shift basis which provides the potential to operate at approximately 70% of total production capacity. The leadership team and supporting infrastructure are largely in place.

Conifex's key priority in the short term continues to be to achieve positive EBITDA from operations. Management will be focused on improving margins by optimizing value from the fibre harvested and reducing cash conversion costs.

The Company expects margins to consistently improve as unit manufacturing costs decrease with increased operating rates and better sales realizations are achieved as a result of production of a higher proportion of premium products. The Company has targeted the end of the second quarter of 2011 to achieve overall operating rates of approximately 70% and the end of the calendar year to achieve operating margins comparable to top-quartile performers in the interior BC forestry and sawmilling sector.

### **Bioenergy segment**

Conifex intends to focus on the appropriate oversight and management of its Bioenergy Project at Mackenzie. The Company also intends to pursue additional high return investment opportunities in this sector which are complementary to its existing operating facilities and assets and by-product fibre suitable for use as bioenergy feedstock.

### **OUTSTANDING SECURITIES**

As at May 20, 2011, the Company had 15,187,068 issued and outstanding common shares, 100,000 options granted under the Company's stock option plan dated June 3, 2010, 375,335 long-term incentive plan awards issued under the Company's long-term incentive plan dated June 3, 2010, and stepped rate subordinated convertible promissory notes in the aggregate principal amount of \$9,967,000, which notes are convertible into a maximum of 1,245,875 common shares of the Company, excluding any common shares issuable in payment of accrued interest thereon.

### **CHANGES IN ACCOUNTING POLICY**

Effective January 1, 2011, the Company adopted an amendment to IAS 24, *Related Party Transactions*, that was issued by the International Accounting Standards Board ("IASB"). The amendment clarifies the definitions of a related party. The adoption of the amendment had no impact on the condensed consolidated financial statements.

In addition to the above, the IASB has issued IFRS 9 – *Financial Instruments (Classification and Measurement)*, which is mandatory for accounting periods beginning January 1, 2013. The Company is currently evaluating the impact of IFRS 9 on its results of operations and financial position.

### **RISKS AND UNCERTAINTIES**

A discussion of the risks and uncertainties to which the Company is subject is included in the 2010 annual MD&A which is available on [www.sedar.com](http://www.sedar.com) or [www.conifex.com](http://www.conifex.com).

**ADDITIONAL INFORMATION**

Additional information about the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).