

Consolidated financial statements of

**Conifex Timber Inc.**

December 31, 2016 and 2015



February 14, 2017

## **Independent Auditor's Report**

### **To the Shareholders of Conifex Timber Inc.**

We have audited the accompanying consolidated financial statements of Conifex Timber Inc., which comprise the consolidated balance sheets as at December 31, 2016 and December 31, 2015 and the consolidated statements of income (loss) and comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.



**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Conifex Timber Inc. as at December 31, 2016 and December 31, 2015 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

*PricewaterhouseCoopers LLP*

**Chartered Professional Accountants**

# Conifex Timber Inc.

Consolidated balance sheets

As at December 31, 2016 and 2015

(thousands of Canadian dollars)	Notes	As at December 31, 2016	As at December 31, 2015
		\$	\$
<b>Assets</b>			
<i>Current assets</i>			
Cash		12,650.3	9,902.9
Cash - restricted	11	10,309.3	8,545.7
Trade and other receivables		28,581.8	25,929.4
Prepaid expenses and deposits		13,906.9	11,108.2
Inventories	4	56,337.9	43,231.9
Assets held for sale		-	10.9
<b>Current assets</b>		<b>121,786.2</b>	<b>98,729.0</b>
Goodwill	5	3,310.5	3,310.5
Intangible assets	5	5,119.8	7,843.1
Property, plant and equipment	6	213,339.0	220,553.3
Long-term investments and other	7	21,729.8	1,661.7
<b>Total assets</b>		<b>365,285.3</b>	<b>332,097.6</b>
<b>Liabilities</b>			
<i>Current liabilities</i>			
Trade payables, accrued liabilities and other payables		28,769.8	23,799.5
Current portion of reforestation obligations	8	5,366.3	2,773.9
Employee liabilities		1,882.1	1,791.0
Operating loans	11	28,198.7	18,326.9
Current portion of convertible notes	12	-	11,797.7
Current portion of mortgage	12	10,440.8	11,957.8
Current portion of long-term debt	12	4,438.2	4,353.3
<b>Current liabilities</b>		<b>79,095.9</b>	<b>74,800.1</b>
Reforestation obligations	8	6,744.2	6,091.4
Environmental liabilities	9	1,474.0	1,529.6
Other long-term liabilities	10	11,798.7	13,089.5
Payment-in-kind note	12	-	30,000.0
Long-term debt	12	88,664.0	100,228.3
<b>Non-current liabilities</b>		<b>108,680.9</b>	<b>150,938.8</b>
<b>Total liabilities</b>		<b>187,776.8</b>	<b>225,738.9</b>
<b>Equity</b>			
Share capital	13	158,601.8	157,835.6
Conversion option on convertible notes	12	326.4	326.4
Contributed surplus		11,634.7	11,484.6
Retained earnings (deficit)		6,945.6	(63,287.9)
<b>Total equity</b>		<b>177,508.5</b>	<b>106,358.7</b>
<b>Total liabilities and equity</b>		<b>365,285.3</b>	<b>332,097.6</b>

## Subsequent Event (note 30)

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

# Conifex Timber Inc.

Consolidated statements of net income (loss) and comprehensive income (loss)  
Years ended December 31, 2016 and 2015

(thousands of Canadian dollars)	Notes	Year ended December 31,	
		2016	2015
		\$	\$
<b>Revenue</b>	16	<b>409,307.7</b>	353,467.3
<b>Costs and expenses</b>			
Cost of goods sold	17	<b>314,934.7</b>	293,634.0
Freight and distribution costs		<b>58,694.4</b>	53,615.6
Export taxes		-	2,213.7
Selling, general and administrative	18	<b>17,522.5</b>	15,611.7
		<b>391,151.6</b>	365,075.0
<b>Operating income (loss)</b>		<b>18,156.1</b>	(11,607.7)
Gain (loss) on disposal of assets		<b>48,002.5</b>	(2.2)
Interest expense and accretion	19	<b>(9,120.3)</b>	(8,560.2)
Other income		<b>848.9</b>	67.2
Foreign exchange (loss) gain		<b>(982.8)</b>	2,782.3
Gain on revaluation	20	<b>13,329.1</b>	-
		<b>52,077.4</b>	(5,712.9)
<b>Net income (loss) and comprehensive income (loss) for the year</b>		<b>70,233.5</b>	(17,320.6)
<b>Net income (loss) per share, basic and diluted: (in dollars)</b>	22	<b>3.32</b>	(0.82)

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

# Conifex Timber Inc.

Consolidated statements of changes in equity  
Years ended December 31, 2016 and 2015

(thousands of Canadian dollars)	Share capital	Conversion option on convertible notes	Contributed surplus	Retained earnings (deficit)	Total equity
	\$	\$	\$	\$	\$
<b>Balance at December 31, 2014</b>	<b>156,423.3</b>	<b>351.3</b>	<b>11,452.4</b>	<b>(45,967.3)</b>	<b>122,259.7</b>
Net loss for the year ended					
December 31, 2015	-	-	-	(17,320.6)	(17,320.6)
Issue of common shares (note 28)	675.0	-	-	-	675.0
Issue of common shares upon vesting of share-based payment	737.3	-	(672.5)	-	64.8
Issue costs for subordinated convertible notes	-	(24.9)	-	-	(24.9)
Recognition of share-based payments	-	-	704.7	-	704.7
<b>Balance at December 31, 2015</b>	<b>157,835.6</b>	<b>326.4</b>	<b>11,484.6</b>	<b>(63,287.9)</b>	<b>106,358.7</b>
<b>Net income for the year ended</b>					
<b>December 31, 2016</b>	-	-	-	<b>70,233.5</b>	<b>70,233.5</b>
<b>Issue of common shares upon vesting of     share-based payment</b>	<b>766.2</b>	-	<b>(740.6)</b>	-	<b>25.6</b>
<b>Recognition of share-based payments</b>	-	-	<b>890.7</b>	-	<b>890.7</b>
<b>Balance at December 31, 2016</b>	<b>158,601.8</b>	<b>326.4</b>	<b>11,634.7</b>	<b>6,945.6</b>	<b>177,508.5</b>

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

# Conifex Timber Inc.

Consolidated statements of cash flows  
Years ended December 31, 2016 and 2015

(thousands of Canadian dollars)	Year Ended December 31,	
	2016	2015
	\$	\$
<b>Cash flows from operating activities</b>		
Net income (loss)	70,233.5	(17,320.6)
Items not affecting cash:		
Amortization and depreciation	18,123.3	16,493.7
Change in mark-to-market value of lumber price derivatives	(395.6)	(77.3)
Change in reforestation obligations	3,245.2	1,243.2
Interest expense and accretion	9,120.3	8,560.2
Share based compensation	916.3	769.6
LDA accretion	(627.4)	(464.8)
(Gain) loss on disposal of assets	(48,002.5)	2.2
Gain on revaluation	(13,329.1)	-
	39,284.0	9,206.2
Change in:		
Trade and other receivables	(4,664.7)	863.5
Prepaid expenses and deposits	(2,544.8)	(2,557.3)
Inventories	(13,105.9)	(6,060.4)
Accounts payable, accrued liabilities and other payables	4,701.9	(2,108.6)
Environmental liabilities	(55.6)	(175.6)
Employee liabilities	91.0	59.0
<b>Net cash provided from (used in) operating activities</b>	<b>23,705.9</b>	<b>(773.2)</b>
<b>Cash flows from investing activities</b>		
Additions to property, plant and equipment	(17,620.0)	(24,577.9)
Additions to long-term investments	(20.9)	(12.2)
Acquisition of El Dorado sawmill assets	-	(16,595.7)
Net proceeds from insurance claim settlement	2,926.0	11,546.0
Proceeds on disposal of assets, net	20,148.6	17.8
<b>Net cash provided from (used in) investing activities</b>	<b>5,433.7</b>	<b>(29,622.0)</b>
<b>Cash flows from financing activities</b>		
Incentive funding received	-	6,625.0
Proceeds of construction loan	-	9,562.5
Proceeds of long-term debt	576.4	(2,256.2)
Proceeds of operating loans	9,871.9	6,526.4
Proceeds of payment-in-kind note	-	30,000.0
Repayment of mortgage	(1,157.1)	-
Repayment of senior secured notes	(5,700.0)	(4,000.0)
Repayment of subordinated convertible notes	(12,000.0)	-
Repayment of term loan	(7,306.8)	(2,080.1)
Financing fees	(694.0)	(358.1)
Interest paid	(8,219.0)	(7,065.7)
<b>Net cash provided from (used in) financing activities</b>	<b>(24,628.6)</b>	<b>36,953.8</b>
<b>Net increase in cash</b>	<b>4,511.0</b>	<b>6,558.6</b>
<b>Cash, beginning of period</b>	<b>18,448.6</b>	<b>11,890.0</b>
<b>Cash, end of period</b>	<b>22,959.6</b>	<b>18,448.6</b>

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

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

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In these notes, "Conifex" or the "Company" means Conifex Timber Inc. and its subsidiaries.

### 1. NATURE OF OPERATIONS

The primary business of Conifex in its lumber segment includes timber harvesting, reforestation, forest management, sawmilling logs into lumber and wood chips, and value added lumber finishing. Conifex's lumber products are sold in the United States, Chinese, Canadian and Japanese markets. The primary activity in its bioenergy segment is the production of electricity for external sale under an Electricity Purchase Agreement and internal supply under a Load Displacement Agreement at the power generation plant at Mackenzie, BC.

Conifex is a publicly traded company listed on the Toronto Stock Exchange under the symbol CFF. The Company is incorporated under the *Canada Business Corporations Act* and is headquartered in Vancouver, BC, Canada.

The address of its registered office is 1000 Cathedral Place, 925 West Georgia Street, Vancouver, BC V6C 3L2.

### 2. SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

#### 2.1 Statement of compliance

The consolidated financial statements of Conifex have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The consolidated financial statements were approved by the Board of Directors on February 14, 2017.

#### 2.2 Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

#### 2.3 Basis of consolidation

Subsidiaries are 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. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances, income and expenses are eliminated on consolidation, where appropriate. Profits and losses resulting from inter-company transactions that are recognized in assets are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

Joint ventures are accounted for using the equity method of accounting.

#### 2.4 Business combinations

The Company applies the acquisition method to account for business combinations. Goodwill is initially measured as the excess of the aggregate of the consideration transferred over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss. Acquisition-related costs are expensed as incurred.



# Conifex Timber Inc.

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(Tabular amounts expressed in thousands except per share amounts)

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### 2.5 Functional and presentation currency

The Canadian dollar is the functional and presentation currency of the Company.

### 2.6 Foreign currency translation

Foreign currency denominated monetary assets and liabilities of the Company are translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Gains or losses on translation of these items are included in earnings.

### 2.7 Cash

In the consolidated statement of cash flows, cash includes cash on hand, deposits held with banks, and other short-term highly liquid investments.

### 2.8 Financial instruments

#### (a) Non-derivative financial instruments

The Company classifies non-derivative financial assets that have fixed or determinable payments that are not quoted in an active market as loans and receivables. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. Loans and receivables are recorded at amortized cost using the effective interest method, less any impairment.

Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial. Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated future cash flows of the asset have been impacted.

#### (b) Derivative financial instruments

The Company utilizes derivative financial instruments to manage its commodity lumber price exposures in the ordinary course of business and interest rate variability. Lumber derivatives are initially recognized at fair value on the date a lumber derivative contract is entered into and are subsequently re-measured at their fair value. The fair values are determined by using observable market inputs for identical assets and liabilities and thus reflect the estimated amount that the Company would have paid or received if required to settle all outstanding contracts at period end. The resulting gain or loss is recognized as a gain (loss) on lumber derivative instruments each period unless the lumber derivative is designated as a hedging instrument under IFRS. If the lumber derivative is designated as a hedging instrument, any unrealized gains or losses are deferred and recognized in earnings when the related hedge transaction occurs.

#### (c) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of new common shares or options are shown in equity as a deduction from the proceeds.

### 2.9 Inventories

Logs and lumber inventories are valued at the lower of average cost and net realizable value. The cost of logs and lumber comprises all costs that relate to purchasing, harvesting and delivery of the logs to their present location, plus costs of production, including labour, overhead and amortization. It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost for completion and applicable variable selling expenses.

Operating and maintenance supplies are valued at the lower of average cost and replacement cost.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

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### 2.10 Goodwill and intangible assets

#### (a) Goodwill

Goodwill arises on the acquisition of subsidiaries and associates and represents the excess of the consideration transferred over the fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. Goodwill impairment is assessed by comparing the fair value of the cash generating unit ("CGU") to the underlying carrying amount of the CGU's net assets, including goodwill. CGUs are the lowest levels of business units for which there are separately identifiable cash flows. When the carrying amount of the CGU exceeds its recoverable amount, the recoverable amount of the CGU's goodwill is compared with its carrying amount to measure the amount of impairment loss, if any. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

#### (b) Other intangible assets

Other intangible assets, comprising forestry licences and software licences, are stated at cost less accumulated amortization.

The forestry licences are amortized on a straight-line basis over 60 years. Software licences are amortized on a straight-line basis over three years.

### 2.11 Property, plant and equipment

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses. Historical cost includes expenditures that are directly attributable to the acquisition of the assets.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land and assets classified as held for sale are not depreciated. Buildings and fixtures and computer hardware are depreciated on a straight-line basis over their estimated useful lives. Machinery, mobile and other production equipment are depreciated using the units of production basis. This method amortizes the cost of equipment over the estimated units that will be produced during its estimated useful life. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

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

Buildings and fixtures	2% - 5%
Machinery and equipment	5% - 33%
Mobile equipment	20% - 50%
Computer hardware	10% - 33%

The rates of depreciation are intended to fully depreciate manufacturing and non-manufacturing assets over their useful lives. These periods are assessed at least annually to ensure that they continue to approximate the useful lives of the related assets. The carrying amount of an asset is written down if it is determined to be greater than its estimated recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

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Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the income statement.

### 2.12 Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to property, plant and equipment are recorded as a reduction to the cost base of the related asset and are credited to the income statement through the recognition of a lower depreciation expense than would be recognized in the absence of the grant.

Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.

### 2.13 Impairment of non-financial assets

Assets that have an indefinite useful life, such as goodwill, are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized in net income at the amount the asset's carrying amount exceeds its recoverable amount. For the purposes of assessing impairment, assets are grouped at the lowest levels for which separately identifiable cash flows are largely independent of the cash flows of other assets or groups of assets (CGUs). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

### 2.14 Employee benefits

The Company has a defined contribution plan, which is a post-employment benefit plan under which the Company makes contributions to a separate entity and has no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense when they are earned.

### 2.15 Provisions

Provisions for reforestation, environmental restoration, restructuring costs and legal claims are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to the passage of time is charged to the income statement in the same expense category as the original expense related to the obligation.

### 2.16 Share-based compensation

The Company operates a long-term performance incentive plan and a stock option plan which provides for options, restricted share units, performance share units and deferred share units to be awarded as consideration for services from directors, employees and consultants. The fair value of the equity instrument and the employee services received in exchange for the grant of the options or share awards is measured at the grant date.

The share awards and stock options vest over multiple periods. The fair value of each tranche is considered to be a separate grant based on its vesting period. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period based on the Company's estimate of equity instruments that will eventually vest.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

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### 2.17 Compound financial instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have a conversion option. The equity component is recognized initially as the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition.

The liability component is classified as a current liability if the maturity date is within 12 months of the end of the reporting period. If not, it is classified as a non-current liability.

### 2.18 Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods supplied, stated net of returns and value added taxes. The Company recognizes revenue when the amount of revenue can be reliably measured, the significant risks and rewards of ownership are passed to the customer, and collectability is reasonably assured.

### 2.19 Borrowing costs

General and specific 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.

### 2.20 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

### 2.21 Income tax

The tax expense for the period comprises current and deferred tax.

Current income tax is the expected tax payable on the taxable income for the period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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### 2.22 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions.

### 2.23 Critical judgements and estimates

The preparation of the consolidated financial statements in conformity with IFRS requires management to make critical judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could materially differ from those estimates. Such differences in estimates are recognized when realized on a prospective basis.

The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. These estimates and judgements have been applied in a manner consistent with prior periods. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year include valuation of inventory, income taxes, provision for accrued liabilities, environmental and reforestation obligations, share-based compensation, impairment and contingencies.

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

### 2.24 Accounting standards issued and not yet adopted

#### (a) IFRS 2, Share-based Payment

In June 2016, the IASB issued an amendment to IFRS 2, *Share-based Payment*, clarifying the accounting for certain types of share-based payment transactions. The amendments provide requirements on accounting for the effects of vesting and non-vesting conditions of cash-settled share-based payments, withholding tax obligations for share-based payments with a net settlement feature, and when a modification to the terms of a share-based payment changes the classification of the transaction from cash-settled to equity-settled. The amendments are effective for the year beginning on or after January 1, 2018. The Company does not expect this amendment to have a significant impact on its consolidated financial statements.

#### (b) IFRS 9, Financial Instruments

In July 2014, the IASB issued the final publication of IFRS 9, *Financial Instruments*, superseding International Accounting Standard (“IAS”) 39, *Financial Instruments*. IFRS 9 includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. It also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management and contains a new impairment model which could result in earlier recognition of losses. IFRS 9 is effective for the year beginning on or after January 1, 2018 with early adoption permitted. The Company does not anticipate the new standard to have a significant impact on its consolidated financial statements.

#### (c) IFRS 15, Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which replaces the existing revenue recognition guidance with a new framework to determine the timing of revenue recognition and the measurement of revenue. In September 2015, the IASB formalized a one-year deferral of the effective date to

# Conifex Timber Inc.

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the year beginning on or after January 1, 2018. In April 2016, the IASB issued an amendment clarifying the guidance on identifying performance obligations, licenses of intellectual property and principal versus agent, and to provide additional practical expedients upon transition. The Company has performed a preliminary assessment of the impact of this standard and currently anticipates no significant impact on its consolidated financial statements.

### (d) IFRS 16, Leases

In January 2016, the IASB issued IFRS 16, *Leases*, which replaces the existing lease accounting guidance. IFRS 16 requires all leases to be reported on the balance sheet unless certain criteria for exclusion are met. IFRS 16 is effective for the year beginning on or after January 1, 2019 with early adoption permitted if IFRS 15 is also adopted at the same time. The Company has not yet determined the impact of this standard on its consolidated financial statements.

### (e) IAS 7, Statement of Cash Flows

In January 2016, the IASB issued an amendment to IAS 7, *Statement of Cash Flows*, introducing additional disclosure requirements for liabilities arising from financing activities. The amendments are effective for the year beginning January 1, 2017. The Company does not expect this amendment to have a significant impact on its consolidated financial statements.

## 3. SEASONALITY OF OPERATIONS

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

The operating results of the bioenergy segment will experience variability as a result of the application of a "time of delivery factor" to electricity pricing which adds a seasonal effect to quarterly revenues. The lowest revenues are expected to be generated in the spring months and the highest in the fall and winter months of each year.

## 4. INVENTORIES

	2016	2015
	\$	\$
Logs	25,712.3	15,408.7
Lumber	24,835.5	22,510.8
Supplies	5,682.0	5,208.0
By-products	108.1	104.4
	<b>56,337.9</b>	<b>43,231.9</b>

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has been written down at December 31, 2016 by nil (2015 – \$652,638). Write-downs are included in cost of goods sold when incurred.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### 5. GOODWILL AND INTANGIBLE ASSETS

#### (a) Goodwill

	2016	2015
	\$	\$
Cost and carrying amount	3,310.5	3,310.5

#### (b) Intangible assets

	Forestry licenses	Software licenses	Total
	\$		\$
<i>Cost</i>			
At December 31, 2014	8,550.0	372.9	8,922.9
Net additions	-	93.5	93.5
At December 31, 2015	8,550.0	466.4	9,016.4
Net dispositions	(2,566.5)	-	(2,566.5)
<b>At December 31, 2016</b>	<b>5,983.5</b>	<b>466.4</b>	<b>6,449.9</b>
<i>Accumulated amortization</i>			
At December 31, 2014	(633.3)	(372.9)	(1,006.2)
Amortization charge for the year	(142.5)	(24.6)	(167.1)
At December 31, 2015	(775.8)	(397.5)	(1,173.3)
Amortization charge for the year	(125.7)	(31.1)	(156.8)
<b>At December 31, 2016</b>	<b>(901.5)</b>	<b>(428.6)</b>	<b>(1,330.1)</b>
<i>Carrying amount</i>			
At December 31, 2015	7,774.2	68.9	7,843.1
<b>At December 31, 2016</b>	<b>5,082.0</b>	<b>37.8</b>	<b>5,119.8</b>

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

### 6. PROPERTY, PLANT AND EQUIPMENT

	Land	Buildings / equipment	Capital work in progress	Power assets	Power capital work in progress	Total
	\$	\$	\$	\$	\$	\$
<i>Cost</i>						
At December 31, 2014	2,854.0	94,718.2	10,056.6	9,874.8	116,606.8	234,110.4
Net additions *	-	-	6,501.0	-	1,977.1	8,478.1
Acquisition of El Dorado Sawmill Assets (note 26)	2,541.0	26,147.4	-	-	-	28,688.4
Transfers	-	14,614.7	(14,614.7)	117,129.9	(117,129.9)	-
Disposals	-	(20.0)	-	-	-	(20.0)
<b>At December 31, 2015</b>	<b>5,395.0</b>	<b>135,460.3</b>	<b>1,942.9</b>	<b>127,004.7</b>	<b>1,454.0</b>	<b>271,256.9</b>
Net additions *	69.0	4,030.3	13,087.2	921.5	(1,454.0)	16,654.0
Revaluation of property, plant and equipment	-	(5,833.0)	-	-	-	(5,833.0)
Disposals	-	(257.3)	-	-	-	(257.3)
<b>At December 31, 2016</b>	<b>5,464.0</b>	<b>133,400.3</b>	<b>15,030.1</b>	<b>127,926.2</b>	<b>-</b>	<b>281,820.6</b>
<i>Accumulated depreciation</i>						
At December 31, 2014	-	(34,377.0)	-	-	-	(34,377.0)
Depreciation charge for the year	-	(12,062.6)	-	(4,264.0)	-	(16,326.6)
<b>At December 31, 2015</b>	<b>-</b>	<b>(46,439.6)</b>	<b>-</b>	<b>(4,264.0)</b>	<b>-</b>	<b>(50,703.6)</b>
Depreciation charge for the year	-	(12,399.2)	-	(5,567.3)	-	(17,966.5)
Disposals	-	188.5	-	-	-	188.5
<b>At December 31, 2016</b>	<b>-</b>	<b>(58,650.3)</b>	<b>-</b>	<b>(9,831.3)</b>	<b>-</b>	<b>(68,481.6)</b>
<i>Carrying amount</i>						
At December 31, 2015	5,395.0	89,020.7	1,942.9	122,740.7	1,454.0	220,553.3
<b>At December 31, 2016</b>	<b>5,464.0</b>	<b>74,750.0</b>	<b>15,030.1</b>	<b>118,094.9</b>	<b>-</b>	<b>213,339.0</b>

\* Insurance proceeds received in the year of \$1,454,000 and in 2015 of \$11,546,000 were netted against the Power capital work in progress additions in the year received.

### 7. LONG-TERM INVESTMENTS AND OTHER

	2016	2015
	\$	\$
Joint venture investment	20,000.0	-
Other investments	577.7	556.8
Deposits	1,152.1	1,104.9
	<b>21,729.8</b>	<b>1,661.7</b>

On April 12, 2016, the Company entered into a timber harvesting cooperation agreement with a regional lumber manufacturer (the "Harvesting Partner") to conduct coordinated joint timber harvesting operations. Pursuant to the agreement, the Harvesting Partner paid \$20 million to acquire 50% of the issued and outstanding shares of a Conifex subsidiary which holds a forest licence with an annual timber harvest of 300,000 m<sup>3</sup>.



# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

The sale of the shares gave rise to a \$19.02 million gain. As a result of non-capital loss carryforwards from previous taxation years, no current income tax arises on the shares sale in the year.

The remaining 50% interest in the former subsidiary is classified as a joint venture and is accounted for using the equity method of accounting. As a result of a loss of control in the former Conifex subsidiary, the investment in the joint venture was revalued to its fair value amount of \$20 million, resulting in a gain on the revaluation of \$19.16 million on the consolidated statement of net income and comprehensive income during the year. The gain on revaluation was netted with the impairment charge against certain property, plant and equipment (note 20).

### 8. REFORESTATION OBLIGATIONS

	2016	2015
	\$	\$
Reforestation obligations		
Current	5,366.3	2,773.9
Non-current	6,744.2	6,091.4
	<b>12,110.5</b>	<b>8,865.3</b>

  

	2016	2015
	\$	\$
Balance at beginning of year	8,865.3	7,622.1
Additional provisions recognized	6,632.7	5,738.7
Reductions arising from payment	(3,314.0)	(4,171.9)
Change arising from re-measurement or settlement without cost	(73.5)	(323.6)
	<b>12,110.5</b>	<b>8,865.3</b>

### 9. ENVIRONMENTAL LIABILITIES

	2016	2015
	\$	\$
Balance at beginning of year	1,529.6	1,705.2
Reductions arising from payment	(58.7)	(219.9)
Change arising from re-measurement or settlement without cost	3.1	44.3
	<b>1,474.0</b>	<b>1,529.6</b>

### 10. OTHER LONG-TERM LIABILITIES

	2016	2015
	\$	\$
Other liabilities	265.8	304.3
Deferred revenue (a)	11,532.9	12,785.2
	<b>11,798.7</b>	<b>13,089.5</b>

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

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### (a) Deferred revenue

Deferred revenue of \$11,532,856 (2015 – \$12,785,212) is comprised of the incentive funds drawn under the Load Displacement Agreement with BC Hydro and is secured by letters of credit (note 12(d)). The incentive funding is recognized in profit on a systematic basis over the 20 year term of the agreement from April 30, 2015. The Company recognized \$627,356 (2015 – \$464,788) of the incentive funding as revenue during the year.

## 11. OPERATING LOANS

### (a) \$35 Million senior secured revolving asset based credit facility

The Company entered into a three-year \$25 million senior secured revolving asset based credit facility (the “Facility”) with a Canadian chartered bank in April 2013. Under the terms of the Facility, amounts drawn and to be repaid are determined by a borrowing base calculation that fluctuates with eligible accounts receivable and inventory balances, net of specific reserves. Borrowings can be in Canadian or US dollars. Interest rates on Canadian dollar borrowings are based on either banker’s acceptances or the Canadian chartered bank prime rate, at the Company’s option, plus an applicable margin.

In January 2016, the Company completed the renewal and amendment of the Facility for a further three-year term. The amendment increases the borrowing availability to \$35 million and extends the maturity date of the Facility to January 29, 2019.

The portion of the commitment that is not drawn is subject to a standby fee. The Facility is primarily secured by a first priority security interest on certain existing and after acquired lumber assets. The Company is subject to customary covenants, including a fixed charge coverage ratio if the amount available for borrowing falls below a certain threshold. Conifex uses the Facility primarily for working capital in its lumber segment and for other permitted general corporate purposes.

As of December 31, 2016, the Company has drawn \$19,750,000 of the Facility (2015 – \$11,050,000).

Subsequent to the end of the year, the Company entered into a new \$130 million secured revolving credit facility. A portion of the new secured revolving credit facility was used to fully repay the balance owing on the Facility (note 30).

### (b) Demand revolving loan and demand revolving line

Lignum Forest Products LLP (“Lignum”), a wholly-owned subsidiary of the Company, has a \$10 million demand revolving loan, a US\$1 million manufacturer’s advance facility to fulfill confirmed sales contract for supply of lumber to foreign buyers, and access to a foreign exchange facility (collectively, the “Revolving Loan”). The Revolving Loan bears interest at Canadian prime rate or US base rate plus an applicable margin.

The Revolving Loan is secured by a general security agreement and a general assignment of Lignum’s assets. Lignum is subject to customary covenants, including maintaining a debt to equity ratio, current ratio and tangible net worth above certain thresholds.

Lignum has drawn \$6,848,728 of the Revolving Loan as at December 31, 2016 (2015 – \$5,776,868).

Subsequent to the end of the year, the Company entered into a new \$130 million secured revolving credit facility. A portion of the new secured revolving credit facility was used to repay in full the balance owing on the Revolving Loan (note 30).

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

### (c) \$1.75 Million revolving operating facility

Conifex Power Limited Partnership ("CP Partnership"), a wholly-owned subsidiary of the Company, has a \$1.75 million revolving operating facility in connection with the project financing secured in November 2013 (note 12(d)).

As of December 31, 2016, CP Partnership has drawn \$1,600,000 of the revolving operating facility (2015 – \$1,500,000).

## 12. BORROWINGS

	2016	2015
	\$	\$
<b>Non-current</b>		
Long-term debt (a)	680.8	45.7
Senior secured notes (b)	19,606.1	24,357.7
Payment-in-kind note (c)	-	30,000.0
Term loan (d)	68,377.1	75,824.9
	<b>88,664.0</b>	<b>130,228.3</b>
<b>Current</b>		
Subordinated convertible notes (e)	-	11,797.7
Mortgage (f)	10,440.8	11,957.8
Current portion of long-term debt and term loan	4,438.2	4,353.3
	<b>14,879.0</b>	<b>28,108.8</b>
<b>Total borrowings</b>	<b>103,543.0</b>	<b>158,337.1</b>

The aggregate amount of contractual cash outflows for borrowings, which reflects payments in full before accretion, are as follows:

	Amount
	\$
2017	35,198.4
2018	4,015.4
2019	64,658.4
2020	137.0
2021	230.9
Thereafter	-
	<b>104,240.1</b>

### (a) Long-term debt

Long-term debt consists of three capital leases for mobile equipment. The capital leases expire between 2017 and 2021. The principal balance outstanding at December 31, 2016 was \$882,946 (2015 – \$220,825).

Long-term debt also included a secured loan facility provided under the Community Adjustment Fund ("CAF") loan program sponsored by the Northern Development Initiative Trust. The CAF loan carried a fixed interest rate of 3.75% and was repayable by 20 quarterly repayments of \$485,700 commencing June 2011. The loan was secured by a general security agreement (excluding inventory and receivables) and a mortgage against

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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certain properties. The Company repaid the remaining balance of \$83,296 of the CAF loan during the year ended December 31, 2016 (2015 – \$1,895,051).

### (b) Senior secured notes

In September 2013, the Company issued promissory notes (the “Notes”) in the aggregate principal amount of \$30 million. The Notes mature on September 18, 2017 and bear interest at a rate of 8% per annum. The Company may redeem the Notes, in whole or in part, upon 15 days’ notice and payment of interest accrued on the amount redeemed to the date of redemption, but otherwise at par.

The Company redeemed \$4,000,000 of the notes on August 4, 2015 and \$5,700,000 on April 12, 2016. Subsequent to the end of the year, the remaining balance outstanding of \$20,300,000 was redeemed (note 30).

As additional consideration for the loan, the Company issued share purchase warrants entitling the holder to purchase up to an aggregate of 1,060,000 common shares of the unissued capital stock of the Company at a price of \$8.25 per share until September 18, 2017.

The fair market value of each share purchase warrant is calculated using the Black-Scholes option pricing model at \$3.41. The related issuance costs will be amortized over the term of the Notes. For the year ended December 31, 2016, the Company recorded expenses that comprised accretion of \$902,873, amortization of issuance costs of \$45,534 and interest expense of \$1,755,879 (2015 – \$902,873, \$45,534 and \$2,268,493 respectively).

The Notes are primarily secured by a first priority security interest in certain long-term lumber segment assets.

The Notes recognized in the consolidated balance sheet are calculated as follows:

	Promissory notes	Issuance costs	Warrants	Accretion	Total
	\$	\$	\$	\$	\$
At December 31, 2014	30,000.0	(125.2)	(3,611.5)	1,145.9	27,409.2
Redemption of promissory notes	(4,000.0)	-	-	-	(4,000.0)
Amortization of issuance costs and accretion	-	45.6	-	902.9	948.5
At December 31, 2015	26,000.0	(79.6)	(3,611.5)	2,048.8	24,357.7
Redemption of promissory notes	(5,700.0)	-	-	-	(5,700.0)
Amortization of issuance costs and accretion	-	45.5	-	902.9	948.4
<b>At December 31, 2016</b>	<b>20,300.0</b>	<b>(34.1)</b>	<b>(3,611.5)</b>	<b>2,951.7</b>	<b>19,606.1</b>

### (c) Payment-in-kind note

In August 2015, the Company’s wholly-owned subsidiary, Conifex Inc., entered into an investment agreement, pursuant to which it issued a payment-in-kind note (the “PIK Note”) in the principal amount of \$30 million. The PIK Note had a term of five years and a maturity date of August 4, 2020. The PIK Note was non-interest bearing from the issue date until August 3, 2017.

On February 12, 2016, the holder of the PIK Note exercised its option to convert the PIK Note into ownership interest in the wholly-owned subsidiary which holds a forest license with 200,000 m<sup>3</sup> of annual cut (the “Forest Licence”).

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

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The redemption of the PIK Note resulted in a gain on the sale of the Forest Licence of \$28.97 million. As a result of a tax election which was filed in 2015 to increase the tax basis of the Forest Licence, no current income tax arises on the PIK Note redemption in the year.

### **(d) Term loan**

CP Partnership secured project financing (the "Project Financing") with a syndicate of four institutional lenders led by a Canadian chartered bank in November 2013. The Project Financing is for an aggregate up to \$102.7 million and includes a development and construction loan facility of up to \$82 million (the "Construction Facility"). The Construction Facility comprises floating rate and fixed rate tranches, both of which matured on July 31, 2015 (amended from June 30, 2015). On July 30, 2015, CP Partnership converted the Construction Facility into an amortized term loan (the "Term Loan") that matures on December 1, 2019. The balance of the Project Financing is in the form of a \$18.95 million letter of credit facility and a \$1.75 million revolving operating facility. The letter of credit facility is utilized primarily to secure certain obligations of CP Partnership under its Load Displacement Agreement and a debt service reserve fund.

Interest rates on the floating rate tranche borrowings are based on either banker's acceptances or the Canadian chartered bank prime rate, at CP Partnership's option, plus an applicable margin. The fixed rate tranche bears an interest rate largely consistent with the floating rate tranche. The Company has entered into an interest rate swap on the floating rate tranche (note 26(a)(iii)).

The Project Financing is primarily secured by a first priority security interest on existing and after acquired assets of CP Partnership.

As at December 31, 2016, CP Partnership had issued letters of credit totaling \$18,750,000 (2015 – \$18,750,000) under the letter of credit facility provided under the Project Financing.

For the year ended December 31, 2016, CP Partnership recorded interest expense of \$5,071,014 and financing expense of \$32,764 (year ended December 31, 2015 – \$3,510,166 and \$13,862 respectively). CP Partnership repaid \$6,029,000 of the floating rate tranche and \$1,277,778 of the fixed rate tranche during the year (year ended December 31, 2015 – \$1,799,000 and \$281,111 respectively).

As at December 31, 2016, CP Partnership held \$10,309,288 of cash in restricted accounts (2015 – \$8,545,653). Funds from restricted accounts are distributed in accordance with the terms of the Project Financing.

### **(e) Subordinated convertible notes**

On December 15, 2014, the Company issued \$12,000,000 in unsecured subordinated convertible notes (the "Convertible Notes"). The Convertible Notes bore interest at a rate of 7% per annum. The Convertible Notes matured and were fully repaid on December 15, 2016. The Convertible Notes were convertible at the option of the holder into common shares at a conversion price of \$6.22 per share.

The values of the liability component and the equity conversion component were determined at issuance of the notes. The fair value of the liability component, included in current liabilities, was calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the value of the equity conversion option, is included in equity. The note discount equal to the value of the option and issuance costs is accreted over the term of the note.

For the year ended December 31, 2016, the Company recorded expenses that comprised accretion of \$156,422, amortization of issuance costs of \$45,875 and interest expense of \$800,984 (2015 – \$167,105, \$49,128 and \$840,000 respectively).

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

The subordinated convertible notes recognized in the consolidated balance sheet are calculated as follows:

	Convertible notes	Issuance costs	Equity component	Liability component
	\$	\$	\$	\$
At December 31, 2014	12,000.0	70.1	351.3	11,581.5
Issuance costs	-	24.9	(24.9)	-
Accretion of subordinated convertible notes	-	-	-	167.1
Amortization of issuance costs	-	(49.1)	-	49.1
At December 31, 2015	12,000.0	45.9	326.4	11,797.7
Repayment of subordinated convertible notes	(12,000.0)	-	-	(12,000.0)
Accretion of subordinated convertible notes	-	-	-	156.4
Amortization of issuance costs	-	(45.9)	-	45.9
<b>At December 31, 2016</b>	<b>-</b>	<b>-</b>	<b>326.4</b>	<b>-</b>

### (f) Mortgage

On August 6, 2015, the Company acquired idled sawmill assets located in El Dorado, Arkansas, United States (note 28). Consideration paid for the acquired assets included a US\$8.64 million vendor mortgage (the "Mortgage"). The Mortgage bears interest at a rate of 6% per annum, payable quarterly beginning on November 1, 2015, and had a maturity date on the earlier of December 1, 2016 or the day before any remodel, construction or addition of buildings and/or equipment of the El Dorado Sawmill Assets.

During the year, an amendment to the Mortgage was negotiated whereby the Company repaid US\$864,000 of the principal amount on November 1, 2016 in order to commence certain site preparation and preconstruction activities at the El Dorado site. A second amendment was entered into during the year to extend the maturity date of the Mortgage to March 31, 2017.

The Mortgage is secured against the El Dorado Sawmill Assets.

For the year ended December 31, 2016, interest of \$676,193 (2015 – \$277,764) has been capitalized to the El Dorado Sawmill Assets.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### 13. SHARE CAPITAL

#### Authorized

Unlimited number of common voting shares without par value.

Common share activity of the Company is as follows:

	Number of common shares (in thousands)	Amount \$
Balance at December 31, 2014	20,922	156,423.3
Shares vested under share-based compensation plan (note 14)	89	737.3
Shares issued (note 28)	100	675.0
Balance at December 31, 2015	21,111	157,835.6
<b>Shares vested under share-based compensation plan (note 14)</b>	<b>92</b>	<b>766.2</b>
<b>Balance at December 31, 2016</b>	<b>21,203</b>	<b>158,601.8</b>

### 14. SHARE-BASED COMPENSATION

#### 14.1 Stock option plan

The Company has a stock option plan primarily applicable to directors and officers. 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 10 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 December 31, 2016 with an exercise price of \$8.25 per share. The options were granted on August 20, 2010 and expire on August 20, 2020 and have fully vested. The options are exercisable only to the extent that they have vested.

The fair value of the options granted was estimated at the time of the grant using the Black-Scholes option pricing model. Based on a share price of \$6.50 on the day of the grant, expected life of 10 years, risk-free interest rate of 3.05% and annualized volatility of 33%, the fair value of the options granted on August 20, 2010 was estimated at \$265,000 or \$2.65 per option. Expense related to the stock option plan of \$9,785 was recognized in the year ended December 31, 2016 (2015 – \$1,398).

#### 14.2 Long-term performance incentive plan

The Company operates a long-term performance incentive plan which provides for long-term incentive plan units, restricted share units, performance share units and deferred share units to be awarded to directors, executives and salaried employees. The Company measures the fair value of the services received as consideration for equity instruments indirectly by reference to the fair value of the equity instruments granted. The fair value is measured on the basis of an observable market price subject to a minimum price.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### (a) Long-term incentive plan units and restricted share units

The following table illustrates the number and weighted average fair value ("WAFV") of, and movements in, long-term incentive plan awards and restricted share units granted during the year:

	2016	2016	2015	2015
	Number	WAFV	Number	WAFV
		\$		\$
Outstanding at January 1	417,837	7.75	445,319	8.28
Granted during the year	385,000	3.38	120,000	6.51
Forfeited during the year	(49,178)	5.90	(58,920)	8.31
Vested during the year	(86,697)	8.06	(88,562)	8.39
Outstanding at December 31	666,962	5.33	417,837	7.75

The awards vest in three, four and five year tranches. The fair value of each tranche is determined separately and recognized as compensation expense over the term of its respective vesting period.

Expense related to the grant of long-term incentive plan awards and restricted share units of \$916,298 was recognized in the year ended December 31, 2016 (2015 – \$761,342). The compensation expense is allocated between cost of goods sold and selling, general and administrative expense.

### (b) Performance share units

Performance share units ("PSUs") generally vest on the third anniversary of the issuance date with the number of vesting shares determined by the 10-day volume-weighted average share price at vesting relative to the share price at issuance. Payments for vested units can be made in cash at the discretion of the Company's Board of Directors. The Company records an expense based on the 10-day volume-weighted average share price at each balance sheet date. No expense was recognized and no cash payments were made in regards to vested PSUs in the year ended December 31, 2016 (2015 – nil).

### (c) Deferred share units

Deferred share units ("DSUs") are awarded to directors who elect to have all or a portion of their directors' fees compensated by DSU awards rather than cash. The election can be made annually. The DSUs may only be redeemed upon a director's retirement from the Company, its subsidiaries or any affiliated entity. The number of DSUs awarded is determined by the 10-day volume-weighted average share price at the time of the award. The Company records an expense based on the 10-day volume-weighted average share price at each balance sheet date. There was no expense recognized for the grant of DSUs in the year ended December 31, 2016 (2015 – \$6,875).

## 15. WARRANTS

	Number of warrants	Amount
		\$
Balance at December 31, 2014 and 2015	1,220,417	3,931,352.6
<b>Warrants expired and cancelled during 2016</b>	<b>(160,417)</b>	<b>(319,861.0)</b>
<b>Balance at December 31, 2016</b>	<b>1,060,000</b>	<b>3,611,491.6</b>



# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

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### (a) Warrants issued in connection with \$5 million senior secured promissory notes

In connection with the February 2013 issuance of senior secured promissory notes by CP Partnership, the Company issued share purchase warrants entitling the holders of the promissory notes to purchase up to an aggregate of 160,417 common shares of the unissued capital stock of the Company at a price of \$9.50 per share. The fair market value of the warrants was capitalized to the power generation plant in prior years. The warrants expired on February 21, 2016.

### (b) Warrants issued in connection with \$30 million senior secured notes

In connection with the September 2013 issuance of senior secured notes (note 12(b)), the Company issued share purchase warrants entitling the holders of the promissory notes to purchase up to an aggregate of 1,060,000 common shares of the unissued capital stock of the Company at a price of \$8.25 per share until September 18, 2017.

The fair market value of the warrants is recorded against the carrying value of the borrowing and amortized over the term of the promissory notes. During the year ended December 31, 2016, the Company recorded accretion expense of \$902,873 (2015 – \$902,873) related to the common share purchase warrants.

## 16. REVENUE

	2016	2015
	\$	\$
Lumber	348,175.6	302,884.7
Lumber by-products	25,526.2	23,994.5
Bioenergy	25,166.2	16,255.9
Transportation services	10,439.7	10,332.2
	<b>409,307.7</b>	<b>353,467.3</b>

## 17. INSURANCE CLAIM SETTLEMENT

In December 2016, the Company completed settlement of a property damage and business interruption insurance claim related to the unexpected outage at the Mackenzie power generation plant in October 2014. The Company received a total of \$17 million under the insurance claim, with \$11.5 million being received in 2015 and the final amount of \$5.5 million being received in 2016. Insurance claim settlement amounts of \$14.5 million received in respect of the property damage and claim costs were recorded as an offset to additional costs incurred as a result of the delayed start-up. The net business interruption claim settlement of \$2.5 million was recognized in operating income during the year.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### 18. SELLING, GENERAL AND ADMINISTRATIVE

	2016	2015
	\$	\$
Selling and logistics services	8,357.4	7,776.6
Salaries and benefits	4,169.2	3,551.3
Other administrative expenses	2,336.0	2,006.4
Legal, professional and organizational	2,346.7	1,899.5
Depreciation and amortization	313.2	377.9
	<b>17,522.5</b>	<b>15,611.7</b>

### 19. INTEREST EXPENSE AND ACCRETION

	2016	2015
	\$	\$
Interest expense	7,848.8	7,208.4
Accretion	1,059.3	1,070.0
Financing expense	212.2	281.8
	<b>9,120.3</b>	<b>8,560.2</b>

Interest and financing of nil (2015 – \$1,673,004) has been capitalized to the power generation plant and interest of \$676,193 (2015 – \$277,764) has been capitalized to the El Dorado Sawmill Assets (note 28).

### 20. REVALUATION OF PROPERTY, PLANT AND EQUIPMENT

During the year, the Company concluded that a change in circumstances arising from entry into the joint venture agreement, combined with increased uncertainty around the successful completion of a negotiated softwood lumber trade agreement with the U.S. prior to the October 2016 expiry of the one-year standstill period which prevents the U.S. from initiating new trade actions against Canada, required assessment of impairment for certain currently idled assets in the lumber segment. As a result, the Company reviewed the property, plant and equipment for impairment and recorded a \$5.8 million impairment charge on the consolidated statement of net income and comprehensive income during the year. The impairment charge was netted against the gain arising on the revaluation of a joint venture investment (note 7).

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### 21. INCOME TAX

#### 21.1 Current income taxes

	2016	2015
	\$	\$
<i>Recognized in income statement</i>		
Tax expense comprises		
Current tax expense (recovery)	-	-
<i>Reconciliation of effective tax rate</i>		
Income (loss) before tax	<b>70,233.5</b>	(17,320.6)
Income tax expense (recovery) at corporation rate of 26.00% (2015 - 26.00%)	<b>18,260.7</b>	(4,503.4)
(Non-taxable) non-deductible items for tax purposes	<b>(4,598.4)</b>	933.9
Effect of unrecognized deferred tax on investment in joint venture	<b>(2,491.1)</b>	-
Change in unused tax losses and tax offsets not recognized as deferred assets	<b>(8,391.0)</b>	8,137.5
Recognition of the benefit of prior years' tax losses	<b>(2,944.5)</b>	(4,585.8)
Other	<b>164.3</b>	17.8
<b>Total income tax expense</b>	<b>-</b>	<b>-</b>

During the year, the Company disposed of 50% of the issued and outstanding shares of a Conifex subsidiary, resulting in a taxable capital gain which was offset by the utilization of loss carryforward amounts (note 7).

#### 21.2 Unrecognized deferred income taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the amounts used for income tax purposes.

The source of unrecognized deferred income taxes is as follows:

	2015	Change		2016
	Opening balance	Related to earnings	Related to equity	Closing balance
	\$	\$	\$	\$
Deferred tax assets related to non-capital losses	8,272.8	(3,081.6)	-	<b>5,191.2</b>
Deferred tax assets related to temporary differences in tax and book basis	5,348.7	(8,253.9)	-	<b>(2,905.2)</b>
<b>Net deferred tax assets</b>	<b>13,621.5</b>	<b>(11,335.5)</b>	<b>-</b>	<b>2,286.0</b>

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

	2014	Change		2015
	Opening balance	Related to earnings	Related to equity	Closing balance
	\$	\$	\$	\$
Deferred tax assets related to non-capital losses	7,904.7	368.1	-	8,272.8
Deferred tax assets related to temporary differences in tax and book basis	2,165.1	3,183.6	-	5,348.7
Net deferred tax assets	10,069.8	3,551.7	-	13,621.5

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

### 21.3 Non-capital loss carry forwards

As at December 31, 2016, the Company has non-capital losses from the following years:

Year of loss	Non-capital loss amount
	\$
2006	43.3
2007	-
2008	317.2
2009	597.8
2010	602.5
2011	1,574.2
2012	756.0
2013	923.7
2014	4,007.5
2015	9,478.3
2016	1,665.8
	19,966.3

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

# Conifex Timber Inc.

## Notes to the consolidated financial statements

December 31, 2016 and 2015

(Tabular amounts expressed in thousands except per share amounts)

### 22. NET INCOME (LOSS) PER SHARE

	Year ended December 31, 2016			Year ended December 31, 2015		
	Net income	Weighted average number of shares	Per share	Net loss	Weighted average number of shares	Per share
	\$		\$	\$		\$
Basic income (loss) per share	70,233.5	21,159	3.32	(17,320.6)	21,027	(0.82)
Convertible notes	-	- *	-	-	1,929 *	-
Diluted income (loss) per share	70,233.5	21,159	3.32	(17,320.6)	21,027	(0.82)

\* The convertible notes matured on December 15, 2016 and have been removed from the computation of net income (loss) per share in 2016. In 2015, the conversion of convertible notes was anti-dilutive and was therefore excluded from the weighted average number of common shares for the purposes of calculating diluted income (loss) per share.

### 23. RELATED PARTY TRANSACTIONS

#### Key management personnel

Compensation of key management (directors and officers) consists of amounts paid and accrued as at the year-end.

	2016	2015
	\$	\$
Short-term benefits	2,644.3	1,520.1
Share-based payments	382.7	130.1
	3,027.0	1,650.2

### 24. SEGMENT AND GEOGRAPHICAL INFORMATION

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

- Lumber - The main activities of the lumber segment include timber harvesting, reforestation, forest management, sawmilling logs into lumber and wood chips, and value added lumber finishing. The Company markets and distributes its lumber products through its wholly-owned subsidiaries, Conifex Fibre Marketing Inc. ("CFMI"), Lignum, and Navcor Transportation Services Inc. ("Navcor"). CFMI, Lignum, and Navcor generate additional revenue from third party transactions.
- Bioenergy - The primary activities of the bioenergy segment are the generation of electrical power and the development of other opportunities in bioenergy and bioproducts which are complementary to the Company's harvesting and manufacturing operations. The Mackenzie power generation plant commenced commercial operations on May 1, 2015.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

Summary by segment:

	Lumber	Bioenergy	Corporate & other	Consolidated
	\$	\$	\$	\$
<b>Year ended December 31, 2016</b>				
Sales to external customers	384,141.5	25,166.2	-	409,307.7
Operating income (loss)	15,084.5	9,016.5	(5,944.9)	18,156.1
Gain on disposal of assets	48,002.5	-	-	48,002.5
Gain on revaluation	13,329.1	-	-	13,329.1
Interest expense and accretion	-	(5,103.8)	(4,016.5)	(9,120.3)
Other income	841.7	7.2	-	848.9
Foreign exchange loss	-	(2.0)	(980.8)	(982.8)
<b>Net income (loss)</b>	<b>77,257.8</b>	<b>3,917.9</b>	<b>(10,942.2)</b>	<b>70,233.5</b>
Depreciation and amortization	12,477.4	5,567.3	78.6	18,123.3
Capital expenditures	16,365.3	54.5	234.2	16,654.0
<b>Identifiable assets</b>	<b>210,997.1</b>	<b>140,304.9</b>	<b>13,983.3</b>	<b>365,285.3</b>
<b>Year ended December 31, 2015</b>				
Sales to external customers	337,211.4	16,255.9	-	353,467.3
Operating income (loss)	(8,722.3)	2,062.2	(4,947.6)	(11,607.7)
Loss on disposal of assets	(2.2)	-	-	(2.2)
Interest expense and accretion	-	(3,538.4)	(5,021.8)	(8,560.2)
Other income	67.2	-	-	67.2
Foreign exchange gain	-	-	2,782.3	2,782.3
<b>Net loss</b>	<b>(8,657.3)</b>	<b>(1,476.2)</b>	<b>(7,187.1)</b>	<b>(17,320.6)</b>
Depreciation and amortization	12,166.1	4,264.0	63.6	16,493.7
Capital expenditures	5,317.2	13,523.1	1,277.3	20,117.6
Acquisition of El Dorado	28,688.4	-	-	28,688.4
<b>Identifiable assets</b>	<b>180,568.7</b>	<b>129,529.7</b>	<b>21,999.2</b>	<b>332,097.6</b>

Revenues by geographic area were as follows:

	2016	2015
	\$	\$
United States	239,156.2	173,878.4
Canada	86,270.9	89,810.7
China	38,470.3	50,169.3
Japan	33,893.5	30,007.4
Other	11,516.8	9,601.5
	<b>409,307.7</b>	<b>353,467.3</b>

All of the Company's harvesting, manufacturing and power generation operations are located in the interior region of British Columbia.

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

### 25. COMMITMENTS

#### Lease payments

The amount of operating lease payments charged to the statement of net income (loss) and comprehensive income (loss) during the year comprised:

	2016	2015
	\$	\$
Equipment	227.8	474.9
Office and office equipment	820.1	831.9
Vehicles	278.4	166.0
	<b>1,326.3</b>	<b>1,472.8</b>

#### Lease commitments

The future aggregate minimum lease payments under non-cancellable leases are as follows:

	2016	2015
	\$	\$
Less than 1 year	1,129.2	1,587.0
Later than 1 year and not later than 5 years	2,805.6	3,131.6
Later than 5 years	1,477.3	2,029.9
	<b>5,412.1</b>	<b>6,748.5</b>

### 26. FINANCIAL RISK AND CAPITAL MANAGEMENT

#### Financial risk management

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange risk, commodity price risk and interest rate risk), credit risk and liquidity risk. The Company's overall financial risk management activities focus on the unpredictability of financial markets and seek to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to reduce certain risk exposures.

The Company's financial risk management activities are governed by Board-approved financial policies that cover risk identification, tolerance, measurement, hedging limits, hedging products, and authorization levels.

#### (a) Market risk

##### (i) Foreign exchange risk

The Company is exposed to currency risk, primarily with respect to the US dollar, as its products are sold principally in US dollars and its costs of production are incurred principally in Canadian dollars. Foreign exchange risk arises from future commercial transactions and recognized assets and liabilities. The Company does not currently use financial derivative instruments for its foreign exchange risk management program.

As at December 31, 2016, the Company's US dollar denominated accounts receivable totaled US\$10,603,695 (2015 – US\$10,044,503) and accounts payable totaled US\$3,533,046 (2015 – US\$3,055,043). The Company estimates that an increase or decrease of one cent in the value of the Canadian dollar per US\$1.00 during

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

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2016 would have decreased or increased, respectively, annual operating earnings by approximately \$1,398,000.

### *(ii) Commodity price risk*

The Company is exposed to commodity price risk related to the sale of lumber and residual products and purchase of certain manufacturing inputs which are purchased primarily on the open market. From time to time, the Company enters into futures contracts on the Chicago Mercantile Exchange to reduce its exposure to risks associated with fluctuations in lumber prices. At December 31, 2016, the fair value of non-covered outstanding commodity financial instruments was \$1,581,546 (2015 – \$872,310). The fair value of these instruments was determined based on market rates for instruments with similar characteristics. An increase (decrease) in the futures market price of lumber of US\$10 per thousand board feet would result in a pre-tax gain (loss) of approximately US\$92,400 in relation to the lumber futures held at year end.

### *(iii) Interest rate risk*

Exposure to interest risk arises primarily when financial assets and financial obligations bear variable interest rates. At December 31, 2016, the Company's financial obligations bearing variable interest rates (excluding borrowings under revolving operating loans) totaled \$51,172,000 (2015 – \$57,201,000). The Company utilizes interest rate swaps to reduce its interest rate risk associated with its financial obligations that bear variable interest rates. At December 31, 2016, the Company had \$46,172,167 (2015 – \$51,816,384) in fixed interest rate swaps with a maturity date of September 30, 2017.

### **(b) Credit risk**

Credit risk is the risk of financial loss to the Company in the event a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily related to its trade receivable balances. The Company's credit department is responsible for managing and analyzing the credit risk for each new client before standard payment and delivery terms and conditions are offered. The Company utilizes a combination of credit insurance, letters of credit and self-insurance to manage risks associated with its trade receivables. Management regularly reviews the collectability of trade receivables and makes provisions where the collectability is uncertain. The Company does not have significant credit risk related to its cash and cash equivalent balances as deposits are held with major Canadian banks.

### **(c) Liquidity risk**

Liquidity risk is the risk that the Company will be unable to meet its financial obligations on a current basis. The Company manages liquidity risk by regularly performing rolling cash flow forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs and commitments. Management uses cash flow forecasts to identify financing requirements, which are then addressed through a combination of committed credit facilities and access to capital markets.

Repayment of amounts due within one year is typically funded by cash on hand, cash flow from operations including management of working capital, normal collection of current trade accounts receivable and refinancings.

### **Capital management**

The Company's objective when managing capital is to maintain a strong balance sheet that ensures adequate capital resources to support operations and to sustain future business development.



# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

The Company monitors capital on the basis of the net debt to total capitalization ratio. Net debt is calculated as current and non-current borrowings including the present value of convertible notes (notes 11 and 12) less cash and cash equivalents. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

The Company's capital structure at year end consisted of the following:

	2016	2015
	\$	\$
Borrowings, current	43,077.7	46,435.7
Borrowings, non-current	88,664.0	130,228.3
Less: Cash	(22,959.6)	(18,448.6)
Net debt	108,782.1	158,215.4
Shareholders' equity	177,508.5	106,358.7
Total capitalization	286,290.6	264,574.1
Net debt to capitalization	38%	60%

The Company's capital structure, excluding borrowings by CP Partnership as described in note 11 and note 12, at year end consisted of the following:

	2016	2015
	\$	\$
Borrowings, current (excluding non-recourse borrowings)	37,241.7	40,840.7
Borrowings, non-current (excluding non-recourse borrowings)	20,286.8	54,403.4
Less: Cash	(22,959.6)	(18,448.6)
Net debt	34,568.9	76,795.5
Shareholders' equity	177,508.5	106,358.7
Total capitalization	212,077.4	183,154.2
Net debt to capitalization	16%	42%

There were no changes in the Company's approach to capital management during the year.

## 27. FINANCIAL INSTRUMENTS

The Company's accounts receivables, other deposits and advances, notes payable, accounts payable and accrued liabilities, and long-term debt are measured at amortized cost subsequent to initial recognition.

Cash and cash equivalents and derivative instruments are measured at fair value.

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are classified within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

# Conifex Timber Inc.

## Notes to the consolidated financial statements

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(Tabular amounts expressed in thousands except per share amounts)

The following table summarizes the Company's financial instruments at December 31, 2016 and 2015, and shows the level within the fair value hierarchy in which they have been classified (for financial instruments measured at fair value):

	Fair value hierarchy level	2016	2015
		\$	\$
<b>Financial assets</b>			
Held for trading			
Derivative financial instruments	Level 2	1,581.5	872.3
		<u>1,581.5</u>	<u>872.3</u>

### 28. ACQUISITION OF EL DORADO SAWMILL ASSETS

On August 6, 2015, the Company purchased the outstanding shares and shareholder loans of a US subsidiary for consideration of 100,000 common shares of the Company at a deemed price of \$6.75, as well as the reimbursement of certain costs previously incurred by the vendor.

Concurrently, the Company exercised its right to acquire a sawmill and related facilities and equipment, including approximately 186 acres of land, located near El Dorado, Arkansas, US (collectively, the "El Dorado Sawmill Assets") for total consideration of US\$21 million. The consideration was comprised of US\$12.36 million in cash and a US\$8.64 million vendor mortgage. The El Dorado Sawmill Assets are currently idled. The Company expects to commence a capital upgrade project to modernize and restart the mill in 2017.

### 29. RECLASSIFICATION OF COMPARATIVE AMOUNTS

Certain comparative amounts for the prior year have been reclassified to conform to the current year's presentation.

### 30. SUBSEQUENT EVENT

#### Closing of \$130 Million Secured Revolving Credit Facility

On January 9, 2017, the Company entered into a \$130 million secured revolving credit facility (the "Credit Facility") with a syndicate of institutional lenders. The Credit Facility is available for a term of five years and is secured by substantially all of the Company's assets excluding the bioenergy segment assets. The Credit Facility will bear interest at CDOR or LIBOR plus an applicable margin. A portion of the Credit Facility was used to repay in full and extinguish the Company's existing revolving credit facilities and senior secured notes.