



## **CONIFEX TIMBER INC. SECOND QUARTER 2015**

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

**Dated as of August 5, 2015**

*This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial performance of Conifex Timber Inc. (the "Company") for the quarter ended June 30, 2015 relative to the quarters ended March 31, 2015 and June 30, 2014, the Company's financial condition and future prospects. This interim MD&A should be read in conjunction with Conifex's unaudited condensed consolidated interim financial statements and accompanying notes for the quarters ended June 30, 2015 and 2014, as well as the 2014 annual MD&A and the December 31, 2014 audited consolidated financial statements and notes thereon which are filed on SEDAR at [www.sedar.com](http://www.sedar.com). The financial information contained herein has been prepared in accordance with International Financial Reporting Standards.*

*In this interim MD&A, reference is made to "EBITDA". EBITDA represents earnings before interest, taxes, depreciation and amortization. The Company discloses EBITDA as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA is a non-GAAP measure, it may not be comparable to EBITDA calculated by others. In addition, as EBITDA is not a substitute for net earnings, readers should consider net earnings in evaluating the Company's performance.*

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

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

### **FORWARD-LOOKING STATEMENTS**

*This interim MD&A contains certain forward-looking information that reflects the current views and/or expectations of the Company with respect to its expectations, beliefs, assumptions, estimates and forecasts about its business and the industries and markets in which it operates. The reader is cautioned that statements comprising forward-looking information are not guarantees of future performance and involve known and unknown risks, uncertainties, assumptions and other factors which are difficult to predict and that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Accordingly, readers should not place undue reliance on forward-looking information. Examples of such forward-looking information that may be contained in this document include statements regarding: growth and future prospects of our business; our expectation for the export tax rate assessed on lumber shipments to the U.S.; our expectation for mill net realizations; our perceptions of the industry and markets in which we operate and anticipated trends in such markets and in the countries in which we do business; benefits that may accrue to the Company as a result of certain capital expenditure programs, such as the lumber segment capital plan*

*and equipment upgrades; and the anticipated benefits, cost, timing and completion dates for projects.*

*Assumptions underlying the Company's expectations regarding forward-looking information contained in this interim MD&A include, among others: that the Company will be able to effectively market its products; that the U.S. housing market will continue to improve; that there will be no unforeseen disruptions affecting the operation of the power generation project and that the Company will be able to continue to deliver power therefrom; that softwood lumber will experience sustained demand in the marketplace; that the export tax rate on U.S. lumber shipments will be less than the maximum rate; the general stability of the economic, political and regulatory environments within the countries where the Company conducts operations; the ability of the Company to obtain financing (if necessary) on acceptable terms or at all; that interest and foreign exchange rates will not vary materially from current levels; and that the equipment at our mills and power plant will operate at expected levels.*

*Persons reading this interim MD&A are cautioned that statements comprising forward-looking information are only predictions, and that the Company's actual future results or performance are subject to certain risks and uncertainties including, without limitation: those relating to potential disruptions to production and delivery, including as a result of equipment failures, labour issues, the complex integration of processes and equipment and other factors; labour relations; failure to meet regulatory requirements; changes in the market; potential downturns in economic conditions; fluctuations in the price and supply of required materials, including log costs; fluctuations in the market price for products sold; foreign exchange fluctuations; trade restrictions or import duties imposed by foreign governments; availability of financing (as necessary); and other risk factors detailed in our Annual Information Form dated March 18, 2015 available on SEDAR at [www.sedar.com](http://www.sedar.com) and other filings with the Canadian securities regulatory authorities. These risks, as well as others, could cause actual results and events to vary significantly. The Company does not undertake any obligation to update any forward-looking information, except as required by applicable securities law.*

## **SIGNIFICANT DEVELOPMENTS**

### **Mackenzie Power Generation Plant Achieves Commercial Operation Date**

On April 24, 2015, the Company's wholly-owned subsidiary, Conifex Power Limited Partnership ("CP Partnership"), achieved a significant milestone related to its power generation project by completing a continuous 72 hour run test at its 36 MW biomass power plant at Mackenzie B.C. The successful completion of the run test was a critical requirement to achieve the Commercial Operation Date ("COD") in accordance with the Electricity Purchase Agreement ("EPA") with BC Hydro. Thereafter, CP Partnership commenced selling electricity under the EPA to BC Hydro in May 2015. The operation of the Mackenzie power generation plant comprises the sole business of CP Partnership and its operating results are reported in the bioenergy segment.

## SUMMARY OF CONSOLIDATED OPERATING RESULTS

### Selected Financial Information

(millions of dollars, except share and per share amounts, unaudited)	<b>Q2</b> <b>2015</b>	<b>Q1</b> <b>2015</b>	<b>YTD</b> <b>2015</b>	<b>Q2</b> <b>2014</b>	<b>YTD</b> <b>2014</b>
Sales	81.8	85.3	167.1	99.6	166.8
<b>Operating Income (Loss) by Segment</b>					
Lumber	(8.1)	2.0	(6.1)	5.4	9.8
Bioenergy	(0.5)	-	(0.5)	-	-
Corporate and other	(1.2)	(0.9)	(2.1)	(1.0)	(2.6)
	(9.8)	1.1	(8.7)	4.4	7.2
<b>EBITDA by Segment</b>					
Lumber	(5.0)	4.7	(0.3)	8.0	15.0
Bioenergy	0.5	-	0.5	-	-
Corporate and other	(2.3)	1.0	(1.3)	(1.8)	(3.1)
	(6.8)	5.7	(1.1)	6.2	11.9
Net income (loss)	(13.0)	1.6	(11.4)	2.0	3.6
Net income (loss) per share - basic and diluted (1)	(0.62)	0.08	(0.55)	0.10	0.17
Shares outstanding - weighted average (millions)	21.0	21.0	21.0	20.9	20.9
Average exchange rate - US\$/Cdn\$ (2)	0.813	0.806	0.810	0.917	0.912
<b>Reconciliation of EBITDA to Net Income (Loss)</b>					
Net income (loss)	(13.0)	1.6	(11.4)	2.0	3.6
Add: Finance costs	2.1	1.3	3.4	1.5	3.0
Amortization	4.1	2.8	6.9	2.7	5.3
EBITDA	(6.8)	5.7	(1.1)	6.2	11.9

(1) The calculation of diluted net income per share excludes the assumed conversion of convertible notes and/or the assumed exercise of outstanding warrants if the resulting effect on net income per share is anti-dilutive.

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

For the quarter ended June 30, 2015, the Company recorded a net loss of \$13.0 million or \$0.62 per share on sales of \$81.8 million compared to net income of \$1.6 million or \$0.08 per diluted share on sales of \$85.3 million during the first quarter of 2015, and net income of \$2.0 million or \$0.10 per diluted share on sales of \$99.6 million during the second quarter of 2014. Net loss for the first six months of 2015 was \$11.4 million or \$0.55 per share compared to net income of \$3.6 million or \$0.17 per diluted share over the same period last year.

The bioenergy segment includes the operating results at the Mackenzie power generation plant from May 2015. The power plant contributed revenues of \$2.6 million from external sources for the two months ended June 30, 2015.

Compared to the first quarter of 2015, the negative variance in net income of \$14.6 million was largely attributable to a sequential decline in lumber segment operating income of \$10.1 million, an operating loss in the bioenergy segment of \$0.5 million, increased interest expense related to the power project construction loan of \$0.8 million and an adverse quarter over quarter change of \$3.0 million from currency rate fluctuations. The decline in lumber segment operating results was due primarily to lower mill net realizations from a 12% decline in Canadian dollar denominated benchmark prices and, to a lesser extent, the imposition of export taxes and

shipment of a lower value product mix. The operating loss of \$0.5 million reported in the bioenergy segment includes depreciation expense of \$1.0 million.

The primary factors contributing to the decrease in lumber segment operating results of \$13.5 million compared to the second quarter of 2014 included significantly lower shipment and production volumes, declines in mill net realizations due to the weaker Canadian dollar denominated benchmark prices and higher export tax rates, and higher unit log costs.

On a year-to-date comparative basis, current year net income was adversely impacted mostly by lower shipment volumes, operating rates and mill net realizations and significantly higher log costs.

EBITDA was negative \$6.8 million in the second quarter of 2015 and represented declines of \$12.5 million from the previous quarter and \$13.0 million from the second quarter of 2014.

The Company had unrestricted cash balances of \$10.2 million at June 30, 2015, \$10.1 million at December 31, 2014, and \$12.4 million at June 30, 2014. At June 30, 2015, the Company had operating working capital of \$33.7 million invested primarily in its lumber segment operations. Net debt increased by \$15.1 million during the first six months of 2015 due primarily to additional drawings of \$5.3 million on the Company's asset backed revolving credit facility and demand revolving loan and \$9.6 million on the construction loan for the power generation project. Excluding borrowings related to the power generation project, which is largely structured on a non-recourse basis to the lumber segment assets and to the parent company, Conifex Timber Inc., the Company ended the second quarter of 2015 with a net debt to capitalization ratio of 30% compared to 25% at December 31, 2014.

## REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

### Lumber Segment

	Q2	Q1	YTD	Q2	YTD
(millions of dollars, unaudited)	2015	2015	2015	2014	2014
Sales -Lumber - Conifex produced	47.5	53.8	101.3	63.8	108.8
- Lumber - wholesale	23.6	22.1	45.7	24.4	37.4
- By-products	6.0	6.4	12.4	8.0	13.7
- Logistics services	2.1	3.0	5.1	3.4	6.9
<b>Total Sales</b>	<b>79.2</b>	<b>85.3</b>	<b>164.5</b>	<b>99.6</b>	<b>166.8</b>
EBITDA	(5.0)	4.7	(0.3)	8.0	15.0
Amortization	3.1	2.7	5.8	2.6	5.2
Operating income (loss)	(8.1)	2.0	(6.1)	5.4	9.8

### Statistics

Lumber shipments - Conifex produced (MMfbm)	116.0	112.8	228.8	146.4	242.3
Lumber shipments - Wholesale (MMfbm)	39.7	34.8	74.5	43.3	68.5
Lumber production (MMfbm)	118.1	119.4	237.5	134.9	263.2
Average exchange rate - US\$/Cdn\$ (1)	0.813	0.806	0.810	0.917	0.912
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$ 271	\$ 304	\$ 288	\$ 335	\$ 351
Average WSPF 2x4 #2&Btr lumber price (Cdn\$) (3)	\$ 333	\$ 378	\$ 355	\$ 365	\$ 385

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

(2) Source: Random Lengths Publications Inc.

(3) Average WSPF 2x4 #2&Btr lumber price (US\$) divided by average exchange rate

### Overview

According to data published by the U.S. Census Bureau, U.S. privately-owned housing starts averaged a seasonally adjusted annualized rate of approximately 1.14 million over the second quarter of 2015, which represented an improvement of approximately 16% over the previous quarter and the second quarter of 2014. Seasonally adjusted single-family housing starts increased by 9% over the previous quarter and 13% over the second quarter of 2015. Although a number of recent economic indicators collectively point towards an underlying strength in the U.S. housing market recovery, this positive trend was not evident in benchmark lumber prices during the quarter. The lumber price for the bellwether WSPF 2x4 #2 & Btr (“WSPF”) averaged US\$271 during the second quarter of 2015, the lowest quarterly average price since early 2012<sup>1</sup>. Canadian dollar denominated benchmark prices declined by 12%, or \$45 per thousand board feet, from the previous quarter due to a weakening in WSPF prices of 11% and the marginal strengthening of the Canadian dollar of 1%<sup>2</sup>. Compared to the second quarter of 2014, Canadian dollar denominated benchmark prices declined by 9% as a decline in WSPF prices of 19% was partially offset by a 10% weaker Canadian currency against the U.S. dollar.

Weaker WSPF prices during the second quarter of 2015 were generally attributed by industry analysts to increased supply in North America due to fewer offshore shipments and mild

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

<sup>2</sup> Currency rates as quoted on the Bank of Canada website [www.bankofcanada.ca](http://www.bankofcanada.ca)

weather conditions in North America which alleviated supply chain constraints, and to the weaker Canadian currency which tends to erode U.S. dollar denominated lumber prices.

Shipments of Conifex produced lumber totaled 116 million board feet during the quarter, an increase of 3% over the previous quarter, and a decline of 21% over the same quarter last year when record shipment volumes for the Company were reported due to the clearing of shipment backlogs from significant industry wide transportation disruptions in the first quarter of 2014. Shipments of Conifex produced lumber totaled 229 million board feet for the first six months of 2015, a decline of 6% from the same period last year. Production volumes of 118 million board feet were similar to the previous quarter and 12% lower than the second quarter of 2014.

The export tax rate on shipments to the U.S. reflected lower average Random Lengths Framing Lumber Composite Prices and averaged 7% during the second quarter of 2015 compared to zero percent during the previous quarter and the second quarter of 2014.

The lumber segment recorded an operating loss of \$8.1 million for the second quarter of 2015 compared to operating income of \$2.0 million in the first quarter of 2015 and \$5.4 million in the second quarter of 2014. Lumber segment EBITDA for the second quarter of 2015 was negative \$5.0 million compared to positive \$4.7 million for the previous quarter and \$8.0 million for the second quarter of 2014.

Compared to the previous quarter, the variance in lumber segment operating results was due primarily to lower mill net realizations from a 12% decline in Canadian dollar denominated benchmark prices and, to a lesser extent, the imposition of export taxes and shipment of a weaker product mix. An increase in unit cash conversion costs of 5% was partially offset by improvement in unit log costs of 2%.

The primary factors contributing to the decrease in lumber segment operating results of \$13.5 million compared to the second quarter of 2014 included significantly lower shipment and production volumes, declining in mill net realizations due to 9% lower Canadian dollar denominated benchmark prices and higher export tax rates, and higher unit log costs.

On a year-to-date comparative basis, current year net income was adversely impacted mostly by lower shipment volumes, operating rates and mill net realizations and significantly higher log costs.

Management expects that general economic activity and the residential construction sector in the U.S. will continue its gradual recovery. We expect sustainable lumber price improvements will remain vulnerable to the strength of the U.S. housing market, supply side response to varying demand, and the volatility and magnitude of offshore demand and of fluctuating currency rates. We expect overall shipment levels to the Canadian and Japanese markets to remain relatively constant, while shipments to the U.S. and Chinese markets will fluctuate depending on market and pricing dynamics. Export taxes on U.S. shipments are expected to average 6% to 8% for the third quarter of 2015. We expect operating rates in the upcoming quarter to remain largely consistent with the first six months of the year despite the two week downtime taken at the Fort St. James mill in July 2015. Production was temporarily curtailed to accommodate a capital project, consolidate seasonal vacation time, and to lessen exposure to the punitive 15% export tax applicable to U.S. shipments in July 2015. We expect the ongoing focus on cost management and mill uptime and reliability, and the benefits of further capital upgrades, will result in sustainably lower unit cash conversion costs. We expect log costs will remain stable or slightly decline over the last half of the year.

## Sales

Lumber shipments of Conifex produced lumber totalled 116 million board feet during the second quarter of 2015 and represented an increase of 3% from the previous quarter and a decline of 21% over the second quarter of 2014. The Company reported record shipment volumes during the second quarter of 2014 as a backlog of shipments from significant industry wide transportation disruptions in the first quarter of 2014 were caught up. Lower operating rates contributed to a decline in shipment of 6% on a year-to-date basis. Total shipments, including wholesale lumber shipments, increased by 5% over the previous quarter and decreased by 18% over the second quarter of 2014.

Compared to the previous quarter, gross revenues from shipments of Conifex produced lumber declined by 12% as the impact of a 14% decline in unit gross sales realizations was offset by a 3% increase in lumber shipments. The decline in unit mill net realizations of 19% was reflective of the 12% reduction in Canadian dollar denominated benchmark prices, increased export tax rate and higher shipments to the Chinese market, which generally consumes lower grade products. Although the export tax is only applicable on softwood lumber shipments to the U.S., prices in other geographical markets, except Japan which is priced on a quarterly basis, are typically somewhat discounted to reflect the lower returns available from the U.S. market. Compared to the second quarter of 2014, a 26% decrease in gross lumber revenues from Conifex produced lumber was largely attributable to lower shipment volumes of 21% and lower gross unit sales realizations of 6%.

The table below shows the percentage of net lumber revenue earned from and volume shipped to each geographic market (based on Conifex produced lumber, unaudited).

	<b>Q2</b>	<b>Q1</b>	<b>YTD</b>	<b>Q2</b>	<b>YTD</b>
	<b>2015</b>	<b>2015</b>	<b>2015</b>	<b>2014</b>	<b>2014</b>
<b>By Revenue (net of freight)</b>					
Canada	17%	17%	17%	13%	13%
USA	44%	55%	50%	46%	49%
China	27%	17%	22%	31%	28%
Japan	9%	9%	9%	9%	9%
Other export	3%	2%	2%	1%	1%
	100%	100%	100%	100%	100%
<b>By Shipment Volume</b>					
Canada	16%	16%	16%	12%	13%
USA	43%	54%	49%	43%	46%
China	31%	21%	26%	37%	34%
Japan	6%	7%	6%	6%	6%
Other export	4%	2%	3%	2%	1%
	100%	100%	100%	100%	100%

Revenue from chips and other residuals were relatively consistent with the previous quarter. The decrease in revenue from by-products of approximately 25% from the second quarter of 2014 was primarily attributable to lower shipment volumes.

## Production and Operations

Lumber production totalled 118 million board feet in the second quarter of 2015 and represented an annualized operating rate of 90% (excluding lumber capacity attributed to the idled

Mackenzie Site I sawmill) compared to 91% in the previous quarter and 103% in the second quarter of 2014. The annual lumber capacity of the Company's two operating sawmills on a two-shift basis is approximately 525 million board feet. The lower operating rate over the first six months of 2015 compared to the same period last year is attributable to a reduced operating hour format intended to contain operating costs and, in the second quarter of 2015, some downtime related to a capital upgrade at Mackenzie.

Costs of goods sold includes costs related to the raw materials and manufacturing of Conifex produced lumber, purchases of wholesale lumber (which may include a freight component), freight procurement costs related to the provision of third party logistics services and costs related to power production (discussed below, under the Bioenergy Segment). Overall lumber segment cost of goods sold increased by 5% compared to the previous quarter due primarily to higher shipment volumes and overall manufacturing costs. A decrease of 7% in lumber segment cost of goods sold over the second quarter of 2014 was primarily attributable to considerably lower shipment volumes partially offset by higher unit log and conversion costs and an inventory valuation charge.

Unit log costs declined marginally compared to the first quarter of 2015 and increased by approximately 21% over the second quarter of 2014. The increase was primarily attributable to costs associated with increased stumpage rates, logging and hauling rates, and purchased log costs. Unit cash conversion costs increased by 5% compared to the previous quarter and the second quarter of 2014. On a year-to-date basis, the heightened focus on cost management has resulted in a 3% improvement in unit cash conversion costs despite a 10% lower operating rate. Cost of goods sold included an inventory valuation charge of \$1.4 million for the six months ended June 30, 2015. An inventory valuation charge was not recorded for the same period last year.

Per unit freight and distribution costs on shipments of Conifex produced lumber decreased by 3% from the previous quarter and increased by 6% over the second quarter of 2014. The variability was primarily attributable to the fluctuating Canadian currency as freight costs outside of Canada are typically denominated in U.S. dollars, which was somewhat offset by the benefit of reduced fuel surcharges.

### **Bioenergy Segment**

On April 24, 2015, CP Partnership achieved a significant milestone related to its power generation project by completing a continuous 72 hour run test at its 36 MW biomass power plant at Mackenzie B.C. The successful completion of the run test was a critical requirement to achieve the COD in accordance with the EPA with BC Hydro. The Mackenzie power generation plant is contracted to supply electricity to the Mackenzie operations under a Load Displacement Agreement ("LDA") and to sell electricity under an EPA with BC Hydro. Both agreements have 20-year terms.

The commencement of commercial operations at the Mackenzie power generation plant in May 2015 contributed \$2.6 million in revenues from external sources in the second quarter of 2015. Operating loss for the two months was \$0.5 million and included depreciation of \$1.0 million. Bioenergy segment EBITDA was \$0.5 million and included interest expense of \$0.8 million.

Although electricity revenues from BC Hydro under the EPA are based upon a fixed base price per MWh, the application of a "time of delivery factor" ("TDF") to the base unit price adds a seasonal effect to quarterly revenues. The TDF is expected to produce considerable variability



in quarterly revenues with the lowest revenues generated in the second quarter and the highest in the first and fourth quarters of each year. The seasonal effect is expected to produce variances in revenues of up to 30% between the strongest and weakest quarters. As a major portion of the costs of electricity production, as well as depreciation and interest charges, are fixed in nature, quarterly operating results in the bioenergy segment are expected to reflect the variability in revenues.

In May 2015, the power plant achieved 69% of targeted operating rates, with performance hampered by downtime associated with boiler cleaning, reduced output associated with post commissioning boiler tuning and preparation of the unit for performance testing. In June 2015, the first full month of operations post performance testing and final boiler tuning, the power plant achieved 98% of targeted operating rates. Operating costs for the second quarter of 2015 were higher than budgeted due primarily to costs related to the use of outside services contractors. Operating costs are expected to normalize in the third quarter of 2015.

Capital expenditures related to the power generation project totalled \$13.9 million during the first six months of 2015 and were partially offset by an advance against insurance proceeds of \$1.5 million. Capital expenditures included costs related to repair and reassembly of equipment and testing and commissioning, as well as carrying costs such as interest, insurance premiums and property tax. CP Partnership expects to receive a major portion of the balance of insurance proceeds by the end of the year.

#### Corporate costs and other items

	Q2	Q1	YTD	Q2	YTD
(millions of dollars, unaudited)	2015	2015	2015	2014	2014
Corporate costs	1.2	0.9	2.1	1.0	2.6
Finance costs	2.1	1.3	3.4	1.5	3.0
Other (income) expense	0.1	0.1	0.2	-	(0.1)
Foreign exchange (gain) loss	1.1	(1.9)	(0.8)	0.8	0.6
	4.5	0.4	4.9	3.3	6.1

Corporate costs were generally consistent in each of the comparative quarters. The increase in quarter over quarter finance costs of \$0.8 million consisted of interest expense related to the construction loan which had been recorded as a capital cost prior to May 2015.

The Company utilizes derivative financial instruments to manage its commodity lumber price exposures in the ordinary course of business and to manage its interest rate variability. Realized and unrealized gains or losses from the revaluation of lumber derivative instruments to fair values at period end are recognized as other income or expense each period and allocated to lumber segment operating results.

The construction loan provided under the project financing facility secured to develop the power generation project consists of a floating rate tranche and a fixed rate tranche (the "Project Financing"). CP Partnership has entered into interest rate swap transactions with the lead arranger to swap the interest rates on the floating rate tranche of the construction loan and the subsequent term loan to fixed interest rates. A loss of \$0.2 million on the interest rate swap instruments was recorded as interest expense in the bioenergy segment and \$0.4 million as capital costs during the first six months of 2015.

The foreign exchange translation gain or loss recorded for each period results from the revaluation of U.S. dollar-denominated working capital balances to reflect the change in the value of the Canadian dollar relative to the value of the U.S. dollar. U.S. dollar-denominated monetary assets and liabilities are translated using the rate of exchange prevailing at the reporting date. The relative magnitude of the translation gain or loss is largely determined by the net amount of U.S. dollar-denominated monetary assets and liabilities and the change in the exchange rates at the end of each period.

### Income tax

At December 31, 2014, the Company had unused non-capital tax losses carried forward totalling approximately \$30.4 million. Although the Company expects to realize the full benefit of the loss carry forwards and unrecognized deferred tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefits of its deferred tax assets available to reduce taxable income.

### SUMMARY OF FINANCIAL POSITION

The following table is a summary of selected financial information as at the end of each of the comparative quarters:

	<b>Q2</b>	<b>Q4</b>	<b>Q2</b>
(millions of dollars, unaudited)	<b>2015</b>	<b>2014</b>	<b>2014</b>
Cash	10.2	10.1	12.4
Cash - restricted	0.8	1.8	3.0
Operating working capital	33.7	36.5	38.4
Operating loans	(17.1)	(11.8)	(6.1)
Convertible notes	-	-	(9.3)
Current portion of long-term debt	(7.9)	(6.7)	(2.1)
Net current assets	19.7	29.9	36.3
Long-term assets - power generation plant	137.9	126.5	102.2
Long-term assets - lumber segment and corporate	82.8	85.5	80.6
Net assets	240.4	241.9	219.1
Non-interest bearing long-term liabilities	14.1	12.3	14.0
Long-term debt - power project construction loan	75.4	68.0	56.2
Long-term debt - other	39.7	39.3	28.3
Shareholders' equity	111.2	122.3	120.6
	240.4	241.9	219.1
Ratio of current assets to current liabilities	1.3	1.5	1.7
Net debt to capitalization, non-recourse borrowings excluded	30%	25%	20%
Net debt to capitalization, non-recourse borrowings included	54%	48%	42%

The Company manages capital with the objective of maintaining a strong balance sheet that helps ensure adequate capital resources to support operations, sustain future development and facilitate access to capital markets at competitive rates. The Company uses the net debt to total capitalization ratio to measure the Company's relative debt position and as an indicator of the relative strength and flexibility of its balance sheet. Net debt is calculated as the principal value of long-term debt, including the current portion and bank advances and the present value of

convertible notes, less cash. Total capital is calculated as “equity” as shown in the consolidated balance sheet plus net debt. Net debt increased by \$15.1 million during the first six months of 2015 due primarily to additional drawings of \$5.3 million on the Company's asset backed revolving credit facility and demand revolving loan and \$9.6 million on the construction loan for the power generation project.

The Project Financing is primarily secured by a first lien security interest on the power generation project assets and recourse to affiliates is largely limited to a \$5 million contingent equity letter of credit issued by the Company and bridge financing of \$6.5 million to be repaid by CP Partnership upon settlement of its insurance claim and receipt of proceeds therefrom. Excluding the effects of the borrowings under the Project Financing, the Company ended the second quarter of 2015 with a net debt to capitalization ratio of 30% compared to 25% at December 31, 2014.

## CHANGES IN FINANCIAL POSITION

### Selected Cash Flow Items

	Q2	Q1	YTD	Q2	YTD
(millions of dollars, unaudited)	2015	2015	2015	2014	2014
<b>Operating Activities</b>					
Cash provided (used) before working capital changes	(7.5)	7.3	(0.2)	5.4	12.9
Cash provided from (used in) non-cash working capital	15.5	(9.8)	5.7	14.9	(3.9)
Cash provided from (used in) operating activities	8.0	(2.5)	5.5	20.3	9.0
<b>Investing Activities</b>					
Additions to:					
Property, plant, equipment - power plant	(8.7)	(5.5)	(14.2)	(16.4)	(32.1)
Property, plant, equipment - lumber and corporate	(1.0)	(2.6)	(3.6)	(1.7)	(4.7)
Other long-term investments	-	-	-	(0.6)	(0.6)
Acquisition of subsidiary	-	-	-	-	(4.8)
Cash used in investing activities	(9.7)	(8.1)	(17.8)	(18.7)	(42.2)
<b>Financing Activities</b>					
Proceeds from construction loan - power project	3.8	5.8	9.6	17.4	33.4
Proceeds from (repayment of) operating loans	(1.5)	6.9	5.4	(10.2)	(0.7)
Repayment of long-term debt	(0.6)	(0.5)	(1.1)	(0.5)	(0.9)
Financing costs paid	(1.1)	(1.4)	(2.5)	(0.7)	(1.8)
Cash provided from (used in) financing activities	0.6	10.8	11.4	6.0	30.0
<b>Change in cash</b>	<b>(1.1)</b>	<b>0.2</b>	<b>(0.9)</b>	<b>7.6</b>	<b>(3.2)</b>

### Cash provided from (used in) non-cash working capital items

	Q2	Q1	YTD	Q2	YTD
(millions of dollars, unaudited)	2015	2015	2015	2014	2014
Trade and other receivables	5.0	1.6	6.6	(4.5)	(0.6)
Inventories	14.6	(13.4)	1.2	25.0	4.6
Accounts payable, accrued liabilities and other payables	(0.1)	(0.6)	(0.7)	0.1	(3.0)
Other	(4.0)	2.6	(1.4)	(5.7)	(4.9)
Cash provided from (used in) non-cash working capital	15.5	(9.8)	5.7	14.9	(3.9)

Operating activities before working capital changes consumed cash of \$7.5 million in the second quarter of 2015 and provided cash of \$7.3 million in the previous quarter and \$5.4 million in the second quarter of 2014. Non-cash working capital changes provided cash of approximately \$15.0 million in the second quarters of 2015 and 2014, and used cash of \$9.8 million in the first quarter of 2015. The pattern of non-cash working capital fluctuations reflects expected seasonal trends as log inventories are typically drawn down during the second quarters of each year following builds in the previous two quarters. The change in inventory levels in the second quarter of 2014 also resulted from record lumber shipments following an atypical build of finished goods inventories during the previous quarter primarily due to weather related railcar shortages in Western Canada throughout much of that quarter and a truckers' strike at the main port in Vancouver, British Columbia in March 2014.

Investing activities during the second quarter of 2015 totalled \$9.7 million and were comprised of \$1.0 million of lumber segment capital expenditures and \$8.7 million of expenditures related to the power generation project. During the previous quarter, the Company invested \$2.6 million on lumber segment capital projects and \$5.5 million on expenditures related to the power generation project. Lumber segment capital expenditures during the first six months of 2015 included payments related to the installation of extensive dust mitigation equipment at the Fort St. James and Mackenzie Site II sawmills in late 2014 and an upgrade to the sawline at Mackenzie. Investing activities during the second quarter of 2014 totalled \$18.7 million, and included expenditures of \$16.4 million on the construction of the power generation project and \$1.7 million on lumber segment capital projects.

Financing activities during the second quarter of 2015 provided net cash of \$0.6 million and included drawings of \$3.8 million from the construction loan, repayment of \$1.5 million of revolving operating loans, and payment of financing costs totalling \$1.1 million. In the previous quarter, financing activities provided net cash of \$10.8 million and included drawings of \$5.8 million from the construction loan and \$6.9 million from revolving operating loans and payment of financing costs totalling \$1.4 million. Cash provided from financing activities during the second quarter of 2014 totalled \$6.0 million and included draws totalling \$17.4 million from the construction loan and repayment of \$10.2 million of operating loans

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company's current principal sources of funds are cash on hand, cash flow from operations, and borrowing availability under its revolving operating loans and the Project Financing.

The Company had unrestricted cash balances of \$10.2 million at June 30, 2015, \$10.1 million at December 31, 2014, and \$12.4 million at June 30, 2014. At June 30, 2015, the Company had operating working capital of \$33.7 million invested primarily in its lumber segment operations. Operating working capital requirements of the bioenergy segment are expected to be relatively modest and primarily financed by an additional \$1.75 million revolving loan facility that is scheduled to become accessible in August 2015. Lumber segment operating working capital levels were approximately 10% lower than typical average amounts carried by the Company due primarily to the seasonal depletion of log inventories and lower values of accounts receivables due to weaker prices. At June 30, 2015, the Company had approximately \$6.0 million of availability under its revolving credit facilities and the construction loan was fully drawn

The Company monitors expected liquidity levels and compliance with debt covenants by regularly preparing rolling cash flow forecasts to ensure sufficient resources are available to meet operational requirements, debt service commitments and to sustain future business

development. Scheduled long-term debt payments, including interest, are estimated to total \$6.9 million for the remaining six months of the year. Capital expenditures related to the power generation project were largely completed at the end of the second quarter of 2015. Subsequent to quarter end, the Company received approximately \$4.5 million of interim insurance proceeds and the balance of \$6.6 million of incentive funding under the LDA. The Company was in compliance with its debt covenants for the quarter ended June 30, 2015. Based on its current forecasts, the Company expects sufficient liquidity will be available to meet its obligations in 2015.

As part of its overall strategy, the Company may acquire businesses or additional assets or expand its facilities from time to time as such opportunities arise. As a result, the Company may require substantial additional capital resources. The Company expects such additional capital resources will be generated from debt financing and/or the sale of equity securities, but no assurance may be given that such additional capital resources will be available on satisfactory terms, or at all.

## SELECTED QUARTERLY FINANCIAL INFORMATION

### Quarterly Earnings Summary

(millions of dollars, except share and per share amounts, unaudited)	2015			2014			2013	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales	81.8	85.3	95.2	90.9	99.6	67.2	63.7	65.3
Operating income (loss)	(9.8)	1.1	0.6	1.5	4.4	2.8	2.2	0.7
Net income (loss)	(13.0)	1.6	-	1.1	2.0	1.6	1.1	(0.1)
Net income (loss) per share - basic and diluted (1)	(0.62)	0.08	-	0.05	0.10	0.08	0.05	(0.01)
EBITDA (2)	(6.8)	5.7	4.1	5.3	6.2	5.7	4.7	2.8
Shares outstanding - weighted average (millions)	21.0	21.0	20.9	20.9	20.9	20.8	20.8	20.8

### Statistics

Lumber shipments - Conifex produced (MMfbm)	116.0	112.8	134.0	130.4	146.4	95.9	118.6	129.3
Lumber production (MMfbm)	118.1	119.4	116.9	125.6	134.9	128.3	116.3	123.0
Average exchange rate - US\$/Cdn\$ (3)	0.813	0.806	0.881	0.918	0.917	0.906	0.953	0.963
Average WSPF 2x4 #2&Btr lumber price (US\$) (4)	\$ 271	\$ 304	\$ 340	\$ 356	\$ 335	\$ 367	\$ 370	\$ 328
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)(5)	\$ 333	\$ 378	\$ 386	\$ 388	\$ 365	\$ 405	\$ 388	\$ 341

### Reconciliation of EBITDA to Net Income (Loss)

Net income (loss)	(13.0)	1.6	-	1.1	2.0	1.6	1.1	(0.1)
Add: Finance costs	2.1	1.3	1.4	1.4	1.5	1.5	1.4	0.7
Amortization	4.1	2.8	2.7	2.8	2.7	2.6	2.2	2.2
EBITDA	(6.8)	5.7	4.1	5.3	6.2	5.7	4.7	2.8

(1) The calculation of diluted net income per share excludes the assumed conversion of convertible notes and/or the assumed exercise of outstanding warrants if the resulting effect on net income per share is anti-dilutive.

(2) The Company's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization. EBITDA for quarterly periods presented has been restated to: (i) exclude deductions for non-cash charges related to employee compensation for 2013; and (ii) include accretion expense as a component of financing costs.

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

(4) Source: Random Lengths Publications Inc.

(5) Average WSPF 2x4 #2&Btr lumber price (US\$) divided by average exchange rate.

The Company's financial results are impacted by a variety of market related factors, including fluctuation in lumber prices and prices of certain commodities related to by-product revenue and manufacturing inputs, and changes in the export tax rate, stumpage rates, and foreign

exchange rates. Other more company specific factors that influence quarterly financial trends include operating rates, shipment volumes, raw material and manufacturing costs, and transactions of a non-recurring nature. The Company relies primarily on third parties for transportation of its products, as well as delivery of raw materials, and any significant or prolonged disruption of services provided by third party carriers may adversely impact operations, cost structure or shipment volumes.

Quarterly trends are also impacted by the seasonal nature of activities such as logging operations and construction and remodelling activity. 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 generally largely curtailed due to unstable road conditions. Operating rates are typically lower, and unit manufacturing costs higher, during the fourth quarter of each year due to planned curtailments related to seasonal holidays. The considerable increase in revenues in the second quarter of 2014 and subsequent quarters was largely attributable to the acquisition of Lignum, a lumber marketing and distribution business, in February 2014.

## **OUTLOOK AND STRATEGY**

In the near-term, management continues to remain focused on a number of initiatives to enhance lumber segment operations and cash flow, including continued heightened cost management and productivity improvements from affordable, high-return capital projects at Fort St. James and Mackenzie.

The Company is currently completing its review to evaluate the optimal capital upgrade for its recently acquired El Dorado Mill, following which management expects to determine the priority in which to rebuild its currently idled Mackenzie Site I mill or the El Dorado Mill. Over the longer term, the Company expects to undertake the capital upgrades to rebuild both of these mills.

## **SUBSEQUENT EVENTS**

### **Receipt of Insurance Proceeds and Incentive Funding**

In July 2015, the Company received approximately \$4.5 million of interim insurance proceeds and the balance of \$6.6 million of incentive funding under the LDA.

### **Term Conversion of Project Financing**

On July 30, 2015, CP Partnership completed the term conversion of the Project Financing facility. As a result of the term conversion, the construction loan portion of the Project Financing has matured and been converted into a term loan that matures on December 1, 2019 (the "Term Loan") and has an 18 year amortization schedule. The Project Financing continues to include a letter of credit facility and a \$1.75 million revolving operating facility until the maturity date of the Term Loan.

### **Completion of Investment Agreement**

On August 4, 2015, our wholly-owned subsidiary, Conifex Inc., completed its previously announced investment agreement, pursuant to which Conifex Inc. issued a \$30 million senior secured note (the "Note").

The Note has a term of five years, bears no interest for the first two years with interest of 5% per annum thereafter until maturity and is secured by, among other things, a first lien on a forest licence with 200,000 m<sup>3</sup> of annual cut held indirectly by a subsidiary of Conifex Inc. (the "Subsidiary"). Conifex Inc. can elect after 17 months to pay the principal amount of the Note by the transfer of all of the issued common shares of the Subsidiary. Additionally, the holder of the Note has the option, exercisable after 12 months, to convert the Note into an ownership interest in the forest licence. The proceeds of the Note are planned to be used for general corporate purposes.

### **Acquisition of Sawmill Assets in El Dorado, Arkansas**

On August 5, 2015, the Company completed the purchase (the "Purchase") of 100% of the outstanding shares and shareholder loans of a private Delaware company ("AcquisitionCo"). The consideration consisted of 100,000 common shares of the Company at a deemed price of CAD\$6.75, as well as the reimbursement of certain costs previously incurred by the vendor.

AcquisitionCo had the exclusive rights to acquire a sawmill and related facilities and equipment, including approximately 186 acres of land, located near El Dorado, Arkansas, United States (the "El Dorado Mill"). Concurrent with the closing of the Purchase, AcquisitionCo exercised its right to acquire the El Dorado Mill for total consideration of US\$21 million, comprised of US\$12.36 million in cash and an US\$8.64 million vendor mortgage.

### **OUTSTANDING SECURITIES**

As at August 5, 2015, the Company had 21,099,658 issued and outstanding common shares, 100,000 options granted, 1,347,393 long-term incentive plan awards, 1,220,417 warrants, and subordinated convertible promissory notes in the aggregate principal amount of \$12 million, which notes are convertible into a maximum of 1,929,260 common shares of the Company.

### **CRITICAL ACCOUNTING ESTIMATES**

There were no significant changes to the Company's critical accounting estimates during the quarter ended June 30, 2015. Conifex's critical accounting estimates are described in its MD&A for the year ended December 31, 2014, filed under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com).

### **RISKS AND UNCERTAINTIES**

A comprehensive discussion of risk factors is included in the Company's 2014 annual information form dated March 18, 2015, and other filings with the Canadian Securities Administrators available on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Softwood Lumber Agreement**

Canadian softwood lumber exports to the U.S. are currently subject to export taxes under the Softwood Lumber Agreement ("SLA") which became effective in October 2006. In January 2012, the Canadian and U.S. governments agreed to a two-year extension of the SLA, extending the expiry to October 2015. Discussions on the upcoming SLA expiry have begun between Canadian and the U.S. governments. The outcome of those discussions is uncertain and could result in significant impacts to our U.S. lumber exports.

The current SLA provides that should an agreement not be reached before the October 2015 expiry, no trade actions may be imposed for the importation of softwood lumber from Canada to the U.S. for a period of twelve months following the current SLA expiry date.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

During the quarter ended June 30, 2015, there were no changes in the Company's internal controls over the financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

## **ADDITIONAL INFORMATION**

Additional information about the Company, including its 2014 Annual Information Form for the year ended December 31, 2014, is available on SEDAR at [www.sedar.com](http://www.sedar.com).