

Condensed consolidated interim financial statements of

# **Conifex Timber Inc.**

September 30, 2011  
(Unaudited)

# Conifex Timber Inc.

September 30, 2011

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# Conifex Timber Inc.

Condensed consolidated statement of net loss and comprehensive loss  
period ended September 30, 2011 (unaudited)

(thousands of Canadian dollars except earnings per share)	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
<b>Revenue</b>	<b>38,181</b>	14,455	<b>86,262</b>	39,136
<b>Costs and expenses</b>				
Cost of goods sold	29,176	11,190	70,142	30,660
Freight and distribution costs	8,744	3,235	17,250	8,006
Export taxes	377	373	1,146	1,110
Selling, general and administrative	3,211	2,062	8,985	4,654
	<b>41,508</b>	16,859	<b>97,523</b>	44,429
<b>Operating Loss</b>	<b>(3,328)</b>	(2,404)	<b>(11,261)</b>	(5,293)
Loss on disposal of assets	-	-	(11)	-
Interest expense	(132)	(24)	(288)	(14)
Other income (expense)	1,131	(148)	2,817	(180)
Foreign exchange gain (loss)	390	(27)	106	(148)
Accretion of convertible debenture	(257)	(259)	(772)	(778)
Write off of revaluation expense	0	0	0	(452)
	<b>1,132</b>	(458)	<b>1,852</b>	(1,571)
Loss before tax	<b>(2,195)</b>	(2,862)	<b>(9,408)</b>	(6,865)
Income taxes	-	-	-	-
<b>Net loss and comprehensive loss for the period</b>	<b>(2,195)</b>	(2,862)	<b>(9,408)</b>	(6,865)
<b>Net loss per share, basic and diluted</b>	<b>(0.14)</b>	(0.19)	<b>(0.62)</b>	(0.76)

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

# Conifex Timber Inc.

Condensed consolidated balance sheet  
as at September 30, 2011 (unaudited)

(thousands of Canadian dollars)	Notes	As at September 30, 2011	As at December 31, 2010
		\$	\$
<b>Assets</b>			
<i>Current assets</i>			
Cash and cash equivalents	5	8,937	26,629
Inventories	6	22,514	15,142
Trade and other receivables		10,456	6,011
Prepaid expenses and deposits		1,386	2,455
Assets held for sale	7	939	1,629
<b>Current assets</b>		<b>44,233</b>	<b>51,867</b>
Intangible assets		8,540	8,607
Property, plant and equipment		71,157	65,693
Deposits		336	338
<b>Total assets</b>		<b>124,266</b>	<b>126,504</b>
<b>Liabilities</b>			
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables		9,189	6,512
Current portion of reforestation obligations		1,590	1,590
Employee liabilities		3,534	1,822
Current portion of long term debt	8	1,679	1,227
<b>Current liabilities</b>		<b>15,991</b>	<b>11,150</b>
Reforestation obligations		5,685	5,118
Environmental liabilities		1,951	1,977
Employee liabilities		161	111
Convertible notes		6,385	5,578
Long term debt	8	5,992	5,738
<b>Non-current liabilities</b>		<b>20,174</b>	<b>18,522</b>
<b>Total liabilities</b>		<b>36,165</b>	<b>29,672</b>
<b>Equity</b>			
Share capital		118,333	117,899
Conversion option on convertible notes		5,170	5,187
Share-based compensation reserve		1,101	841
Deficit		(36,503)	(27,095)
<b>Total equity</b>		<b>88,101</b>	<b>96,832</b>
<b>Total liabilities and equity</b>		<b>124,266</b>	<b>126,504</b>

Contingencies - Note 10

Events after the reporting period - Note 11

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

# Conifex Timber Inc.

Condensed consolidated statement of changes in equity  
period ended September 30, 2011 (unaudited)

(thousands of Canadian dollars)	Share capital	Conversion option on convertible notes	Share-based compensation reserve	Deficit	Total equity
	\$	\$	\$	\$	\$
<b>Balance at December 26, 2009</b>	<b>31,021</b>	<b>4,095</b>	<b>277</b>	<b>(16,030)</b>	<b>19,363</b>
Net loss for the nine months ended September 30, 2010	-	-	-	(6,865)	(6,865)
Changes arising from Qualifying Transaction	699	-	37	(287)	449
Capital introduced during the period	85,883	-	-	-	85,883
Exercise of stock options	47	-	-	-	47
Issue of convertible notes	-	1,092	-	-	1,092
Recognition of share-based payments	-	-	236	-	236
<b>Balance at September 30, 2010</b>	<b>117,650</b>	<b>5,187</b>	<b>550</b>	<b>(23,182)</b>	<b>100,205</b>
Net loss for the period October 1, 2010 to December 31, 2010	-	-	-	(3,913)	(3,913)
Issue of common shares for payment in kind of interest on convertible notes	249	-	-	-	249
Recognition of share-based payments	-	-	291	-	291
<b>Balance at December 31, 2010</b>	<b>117,899</b>	<b>5,187</b>	<b>841</b>	<b>(27,095)</b>	<b>96,832</b>
Net loss for the nine months ended September 30, 2011	-	-	-	(9,408)	(9,408)
Issue of common shares upon conversion of notes	33	(17)	-	-	16
Issue of common shares upon vesting of share-based payment	401	-	(401)	-	-
Recognition of share-based payments	-	-	661	-	661
<b>Total of other changes in equity</b>	<b>434</b>	<b>(17)</b>	<b>260</b>	<b>-</b>	<b>677</b>
<b>Balance at September 30, 2011</b>	<b>118,333</b>	<b>5,170</b>	<b>1,101</b>	<b>(36,503)</b>	<b>88,101</b>

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

# Conifex Timber Inc.

Condensed consolidated statement of cash flows  
as at September 30, 2011 (unaudited)

(thousands of Canadian dollars)	Notes	Three months ended September 30,		Nine months ended September 30,	
		2011	2010	2011	2010
		\$	\$	\$	\$
<b>Cash flows from operating activities</b>					
Net loss		(2,195)	(2,862)	(9,408)	(6,865)
Items not affecting cash:					
Amortization		1,823	512	4,914	1,518
Changes in mark-to-market value of lumber price derivatives		-	148	(815)	180
Change in reforestation obligations		449	(212)	567	(212)
Accretion of convertible notes and related financing cost		241	276	790	829
Revaluation of shares to fair value		-	-	-	452
Share Compensation		178	93	694	236
		496	(2,045)	(3,258)	(3,862)
Change in:					
Trade and other receivables		(3,573)	(2,716)	(5,162)	(2,510)
Prepaid expenses and deposits		1,356	798	1,071	(1,263)
Inventories	3	83	(2,537)	(7,372)	(6,076)
Accounts payable, accrued liabilities and other payables		4,198	952	2,678	2,521
Environmental liabilities		-	-	(27)	-
Employee liabilities		259	194	1,761	859
<b>Net cash provided by (used in) operating activities</b>		<b>2,819</b>	<b>(5,354)</b>	<b>(10,308)</b>	<b>(10,331)</b>
<b>Cash flows from investing activities</b>					
Additions to intangible assets		(3)	(58)	(119)	(74)
Additions to property, plant and equipment		(1,442)	(13,218)	(9,820)	(18,031)
Acquisition of Mackenzie Assets		-	-	-	(34,460)
Proceeds on disposal of assets held for sale	7	204	789	1,850	789
<b>Net cash used in investing activities</b>		<b>(1,242)</b>	<b>(12,487)</b>	<b>(8,090)</b>	<b>(51,776)</b>
<b>Financing activities</b>					
Capital introduced - share proceeds		-	-	-	85,883
Bank indebtedness on reverse asset acquisition		-	-	-	(3)
Proceeds from exercise of stock options		-	-	-	47
Net proceeds (Repayment) from CAF loan	8	(410)	1,981	706	4,250
Proceeds from convertible notes		-	-	-	2,009
<b>Net cash provided by (used in) financing activities</b>		<b>(410)</b>	<b>1,981</b>	<b>706</b>	<b>92,186</b>
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>1,167</b>	<b>(15,860)</b>	<b>(17,692)</b>	<b>30,079</b>
<b>Cash and cash equivalents, beginning of period</b>		<b>7,770</b>	<b>52,016</b>	<b>26,629</b>	<b>6,077</b>
<b>Cash and cash equivalents, end of period</b>		<b>8,937</b>	<b>36,156</b>	<b>8,937</b>	<b>36,156</b>

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

# Conifex Timber Inc.

## Notes to unaudited condensed consolidated interim financial statements September 30, 2011

(Tabular amounts expressed in thousands of Canadian dollars)

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### 1. General information

Conifex Timber Inc. ("Conifex" or the "Company") is a public company incorporated and domiciled in Canada. Its shares are listed on the TSX Venture Exchange. The address of its registered office is 1000 Cathedral Place, 925 West Georgia Street, Vancouver, British Columbia ("BC") V6C 3L2.

The principal activities of the Company and its subsidiaries are described in Note 4.

These condensed consolidated interim financial statements were approved by the Board of Directors on November 22, 2011.

These condensed consolidated interim financial statements have been reviewed, not audited.

### 2. Basis of preparation

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34 *Interim Financial Reporting* ("IAS 34") and do not include all of the information required for full annual financial statements. The condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2010, which have been prepared in accordance with International Financial Reporting Standards ("IFRS").

### 3. Seasonality of operations

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

### 4. Operating segment information

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

- Lumber - The main activities of the lumber segment include timber harvesting, reforestation, forest management, manufacture of logs into finished lumber and residual products at its sawmills and distribution of its finished products.
- Bioenergy - The primary activities of the bioenergy segment will be the development of the bioenergy generation project at Mackenzie, BC as described in note 10 and the development of other opportunities in the bioenergy sector which are complementary to the Company's existing operating facilities and assets.

# Conifex Timber Inc.

## Notes to unaudited condensed consolidated interim financial statements September 30, 2011

(Tabular amounts expressed in thousands of Canadian dollars)

### 4. Operating segment information (continued)

Summary by segment:

	Lumber	Bioenergy	Corporate & other	Consolidated
	\$	\$	\$	\$
<b>3 months ended September 30, 2011</b>				
Sales to external customers	38,181	-	-	38,181
Net loss	(2,494)	(189)	488	(2,195)
Amortization	1,823	-	-	1,823
Capital expenditures	498	947	-	1,445
<b>3 months ended September 30, 2010</b>				
Sales to external customers	14,455	-	-	14,455
Net loss	(1,436)	(289)	(1,137)	(2,862)
Amortization	512	-	-	512
Capital expenditures	13,276	-	-	13,276
<b>9 months ended September 30, 2011</b>				
Sales to external customers	86,262	-	-	86,262
Net loss	(8,492)	(720)	(196)	(9,408)
Amortization	4,914	-	-	4,914
Capital expenditures	7,652	2,287	-	9,939
Identifiable assets	102,864	12,465	8,937	124,266
<b>9 months ended September 30, 2010</b>				
Sales to external customers	39,136	-	-	39,136
Net loss	(3,815)	(339)	(2,711)	(6,865)
Amortization	1,518	-	-	1,518
Capital expenditures*	42,580	9,985	-	52,565
Identifiable assets*	79,810	10,170	36,156	126,136

\* Includes purchase of Mackenzie Assets in June 2010.

Revenues by geographic area were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Asia	23,388	5,805	49,533	12,721
Canada	9,282	3,583	23,126	11,633
United States	5,511	5,067	13,603	14,782
	<b>38,181</b>	<b>14,455</b>	<b>86,262</b>	<b>39,136</b>

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

# Conifex Timber Inc.

## Notes to unaudited condensed consolidated interim financial statements September 30, 2011

(Tabular amounts expressed in thousands of Canadian dollars)

### 5. Cash and cash equivalents

	September 30, 2011	December 31, 2010
	\$	\$
Cash at bank and in hand	7,277	26,629
Short term deposits	1,660	-
	<b>8,937</b>	<b>26,629</b>

The \$1,660,000 held in short term deposits at September 30, 2011, secures a standby letter of credit issued in the same amount by the Company to BC Hydro pursuant to the terms of the Electricity Purchase Agreement.

### 6. Inventories

	September 30, 2011	December 31, 2010
	\$	\$
Logs	6,499	5,729
Lumber	11,874	5,911
Supplies	4,141	3,502
	<b>22,514</b>	<b>15,142</b>

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has been written down at September 30, 2011 by \$1,790,391 (December 31, 2010: \$658,760; September 30, 2010: \$320,191) and this amount is included in cost of goods sold.

### 7. Assets held for sale

The Company entered into an agreement in September 2011 under the terms of which certain redundant assets at its Mackenzie BC facilities, currently recorded as assets held for sale, will be demolished and removed. The Company will be paid for all salvaged materials. As it is difficult to estimate the expected proceeds of disposition, any gain or loss on the transaction will be recorded when the removal is completed. The removal is expected to be completed by August 2012.

### 8. Long-term Debt

The Company has a secured loan facility of \$8,486,866 under the Community Adjustment Fund ("CAF") loan program sponsored by the Northern Development Initiative Trust. The CAF loan was fully drawn in April 2011 and carries a fixed interest rate of 3.75% with twenty quarterly repayments commencing June 2011. The loan is secured by a General Security Agreement (excluding inventory and receivables) and a mortgage against specific properties. In September 2011 the Company repaid \$409,942 of the CAF loan.

### 9. Related party transactions

LJ Resources Co., Ltd.

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

The Company transacted sales of finished lumber products totaling \$769,344 for the three months ended September 30, 2011 (three months ended September 30, 2010: \$ nil) to LJ. The sales to the related party are made at terms equivalent to those that prevail in arm's length transactions. Outstanding balances at the period end are unsecured, interest free and settlement occurs in cash. There have been no guarantees provided for

# Conifex Timber Inc.

## Notes to unaudited condensed consolidated interim financial statements September 30, 2011

(Tabular amounts expressed in thousands of Canadian dollars)

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*LJ Resources Co., Ltd. (continued)*

any related party receivables. The outstanding accounts receivable balance from LJ at September 30, 2011 was \$ nil (December 31, 2010: \$211,259).

### 10. Contingencies

#### ***Softwood Lumber Agreement***

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

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

#### ***Equipment purchase related to bioenergy generation project at Mackenzie BC***

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

In June 2011, Conifex finalized an Electricity Purchase Agreement ("EPA") and a Load Displacement Agreement ("LDA") with BC Hydro. The transactions contemplated by the EPA and LDA are subject to the EPA being accepted by the British Columbia Utilities Commission ("BCUC") as an energy supply contract.

In October 2011, the Company entered into an agreement (the "Amendment Agreement") modifying certain terms of the EPA. The EPA specified a period of 150 days from the date that the agreement was entered into within which acceptance for filing by the BCUC was required. The Amendment Agreement extends this period by 90 days to allow for the completion of the Province's review of BC Hydro prior to the filing of the EPA with the BCUC.

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

### 11. Events after the reporting period

#### ***Purchase of property in the District of Mackenzie***

The Company currently leases property in the District of Mackenzie on which its Site II Mackenzie sawmill complex is situated. In October 2011, the Company entered into an agreement to purchase the property. The purchase price of approximately \$1.25 million is payable by a combination of cash and a vendor take back mortgage. The transaction is expected to close in November 2011.

# Conifex Timber Inc.

## Notes to unaudited condensed consolidated interim financial statements September 30, 2011

(Tabular amounts expressed in thousands of Canadian dollars)

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### **11. Events after the reporting period (continued)**

#### ***Completion of agreement to acquire lumber distribution and transportation and logistics businesses***

In November 2011, the Company entered into a Share Purchase Agreement under the terms of which it will acquire the commodity lumber distribution business owned and operated by Welco Lumber Corp. ("Welco") and the transportation and logistics business owned and operated by Navcor Transportation Services Inc. ("Navcor"). Welco and Navcor are both B.C. private businesses that have provided lumber marketing and logistics services to Conifex under a three-year service agreement which expires in November 2011. The proposed purchase will include all assets related to Welco's commodity lumber segment, the assumption of the existing office lease and employment agreement with key employees, and all of the issued and outstanding shares of Navcor. The proposed transaction remains subject to customary closing conditions and the receipt of applicable regulatory approvals. The proposed transaction is expected to close in December 2011.

#### ***Senior secured financing agreement***

In November 2011, the Company entered into a senior secured financing agreement under the terms of which it will issue promissory notes in the aggregate amount of \$12 million. The notes will expire on December 31, 2012 and bear interest rates of 10% for the first six months and 12% for the remaining term of the loan. As additional consideration for the loan, the Company will issue at the time of funding share purchase warrants entitling the holders to purchase up to an aggregate of 325,000 common shares of the unissued capital stock of the Company. The proceeds of the note will be used for general corporate purposes.