

Interim consolidated financial statements of

Conifex Timber Inc.

September 30, 2010
(Unaudited)

Conifex Timber Inc.

September 30, 2010

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Conifex Timber Inc.

Interim consolidated statement of net loss and comprehensive loss
period ended September 30, 2010 (unaudited)

	Notes	Three months ending		Nine months ending	
		Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
		\$	\$	\$	\$
Revenue	7	14,455	11,931	39,136	20,506
Costs and expenses					
Cost of goods sold		10,464	8,532	29,697	20,124
Freight and distribution costs		3,235	2,622	8,006	4,469
Export taxes		373	584	1,110	941
(Gain) / loss on lumber price derivatives		148	(219)	180	(452)
Selling, general and administrative	9	2,787	1,273	5,616	3,374
		17,007	12,792	44,609	28,456
Operating Income (Loss)		(2,552)	(861)	(5,473)	(7,950)
Interest income / (expense)		(24)	2	(14)	19
Foreign exchange gain / (loss)		(27)	(160)	(148)	(197)
Accretion of convertible debenture		(259)	-	(778)	-
Write off of revaluation expense		-	-	(452)	-
		(310)	(158)	(1,392)	(178)
Loss before tax		(2,862)	(1,019)	(6,865)	(8,128)
Income taxes	10	-	-	-	-
Net loss and comprehensive loss for the period		(2,862)	(1,019)	(6,865)	(8,128)
Net loss per share, basic and diluted	11	(0.19)	(0.24)	(0.76)	(1.94)

See accompanying notes to the unaudited interim consolidated financial statements

Conifex Timber Inc.

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

(thousands of Canadian dollars)	Notes	September 30, 2010	December 26, 2009
		\$	\$
Assets			
<i>Non-current assets</i>			
Intangible assets	12	8,667	2,964
Property, plant and equipment	13	58,376	9,137
Deposits		323	155
Total non-current assets		67,366	12,256
<i>Current assets</i>			
Cash	14	36,156	6,077
Inventories	15	12,574	5,449
Trade and other receivables	16	6,794	2,932
Prepaid expenses and deposits		2,066	623
Assets held for sale	5	1,180	-
Total current assets		58,770	15,081
Total assets		126,136	27,337
Liabilities			
<i>Non-current liabilities</i>			
Reforestation obligations	17	(6,052)	(586)
Environmental liabilities	5	(1,500)	-
Employee liabilities	18	(170)	(204)
Convertible notes	20	(5,301)	(3,555)
Long term debt	21	(4,250)	-
Total non-current liabilities		(17,273)	(4,345)
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables	19	(5,466)	(2,497)
Reforestation obligations	17	(1,339)	(173)
Employee liabilities	18	(1,762)	(869)
Income tax payable		(91)	(91)
Total current liabilities		(8,658)	(3,630)
Total liabilities		(25,931)	(7,975)
Net assets		100,205	19,362
Equity			
Share capital	22	117,650	31,021
Conversion option on convertible notes	20	5,187	4,095
Share-based compensation reserve		550	277
Deficit		(23,182)	(16,031)
Total equity and shareholders' funds		100,205	19,362

Commitments and Contingencies - Note 26 and 27

See accompanying notes to the unaudited interim financial statements

Conifex Timber Inc.

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

(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 period January 1, 2009 to September 26, 2009	-	-	-	(8,128)	(8,128)
Capital introduced during the period	975	-	-	-	975
Share-based compensation during the period	-	-	207	-	207
Balance at September 26, 2009	31,021	-	207	(13,828)	17,400
Net loss for the period September 27, 2009 to December 26, 2009	-	-	-	(2,202)	(2,202)
Issue of convertible notes	-	4,095	-	-	4,095
Share-based compensation during the period	-	-	70	-	70
Balance at December 26, 2009	31,021	4,095	277	(16,030)	19,362
Net loss for the nine months ended September 30, 2010	-	-	-	(6,865)	(6,865)
Total recognized income and expense for the period	-	-	-	(6,865)	(6,865)
Fourth share capital	247	-	-	-	247
Revaluation of Fourth shares to fair value	452	-	-	-	452
Share-based compensation	-	-	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 convertible notes	-	1,092	-	-	1,092
Share-based compensation	-	-	236	-	236
Total of other changes in equity	85,930	1,092	236	-	87,258
Balance at September 30, 2010	117,650	5,187	550	(23,182)	100,205

See accompanying notes to the unaudited interim consolidated financial statements

Conifex Timber Inc.

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

(thousands of Canadian dollars)	Notes	For three months ending		For nine months ending	
		Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
		\$	\$	\$	\$
Cash provided by (used in):					
Operating activities:					
Net loss		(2,862)	(1,019)	(6,865)	(8,128)
Items not affecting cash:					
Amortization of non-current assets		512	320	1,518	758
Loss on lumber price derivatives		148	(219)	180	(452)
Net realizable value adjustment to inventory		(485)	(1,241)	(211)	814
Change in reforestation obligations		(212)	45	(212)	45
Financing cost related to convertible notes		17	-	51	-
Accretion of convertible notes		259	-	778	-
Share compensation		93	69	236	207
Revaluation of shares to fair value		-	-	452	-
		(2,530)	(2,045)	(4,073)	(6,756)
Cash generated from (used in) operating working capital:					
Trade and other receivables		(4,248)	900	(4,042)	(1,742)
Prepaid expenses and deposits		798	(126)	(1,263)	(131)
Inventories		(2,052)	1,673	(5,865)	(3,171)
Accounts payable, accrued liabilities and other payables		952	1,515	2,521	1,801
Employee liabilities		194	75	859	1,055
		(6,885)	1,991	(11,863)	(8,944)
Investing activities:					
Additions to intangible assets		(58)	4	(73)	(50)
Additions to property, plant and equipment		(13,218)	21	(18,031)	(728)
Acquisition of Assets	(5)	-	-	(34,460)	-
Proceeds on disposal of assets held for sale		2,321	-	2,321	-
		(10,956)	25	(50,244)	(778)
Financing activities					
Capital introduced - share proceeds		-	-	85,883	975
Bank indebtedness on reverse asset acquisition		-	-	(3)	-
Proceeds from exercise of stock options		-	-	47	-
Proceeds from CAF loan	(21)	1,981	-	4,250	-
Proceeds from conversion option on convertible notes		-	-	2,009	-
Loan repayment		-	(750)	-	-
		1,981	(750)	92,186	975
Net increase (decrease) in cash		(15,860)	1,266	30,079	(8,747)
Cash, beginning of period		52,016	168	6,077	10,181
Cash, end of period		36,156	1,434	36,156	1,434

See accompanying notes to the unaudited Interim consolidated financial statements

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

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 commenced manufacturing operations at one of its two sawmills on a one-shift basis on November 1, 2010.

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. 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 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.

3. Summary of significant accounting policies

The preparation of financial data is based on accounting principles and practices consistent with those used in the preparation of DTR's annual audited financial statements as at December 26, 2009 except as noted below. The accompanying consolidated interim financial statements should be read in conjunction with DTR's audited consolidated financial statements for the year ended December 26, 2009.

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

3. Summary of significant accounting policies (continued)

(a) *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. 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").

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.

(b) *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.

(c) *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. Assets held for sale are not depreciated once they are classed as held for sale, but are tested for impairment in accordance with IAS 36 Impairment of Assets.

(d) *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.

(e) *Changes in accounting policy*

Operating Segments

Effective December 27, 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 8.

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

3. Summary of significant accounting policies (continued)

(e) Changes in accounting policy (continued)

Revised IAS 23, *Borrowing Costs*, is effective for the quarters ended in, and 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 had no impact on the financial statements.

Amendment IAS 39, *Financial Instruments - Recognition and Measurement*, is effective for the quarters ended in, and 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 quarters ended in, and 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

4. 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.

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

5. 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 6). 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 September 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.

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

	\$
Prepays	349
Inventories	1,049
Assets 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)
	<hr/> 34,460

During the current period, the Company sold a portion of the assets held for sale that were purchased with the acquisition of the Mackenzie Assets. The carrying value of the assets held for sale has been reduced by the total proceeds of disposition of \$2,320,553.

No adjustments have been made to the preliminary allocation at September 30, 2010.

6. 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.

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

7. Revenue

	Three months ended		Nine months ended	
	Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
	\$	\$	\$	\$
Revenue				
Sale of lumber	12,784	10,686	34,128	17,946
Sale of by-product	1,671	1,245	5,008	2,560
	14,455	11,931	39,136	20,506

8. 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 sawmills 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 5). Future wood biomass converting and power related activities are expected to be segregated into a separate operating segment when the scope of these activities has been defined and the assets become operational.

9. Selling, general and administrative

	Three months ended		Nine months ended	
	Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
	\$	\$	\$	\$
Salaries and benefits	483	337	1,126	972
Selling costs	523	469	1,450	850
Costs related to non-operating assets	1,380	-	1,701	-
Other administrative expenses	99	256	777	1,163
Legal, professional and organizational	288	201	527	360
Depreciation and amortization	14	10	35	29
	2,787	1,273	5,616	3,374

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

10. Income tax expense

(a) Current income taxes

	Three months ended		Nine months ended	
	Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
	\$	\$	\$	\$
<i>Recognized in income statement</i>				
Tax expense comprises				
Current tax expense	-	-	-	-
<i>Reconciliation of effective tax rate</i>				
Loss before taxation	(2,862)	(1,019)	(6,865)	(8,128)
Income tax expense at corporation rate of 28.5% (2009 - 30%)	(816)	(306)	(1,956)	(2,438)
Expenses not deductible for tax purposes	271	5	461	21
Effect on deferred balances due to changes in income tax rates	(11)	53	200	423
Effect of unused tax losses and tax offsets not recognized as deferred assets	292	248	1,031	1,994
Effect of previously unrecognized deferred tax	264	-	264	-
Total income tax expense	-	-	-	-

(b) Unrecognized deferred income taxes

The sources of unrecognized deferred income taxes are as follows:

	Dec. 26, 2009	Change		Sept. 30, 2010
	Opening balance	Related to earnings	Related to equity	Closing balance
	\$	\$	\$	\$
Deferred tax assets related to non-capital losses	3,984	75	-	4,059
Deferred tax assets related to temporary differences in tax and book basis	(81)	956	804	1,679
Net deferred tax assets	3,903	1,031	804	5,738

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

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

10. Income tax expense (continued)

(b) 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 tax assets were recognized in 2009 due to the uncertainty as to realization.

(c) Non-capital loss carry forwards

As at September 30, 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	3,779
	16,212

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

11. Net loss per share

	Three months Sept. 30, 2010			Three months Sept. 26, 2009		
	Net loss	Shares	Per share	Net loss	Shares	Per share
	\$		\$	\$		\$
Basic loss per share	(2,862)	15,137	(0.19)	(1,019)	4,256	(0.24)
Convertible notes	-	1,250*	-	-	-	-
Diluted loss per share	(2,862)	15,137	(0.19)	(1,019)	4,256	(0.24)

	Nine months Sept. 30, 2010			Nine months Sept. 26, 2009		
	Net loss	Shares	Per share	Net loss	Shares	Per share
Basic loss per share	(6,865)	9,039	(0.76)	(8,128)	4,197	(1.94)
Convertible notes	-	1,250*	-	-	-	-
Diluted loss per share	(6,865)	9,039	(0.76)	(8,128)	4,197	(1.94)

*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.

12. Intangible assets

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

	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 September 30, 2010	8,550	256	8,806
<i>Accumulated amortization</i>			
At December 26, 2009	-	(69)	(69)
Amortization charge for the period	(24)	(46)	(70)
At September 30, 2010	(24)	(115)	(139)
<i>Carrying amount</i>			
At December 26, 2009	2,850	114	2,964
At September 30, 2010	8,526	141	8,667

13. 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	-	95	5,772	278	14	-	11,872	18,031
Acquisition Mackenzie	1,927	3,639	16,688	400	-	10,000	-	32,654
Disposals	-	-	(322)	-	-	-	-	(322)
At September 30, 2010	2,048	5,112	28,809	1,552	107	10,000	12,897	60,524
<i>Accumulated depreciation</i>								
At December 26, 2009	-	(68)	(725)	(196)	(35)	-	-	(1,024)
Depreciation charge for the period	-	(39)	(1,201)	(182)	(24)	-	-	(1,446)
Disposals	-	-	322	-	-	-	-	322
At September 30, 2010	-	(107)	(1,604)	(378)	(59)	-	-	(2,148)
<i>Carrying amount</i>								
At December 26, 2009	121	1,310	5,946	678	58	-	1,025	9,137
At September 30, 2010	2,048	5,005	27,205	1,174	48	10,000	12,897	58,376

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

14. Cash

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

	September 30, 2010	December 26, 2009
	\$	\$
Bank balances	36,156	6,077

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

15. Inventories

	September 30, 2010	December 26, 2009
	\$	\$
Logs	4,216	1,631
Lumber	5,099	1,938
Supplies	3,259	1,881
	12,574	5,449

Inventory expensed in the period ended September 30, 2010 was \$29,179,436 (December 26, 2009 - \$29,159,624). Inventory is written down to the lower of 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. The inventory writedown at September 30, 2010 was \$320,191 (December 26, 2009 - \$531,642).

16. Trade and other receivables

	September 30, 2010	December 26, 2009
	\$	\$
Trade receivables	2,401	1,797
Other receivables	2,933	1,081
HST receivable	1,460	54
	6,794	2,932

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

17. Reforestation obligations

	September 30, 2010	December 26, 2009
	\$	\$
Silviculture liability		
Current	1,339	173
Non-current	6,052	586
	7,391	759

18. Employee liabilities

Conifex Timber Inc.

Notes to unaudited interim consolidated financial statements

September 30, 2010

(Tabular amounts expressed in thousands except per share amounts)

	September 30, 2010	December 26, 2009
	\$	\$
Non-current		
Long-term employee liability	170	204
Current		
Payroll	912	352
Deferred union payroll liability	850	517
	1,762	869
	1,932	1,073

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 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 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

	September 30, 2010	December 26, 2009
	\$	\$
Trade payables	4,566	1,420
Accruals	900	985
Related party payables	-	92
	5,466	2,497

20. 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:

20. Convertible notes (continued)

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- 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 September 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 September 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.

21. 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 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 \$ 1,980,587 of this loan facility during the current interim period (\$4,249,771 year-to-date). In accordance with the Company's borrowing cost accounting policy, the interest has been capitalized.

22. Share capital

Authorized

Unlimited number of common voting shares without par value.

Issued and fully paid

DTR completed equity financing during the nine months ended September 30, 2010 as described in Note 6.

	Number of common shares	Amount \$
Balance, December 31, 2009	4,256	31,021
Shares issued	10,788	85,883
Balance, September 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.

22. Share capital (continued)

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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, September 30, 2010	15,137	117,650

23. Stock option plan and share-based compensation

(a) 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. 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 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 23%, the fair value of the options granted on August 20, 2010 is estimated at \$200,000 or \$2.00 per option. Expense related to the stock option plan of \$10,000 was recognized in the nine month period ended September 30, 2010 (December 26, 2009 - \$nil).

(b) Share-based compensation

The Company operates a share compensation program for executives and salaried employees. The program has set aside 244,114 shares, with a fair value of \$8 per share at the grant date, at a total value of \$1,952,912 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.

The total number of shares recognized as an expense during the period from July 1, 2010 to September 30, 2010 was 11,537 for a recorded expense of \$93,089 and from December 27, 2009 to June 30, 2010, 17,909 shares for a recorded expense of \$143,267 for a total year-to-

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

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(b) *Share-based compensation (continued)*

date recorded expense of \$236,356 (2009 total - \$276,552). The expense is allocated between cost of sales and selling, general and administrative expense.

24. Financial instruments

(a) *Capital risk management*

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). Management has concluded that this will be sufficient to address liquidity risk and to support their assessment that the business is a going concern.

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

Categories of financial instruments and their fair values

					Sept. 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	6,794	-	-	6,794	6,794	2,932
Cash	36,156	-	-	36,156	36,156	6,077
Total financial assets	42,950	-	-	42,950	42,950	9,009
Financial liabilities						
Trade and other payables	-	-	5,466	5,466	5,466	2,497
CAF loan	-	-	4,250	4,250	4,250	-
Convertible notes	-	-	5,301	5,301	5,301	3,555
Total financial liabilities	-	-	15,017	15,017	15,017	6,052

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 \$136,820 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.

24. Financial instruments (continued)

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(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	Sept. 30,	December 26,
			<1 year	1-5 years	>5 years		2010	2009
							Total	Total
	%	\$	\$	\$	\$	\$	\$	
Financial assets								
Trade and other receivables	-	-	-	-	-	6,794	2,832	
Cash	0.1	36,156	-	-	-	36,155	6,077	
Total financial assets		36,156	-	-	-	42,950	9,009	
Financial liabilities								
Trade and other payables	-	-	-	-	-	5,466	2,497	
CAF loan	3.75	-	-	4,250	-	4,250	-	
Convertible notes	6.50	-	-	5,301	-	5,301	3,555	
Total financial liabilities		-	-	9,551	-	15,017	6,052	

(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 September 30, 2010, the Company's accounts receivable denominated in U.S. dollars totaled US\$1,127,229. The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US\$1.00 during the third quarter of 2010 would have decreased or increased, respectively, third quarter operating earnings by approximately \$81,000. 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 September 30, 2010, the fair value of outstanding commodity financial instruments was \$136,820 (December 26, 2009 - \$207,326). The fair value of these instruments was determined based on market rates for instruments with similar characteristics.

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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		Nine months ended	
	Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
	\$	\$	\$	\$
Short-term benefits	478	210	898	632
Share-based payments	52	23	99	52
	530	233	997	684

26. Commitments

Operating lease payments

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

	Three months ended		Nine months ended	
	Sept. 30, 2010	Sept. 26, 2009	Sept. 30, 2010	Sept. 26, 2009
	\$	\$	\$	\$
Equipment	27	28	85	77
Land	19	-	25	-
Office equipment	6	5	13	13
Vehicles	8	7	25	26
	60	40	148	116

Operating lease commitments

	Sept. 30, 2010	Dec. 26, 2009
	\$	\$
Not longer than 1 year	184	156
Longer than 1 year and not longer than 5 years	187	245
	371	401

27. Contingencies

The Company continues to defer payroll costs for unionized employees, as disclosed in Note 18. Payroll costs will continue to be deferred as long as lumber selling prices are below a specified value. To September 30, 2010, payroll costs of \$849,696 have been deferred and there is uncertainty as to when these amounts will be paid.