



**CONIFEX TIMBER INC.
SECOND QUARTER 2016**

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 2, 2016

This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial condition and results of Conifex Timber Inc. (the "Company", "Conifex", "us", "we", or "our"), on a consolidated basis, for the quarter ended June 30, 2016 relative to the quarters ended March 31, 2016 and June 30, 2015. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the quarters ended June 30, 2016 and 2015 as well as the 2015 annual MD&A and the December 31, 2015 audited consolidated financial statements and notes thereon, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") and filed on SEDAR at www.sedar.com.

In this interim MD&A, reference is made to "EBITDA" and "adjusted EBITDA". EBITDA represents earnings before finance costs, taxes, and depreciation and amortization. Adjusted EBITDA is calculated to exclude unusual items or items that are not ongoing and do not reflect ongoing operations of the Company. Adjusted EBITDA excludes gains or losses resulting from asset sales, disposals or revaluations. The Company discloses EBITDA and has disclosed adjusted EBITDA, as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA and adjusted EBITDA are non-GAAP measures, they may not be comparable to EBITDA and adjusted EBITDA calculated by others. In addition, EBITDA and adjusted EBITDA are not substitutes for net earnings and cash flow, therefore readers should consider earnings in evaluating the Company's performance.

In this interim MD&A, all references to \$ are to Canadian dollars and references to "US\$" are to the United States dollar.

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 our expectations, beliefs, assumptions, estimates and forecasts about our business and the industries and markets in which we operate. 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 sales 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; our expectations of the benefits and effects of the timber harvesting cooperation agreement; use of proceeds of financing operations; and the anticipated benefits, cost, timing and completion dates for projects.

Assumptions underlying our expectations regarding forward-looking information contained in this interim MD&A include, among others: that we will be able to effectively market our 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 plant and that we will be able to continue to deliver power therefrom;

that softwood lumber will experience sustained demand in the marketplace; the general stability of the economic, political and regulatory environments within the countries where we conduct operations; our ability to obtain financing (if necessary) on acceptable terms or at all; that interest and foreign exchange rates will not vary materially from current levels; that the equipment at our mills and power plant will operate at expected levels; and that management will effectively execute the Company's strategy to grow and add value to its business.

Persons reading this interim MD&A are cautioned that statements comprising forward-looking information are only predictions, and that our 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 similar 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 29, 2016 available on SEDAR at 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 IN SECOND QUARTER OF 2016

Completion of Coordinated Harvesting Cooperation Agreement Contributes to Stronger Balance Sheet

In April 2016, we completed a timber harvesting cooperation agreement with a regional lumber manufacturer to conduct coordinated joint timber harvesting operations on certain portions of Conifex's harvesting areas in the Mackenzie Timber Supply Area. We believe the coordinated harvesting operations will enhance fibre optimization between the two companies, improve supply chain efficiencies, and contribute to more stable harvest levels in the Mackenzie Timber Supply Area. We also believe that this innovative arrangement can provide additional volumes of affordable feedstock to our power generation unit at Mackenzie through increased utilization of lower quality wood and harvest residuals.

Pursuant to the agreement, Conifex was paid \$20.0 million for the sale of one-half of the shares of a Conifex subsidiary which holds a forest licence having a 300,000 cubic metre annual harvest of timber. We recorded a net gain on the sale of shares of \$19.0 million in the second quarter of 2016.

Our remaining 50% interest in the former subsidiary is now classified as a joint venture and was therefore revalued to its fair value amount of \$20.0 million. We recorded a gain on the revaluation of \$19.2 million in the second quarter of 2016.

Conifex used the net proceeds from the transaction to repay \$5.7 million of the senior secured notes and repay advances on our operating loans. The reduction in debt and increase in shareholders' equity contributed to an improved net debt to capitalization ratio of 36% at June 30, 2016 compared to 60% at December 31, 2015.

Excluding the effects of borrowing by Conifex Power Limited Partnership, which are non-recourse to our other operations, net debt was \$18.1 million and the net debt to capitalization ratio was 10% at June 30, 2016 compared to \$76.8 million and 42%, respectively, at December 31, 2015.

SUMMARY OF OPERATING RESULTS

Selected Financial Information

(millions of dollars except share and per share amounts and exchange rate information, unaudited)	Q2 2016	Q1 2016	YTD 2016	Q2 2015	YTD 2015
Sales by Segment					
Lumber	98.7	91.8	190.5	79.2	164.5
Bioenergy	5.0	7.7	12.7	2.6	2.6
	103.7	99.5	203.2	81.8	167.1
Operating Earnings (Loss) by Segment					
Lumber	5.4	1.2	6.6	(8.1)	(6.1)
Bioenergy	1.6	2.6	4.2	(0.5)	(0.5)
Corporate and other unallocated items	(1.9)	(0.8)	(2.7)	(1.2)	(2.1)
	5.1	3.0	8.1	(9.8)	(8.7)
Adjusted EBITDA by Segment					
Lumber	8.7	4.5	13.2	(5.0)	(0.3)
Bioenergy	2.4	4.2	6.6	0.5	0.5
Corporate and other unallocated items	(2.1)	(1.8)	(3.9)	(2.3)	(1.3)
	9.0	6.8	15.9	(6.8)	(1.1)
Net income (loss)	35.2	28.5	63.7	(13.0)	(11.4)
Net income (loss) per share - basic	1.67	1.35	3.01	(0.62)	(0.55)
Net income (loss) per share - diluted (1)	1.54	1.24	2.78	(0.62)	(0.55)
Shares outstanding - weighted average (millions)	21.1	21.1	21.1	21.0	21.0
Average exchange rate - US\$/Cdn\$ (2)	0.776	0.727	0.752	0.813	0.810
Reconciliation of adjusted EBITDA to Net Income (Loss)					
Net income (loss)	35.2	28.5	63.7	(13.0)	(11.4)
Add: Finance costs	2.3	2.5	4.8	2.1	3.4
Amortization	3.9	4.8	8.7	4.1	6.9
EBITDA (3)	41.4	35.8	77.2	(6.8)	(1.1)
Less: Gain on sale of asset	(19.0)	(29.0)	(48.0)	-	-
Less: Gain on revaluation	(19.2)	-	(19.2)	-	-
Add: Impairment of property, plant and equipment	5.8	-	5.8	-	-
Adjusted EBITDA (4)	9.0	6.8	15.9	(6.8)	(1.1)

(1) If the conversion of convertible notes and/or the inclusion of outstanding warrants and options is anti-dilutive, it is excluded from the calculation of diluted net income per share.

(2) Source: Bank of Canada, www.bankofcanada.ca.

(3) The Company's EBITDA calculation represents earnings before finance costs, taxes, and depreciation and amortization.

(4) The Company's adjusted EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization, gains or losses from asset sales, disposals or revaluations.

Revenues totaled \$103.7 million in the second quarter of 2016, an improvement of 4% over the prior quarter and 27% over the same quarter last year. The revenue growth over the previous quarter was attributable to an 8% increase in lumber segment revenues partially offset by seasonally lower revenues from electricity sales. Lumber segment revenues increased by 25% and bioenergy segment revenues increased by 92% over the second quarter of 2015. Electricity sales from the Mackenzie power generation plant commenced in May 2015.

Operating income improved to \$5.1 million compared to \$3.0 million in the previous quarter and an operating loss of \$9.8 million in the same quarter last year. Compared to the prior quarter, an increase in lumber segment operating earnings of \$4.2 million was somewhat offset by a decline in bioenergy segment operating earnings and higher corporate and other costs. Lumber segment operating earnings increased by \$13.5 million, and bioenergy segment operating earnings by \$2.1 million, over the second quarter of 2015.

Net income for the second quarter of 2016 included a net gain on sale of assets of \$19.0 million related to the completion of the timber harvesting cooperation agreement, with some of the ancillary costs related to the transaction included in corporate costs. Current quarter net income also included a gain on revaluation of our investment in the resulting joint venture of \$19.2 million. Net income for the first quarter of 2016 included a net gain on sale of assets of \$29.0 million resulting from the redemption of the payment in kind note ("PIK Note").

During the second quarter of 2016, we determined 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 idled assets in the lumber segment. As a result, we reviewed the property, plant and equipment for impairment and recorded a \$5.8 million impairment charge in the current quarter.

Net income for the second quarter of 2016 was \$35.2 million, or \$1.67 per basic and \$1.54 per diluted share, compared to net income of \$28.5 million or \$1.35 per basic and \$1.24 per diluted share in the previous quarter and net loss of \$13.0 million or \$0.62 per basic and diluted share in the second quarter of 2015. Year to date net income was \$63.7 million, or \$3.01 per basic and \$2.78 per diluted share compared to net loss of \$11.4 million, or \$0.55 per basic and diluted share for the same period last year.

Adjusted EBITDA was \$9.0 million in the second quarter of 2016 compared to \$6.8 million in the first quarter of 2016 and negative \$6.8 million in the second quarter of 2015. Compared to the previous quarter, adjusted EBITDA benefited from improved lumber segment results partially offset by lower bioenergy segment results and higher corporate and other costs. Compared to the second quarter of 2015, lumber segment adjusted EBITDA improved by \$13.7 million and bioenergy segment adjusted EBITDA by \$1.9 million. Adjusted EBITDA was \$15.9 million for the six month period ended June 30, 2016 compared to negative adjusted EBITDA of \$1.1 million for the six month period ended June 30, 2015.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, other than statistical and exchange rate information and lumber prices, unaudited)	Q2 2016	Q1 2016	YTD 2016	Q2 2015	YTD 2015
Sales -Lumber - Conifex produced	63.8	57.0	120.9	47.5	101.3
- Lumber - wholesale	26.0	25.1	51.1	23.6	45.7
- By-products	6.2	6.5	12.7	6.0	12.4
- Logistics services	2.7	3.2	5.8	2.1	5.1
Total Sales	98.7	91.8	190.5	79.2	164.5
Adjusted EBITDA	8.7	4.5	13.2	(5.0)	(0.3)
Amortization and other	3.3	3.3	6.6	3.1	5.8
Operating income (loss)	5.4	1.2	6.6	(8.1)	(6.1)

Statistics (in millions, other than exchange rate and lumber prices)

Lumber production (MMfbm)	134.7	135.8	270.5	118.1	237.5
Lumber shipments - Conifex produced (MMfbm)	138.4	127.0	265.4	116.0	228.8
Lumber shipments - Wholesale (MMfbm)	41.0	40.7	81.7	39.7	74.5
Average exchange rate - US\$/Cdn\$ (1)	0.776	0.727	0.752	0.813	0.810
Average WSPF 2x4 #2&Btr lumber price (US\$) (2)	\$310	\$272	\$291	\$269	\$289
Average WSPF 2x4 #2&Btr lumber price (Cdn\$) (3)	\$399	\$373	\$386	\$331	\$357

(1) Source: Bank of Canada, www.bankofcanada.ca

(2) Source: Random Lengths Publications Inc.

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

The U.S. Census Bureau reported privately-owned housing starts averaged a seasonally adjusted annualized rate of approximately 1.16 million units over the second quarter of 2016, a level largely consistent with the previous quarter and the second quarter of 2015. Single-family housing starts accounted for 66% of total second quarter 2016 U.S. housing starts and marked an increase in units of 8% over the second quarter of 2015. Lumber consumption per unit in single-family housing starts is generally considered to be two to three times greater than in multi-family units.

Housing starts in the U.S. remain a key indicator of North American lumber prices, although growth in demand from export markets, most notably China, has played an increasingly important role in influencing domestic prices over the last several years. Prices for the bell-weather WSPF #2 & Btr product averaged US\$310 during the second quarter of 2016, an improvement of over 14% over the previous quarter and the second quarter of 2015.¹ Several industry analysts have attributed the improvement in the U.S. dollar benchmark price in the current quarter to an early start to the building season supported by favorable weather, several mill curtailments, and low inventories in the supply chain.

The U.S. dollar averaged US\$0.776 for each Canadian dollar during the second quarter of 2016, which represented a depreciation of 6% over the previous quarter and an appreciation of 5% over the same quarter last year.² Canadian dollar-denominated benchmark lumber prices, which averaged \$399 in the second quarter of 2016, improved by 7% or \$26 over the previous quarter and 21% or \$68 over the second quarter of 2015.

¹ As quoted in Random Lengths Publications Inc.

² Source: Bank of Canada, www.bankofcanada.ca

The U.S. and China remained our principal markets and accounted for approximately 78% of total lumber shipments in each of the comparative quarters while shipments to Japan remained steady at approximately 7%. Shipments to other offshore markets averaged 5% of total volumes in the comparative quarters. The balance of lumber shipments were directed to the Canadian market.

Revenue from Conifex produced lumber was \$63.8 million in the second quarter of 2016. The 12% increase over the previous quarter was attributable to 9% higher shipment volumes and a 3% improvement in sales realizations. The higher sales realizations generally reflected stronger lumber prices which were somewhat offset by the appreciation of the Canadian currency. The growth in revenue of 34% over the second quarter of 2015 was largely due to an increase of 19% in shipment volumes and a 13% improvement in sales realizations.

Wholesale lumber revenues were \$26.0 million, an increase of 4% over the previous quarter and 10% over the same quarter last year. The growth over the prior quarter and the second quarter of 2015 was primarily attributable to improved sales realizations due to shipment of a higher value product mix.

Revenues from wood chips and other by-products and from provision of third party logistics services were generally consistent in each of the comparative quarters.

Lumber production totalled approximately 135 million board feet during the second quarter of 2016 and the first quarter of 2016 and represented an annualized operating rate of 103% (excluding production capacity attributed to the idled Mackenzie Site I sawmill) compared to 90% in the same quarter last year. Hourly productivity improved by 14% over the second quarter of 2015. The higher operating rates were mainly attributable to production efficiencies from capital upgrades, enhanced maintenance protocols and improved log quality.

The two main elements of our lumber manufacturing costs are log costs and conversion costs. Log costs typically account for the majority of the costs. Cash conversion costs exclude depreciation and amortization expense. Unit manufacturing costs were consistent in the second quarter of 2016 and the first quarter of 2016 and improved by 10% compared to the second quarter of 2015.

Unit log costs were consistent in the second quarter of 2016 and the previous quarter and 10% lower than the second quarter of last year. The year-over-year improvement was primarily due to a successful fall and winter logging season which resulted in lower unit delivery costs, largely due to improvements in our supply chain management systems.

High operating rates and production efficiencies permit us to lower our average cost by spreading fixed costs over more units. Unit cash conversion costs improved by 2% over the previous quarter due primarily to lower energy costs. Unit cash conversion costs improved by 10% over the second quarter of 2015 as improved productivity more than offset generally higher operating costs.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were 3% lower than the previous quarter due primarily to the stronger Canadian currency.

The Softwood Lumber Agreement with the United States expired on October 12, 2015. The agreement provided for a one-year standstill after expiry that prevented the United States from initiating new trade actions against Canada with respect to the importation of softwood lumber. Canadian lumber is currently being shipped without a duty, tax or quota. We recorded an export tax expense of \$0.9 million in the second quarter of 2015 which reflected an average export tax rate of approximately 7%.

The lumber segment recorded operating income of \$5.4 million in the second quarter of 2016 compared to \$1.2 million in the previous quarter and an operating loss of \$8.1 million in the second quarter of 2015. Compared to the previous quarter, current quarter lumber segment operating results benefited from higher lumber prices, increased shipments of Conifex produced lumber and a modest improvement in unit cash conversion costs which were partially offset by a stronger Canadian dollar. Compared to the second quarter of 2015, current quarter operating results benefited from higher lumber shipments and lumber

prices, a weaker Canadian currency, and lower unit log and cash conversion costs. Year-to-date lumber segment operating earnings were \$6.6 million, an improvement of \$12.7 million over the same period last year.

Lumber segment adjusted EBITDA was \$8.7 million in the second quarter of 2016 compared to \$4.5 million in the previous quarter and negative adjusted EBITDA of \$5.0 million in the second quarter of 2015. Lumber segment adjusted EBITDA was \$13.2 million for the six months ended June 30, 2016 and negative \$0.3 million for the six months ended June 30, 2015.

Bioenergy Segment

The Mackenzie power generation plant (the "Mackenzie Plant") commenced commercial operations in May 2015. The ramp up and optimization of the Mackenzie Plant continued throughout the balance of 2015. Despite some typical challenges related to operating a newly commissioned facility, including unplanned outages and operator familiarization of a new plant, average hourly electricity production achieved 105% of operating target during the first twelve months of commercial operations.

The 20-year Electricity Purchase Agreement ("EPA") with BC Hydro provides for a one-time option to increase our electricity deliveries by 10% for the duration of the contract term. In April 2016, we notified BC Hydro that we would be exercising the option with increased volume commitments commencing in May 2016.

The EPA provides BC Hydro with the option to "turn down" electricity purchased from independent power producers during periods of low demand by issuing a dispatch order outlining the requested dispatch period. In April 2016, BC Hydro issued a dispatch order to, among others, our power plant advising us of a dispatch period of 61 days from May 1, 2016 to June 30, 2016. During the dispatch period, we only produced electricity to fulfill volume commitments under the Load Displacement Agreement. We continued to earn revenues based upon a reduced base rate and on volumes that are generally reflective of recent average hourly megawatt production.

The Mackenzie Plant sold approximately 55 gigawatt hours of electricity under the EPA in the first and second quarters of 2016, and approximately 24 gigawatt hours during the second quarter of 2015.

Revenues from electricity sales were \$5.0 million in the second quarter of 2016 compared to \$7.7 million in the previous quarter and \$2.6 million in the second quarter of 2015. Revenues for the current quarter were impacted by the plant dispatch and revenues for the second quarter of 2015 represented two months of start-up operations. The application of a "time of delivery factor" ("TDF") to the fixed based price per megawatt hour, which generally produces the lowest quarterly revenues of the year during the second quarter, further contributed to the reduced bioenergy segment revenues in the second quarters of 2016 and 2015.

The application of the TDF produces a seasonal effect and considerable variability on quarterly revenues with the lowest revenues generated in the second quarter and the highest in the first and fourth quarters of each year. Quarterly electricity revenues can vary 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.

Bioenergy segment operating costs were \$3.4 million and segment operating earnings were \$1.6 million in the second quarter of 2016 compared to operating costs of \$5.1 million and segment operating earnings of \$2.6 million in the previous quarter, and operating costs of \$3.1 million and operating loss of \$0.5 million in the second quarter of 2015. Operating costs included depreciation expense of \$0.8 million, \$1.6 million and \$1.0 million, respectively. Idled components were not depreciated during the dispatch period in the second quarter of 2016.

Interest on the power project term loan was \$1.3 million for the second quarter of 2016 and the previous quarter and \$0.8 million for the second quarter of 2015. Adjusted bioenergy segment EBITDA was \$2.4 million in the second quarter of 2016, \$4.2 million in the previous quarter and \$0.5 million in the second quarter of 2015.

The Mackenzie Plant has operated at approximately 70% of targeted rates since production resumed in July 2016 following the dispatch period. Four days of downtime was taken in July to effect certain operating improvements and we may take additional limited downtime at the plant in August 2016 to effect other improvements. We expect revenues in the bioenergy segment to be sequentially lower and operating costs to be relatively higher in the third quarter of 2016.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were \$1.9 million in the second quarter of 2016, \$0.8 million in the previous quarter and \$1.2 million in the second quarter of 2015. Corporate costs were \$2.7 million for the six months ended June 30, 2016 compared to \$2.2 million for the six months ended June 30, 2015. The increase in year to date corporate costs was primarily attributable to professional fees and other costs related to certain non-operational transactions.

Finance Costs

Finance costs are comprised of interest expense and amortization costs related to debt issuance and accretion of convertible notes and senior secured notes. Finance costs totalled \$2.3 million in the second quarter of 2016, \$2.5 million in the previous quarter and \$2.1 million in the second quarter of 2015. Year to date finance costs were \$4.8 million for 2016 compared to \$3.4 million for 2015, with the increase primarily attributable to interest expense on the power project term loan of approximately \$1.3 million per quarter. We ceased capitalizing interest on the power project term loan in May 2015.

Gain or Loss on Derivative Financial Instruments

We utilize derivative financial instruments to manage commodity lumber price exposures in the ordinary course of our business and to manage interest rate variability. Gains or losses on lumber derivative instruments are recognized as other income or expense and allocated to lumber segment operating results, either as they are settled or as they are marked to market for each reporting period. We recorded gains from lumber derivative instruments of \$0.3 million in the second quarter of 2016 and \$0.1 million in the first quarter of 2016, and a loss of \$0.1 million in the second quarter of 2015.

The term loan provided under the power project financing consists of a floating rate tranche and a fixed rate tranche. Conifex Power Limited Partnership has entered into interest rate swap transactions with the lead arranger to swap the interest rates on the floating rate tranche of the term loan to fixed interest rates. A loss of \$0.6 million and \$0.2 million on the interest rate swap instruments was recorded as interest expense during the first six months of 2016 and 2015, respectively. Additionally, \$0.4 million was recorded as capital costs during the first six months of 2015.

Foreign Exchange Translation Gain or Loss

The foreign exchange translation gain or loss recorded for each period results from the revaluation of U.S. dollar-denominated working capital balances and the U.S. dollar-denominated mortgage 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.

The exchange rate for one Canadian dollar was US\$0.774 at June 30, 2016, US\$0.770 at March 31, 2016 and US\$0.801 at June 30, 2015.³ The foreign exchange translation loss was \$0.2 million in the second quarter of 2016 and \$1.1 million in the first quarter of 2016 and the second quarter of 2015. We recorded a foreign exchange translation loss of \$1.3 million for the six months ended June 30, 2016 compared to a gain of \$0.8 million for the same period last year.

Income tax

At December 31, 2015, the Company had unused non-capital tax losses carried forward totalling \$32.1 million and unrecognized deferred tax assets totalling \$13.6 million. The redemption of the PIK Note resulted in a gain on the sale of assets of approximately \$29.0 million in the first quarter of 2016. As a result of a tax election which was filed in 2015 to increase the tax basis of the asset, no current income tax should arise on the PIK Note redemption in 2016. The tax effects of the transaction were fully reflected in the tax balances at December 31, 2015.

As previously noted, we recorded a net gain on sale of assets of \$19.0 million in the second quarter of 2016. No current income taxes arise on the sale of shares of the Conifex subsidiary due to the expected utilization of non-capital loss carry forwards from previous taxation years.

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.

³ Source: Bank of Canada, www.bankofcanada.ca

SUMMARY OF FINANCIAL POSITION

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

(millions of dollars, unaudited)	Q2 2016	Q4 2015	Q2 2015
Cash	22.6	9.9	10.2
Cash - restricted	8.5	8.5	0.8
Operating working capital	51.2	51.9	33.7
Operating loans	(8.3)	(18.3)	(17.1)
Current portion of convertible notes	(11.9)	(11.8)	-
Current portion of mortgage	(11.1)	(12.0)	-
Current portion of long-term debt	(4.1)	(4.3)	(7.9)
Net current assets	46.9	23.9	19.7
Long-term assets related to power project	122.7	124.2	137.9
Long-term assets - lumber segment and corporate	116.0	109.2	82.8
	285.6	257.3	240.4
Non-interest bearing long-term liabilities	23.0	20.7	14.1
Long-term debt - power project construction loan	72.9	75.8	75.4
Payment-in-kind notes (1)	-	30.0	-
Long-term debt - other	19.1	24.4	39.7
Shareholders' equity	170.6	106.4	111.2
	285.6	257.3	240.4
Ratio of current assets to current liabilities	1.7	1.3	1.3
Net debt to capitalization	36%	60%	54%
Net debt to capitalization (2)	10%	42%	30%

(1) The PIK Note was redeemed in February 2016.

(2) Excluding borrowings by Conifex Power Limited Partnership, which are non-recourse to our other operations.

The ratio of current assets to current liabilities at June 30, 2016 improved to 1.7:1 compared to 1.3:1 at December 31, 2015 and June 30, 2015. During the first six months of 2016, the ratio was positively impacted by higher cash balances and a reduction in operating loans. Higher cash and working capital balances and reduced borrowings on the operating loans contributed to the positive ratio variance compared to the end of the second quarter of 2015.

We manage capital with the objective to maintain a strong balance sheet that ensures adequate capital resources to support operations, sustain future development and facilitate access to capital markets at competitive rates. We use the net debt to total capitalization ratio to measure our relative debt position and as an indicator of the relative strength and flexibility of our balance sheet. Net debt is calculated as the principal value of long-term debt, including the current portion, bank advances, the present value of convertible notes, the mortgage, and PIK Note, less cash and restricted cash. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

Net debt at June 30, 2016 of \$96.3 million. The reduction of net debt of \$61.9 million during the first six months of 2016 was due primarily to the redemption of the PIK Note and the proceeds from the timber harvesting cooperation agreement. The gain on sale of assets resulting from the two transactions contributed to an increase of \$64.2 million in shareholders' equity. The net debt to capitalization ratio improved to 36% from 60% during the first six months of 2016.

Excluding the effects of borrowings by Conifex Power Limited Partnership, net debt was \$18.1 million and the net debt to capitalization ratio was 10% at June 30, 2016 compared to \$76.8 million and 42%, respectively, at December 31, 2015.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	Q2 2016	Q1 2016	YTD 2016	Q2 2015	YTD 2015
Cash generated from (used in)					
Operating activities	18.0	0.7	18.6	8.0	5.5
Financing activities	(23.2)	(0.3)	(23.5)	0.6	11.3
Investing activities	18.5	(1.1)	17.5	(9.7)	(17.7)
Increase (decrease) in cash	13.3	(0.7)	12.6	(1.1)	(0.9)

Operating Activities

We operate in a cyclical industry and our operating cash flows vary accordingly.

Working capital levels fluctuate through the year and are impacted by a variety of factors, including changes in sales volume and price, shipment patterns, operating rates, seasonality and timing of receivables and payment of payable and expenses. Our fibre inventories exhibit seasonal swings as log inventories are increased during the fall and winter months to help ensure adequate supply of fibre to our mills during the spring months. Factors such as disruption of transportation services by third party providers and variability in export shipments can impact the level of lumber inventories. We believe our management practices with respect to working capital conform to common business practices.

We generated cash from operations before working capital changes of \$17.4 million in the first six months of 2016 and consumed cash of \$0.2 million in the first six months of 2015. The year over year positive variance in cash generation is attributable to improved operating results. Changes in non-cash working capital provided cash of \$1.2 million in the first six months of 2016 and \$5.7 million in the same period last year.

Financing Activities

Financing activities consumed net cash of \$23.5 million in the first six months of 2016 and were comprised of repayment of operating loans of \$10.1 million, debt repayments of \$8.9 million and payment of financing costs totalling \$4.5 million.

Financing activities provided net cash of \$11.3 million in the first six months of 2015 and included net proceeds from operating loans of \$5.3 million and from the construction loan of \$9.6 million, debt repayments of \$1.1 million, and the payment of finance expenses of \$2.5 million.

Investing Activities

Investing activities provided cash of \$17.5 million in the first six months of 2016 and were comprised of proceeds from sale of assets of \$20.1 million offset by \$1.3 million lumber segment capital expenditures, \$0.3 million bioenergy segment capital expenditures and \$1.0 million in pre-development and carrying costs related to the El Dorado assets.

Investing activities consumed cash of \$17.7 million in the first six months of 2015 and were comprised of \$3.6 million of lumber segment capital expenditures and \$14.1 million of expenditures related to the power generation project. Lumber segment capital expenditures included payments related to the installation of extensive dust mitigation equipment at our Fort St. James and Mackenzie Site II sawmills in late 2014 and an upgrade to the sawline at Mackenzie.

Liquidity

Our principal sources of funds are cash on hand, cash flow from operations, and our revolving working capital loan facilities. Our principal uses of funds consist of operating expenditures, interest payments, repayment of debt, and capital expenditures.

Total liquidity comprises unrestricted cash and available credit under our revolving credit facilities. At June 30, 2016, we had total liquidity of \$44.4 million, compared to \$22.6 million at December 31, 2015 and \$17.1 million at June 30, 2015. Liquidity at June 30, 2016 was comprised of unrestricted cash of \$22.6 million and unused availability under our revolving loan working capital facilities of \$21.8 million. The improvement in liquidity during the first six months of 2016 was due primarily to the receipt of proceeds of \$20.0 million for the completion of the timber harvesting cooperation agreement in April 2016.

We monitor 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. Based on the current level of operations and our current expectations for future periods in light of the current economic environment, we believe that our cash flow from operations and available cash, together with available borrowings under our revolving credit facilities, will be adequate to meet our obligations in 2016.

In the future, we may make acquisitions of businesses or assets or commitments to additional capital projects. To achieve any such long-term goals of expanding our assets and earnings, including through acquisitions, capital resources will be required. We expect 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.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements at June 30, 2016 were comprised of standby letters of credit totalling \$18.75 million posted by Conifex Power Limited Partnership and operating leases for vehicles, equipment and machinery.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(millions of dollars, except share and per share amounts, statistical and exchange rate information and lumber price	2016			2015			2014	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales - lumber segment	98.7	91.8	92.7	80.0	79.2	85.3	95.2	90.9
Sales - electricity	5.0	7.7	7.8	5.9	2.6	-	-	-
Operating income (loss)	5.1	3.0	1.6	(4.5)	(9.8)	1.1	0.6	1.5
Net income (loss)	35.2	28.5	(0.3)	(5.6)	(13.0)	1.6	-	1.1
Net income (loss) per share - basic	1.67	1.35	(0.01)	(0.26)	(0.62)	0.08	-	0.05
Net income (loss) per share - diluted (1)	1.54	1.24	(0.01)	(0.26)	(0.62)	0.08	-	0.05
Adjusted EBITDA (2)	9.0	6.8	7.3	1.5	(6.8)	5.7	4.1	5.3
Shares outstanding - weighted average (millions)	21.1	21.1	21.1	21.1	21.0	21.0	20.9	20.9
Statistics (in millions, other than exchange rate and lumber prices)								
Lumber production (MMfbm)	134.7	135.8	131.1	112.3	118.1	119.4	116.9	125.6
Lumber shipments - Conifex produced (MMfbm)	138.4	127.0	139.4	107.6	116.0	112.8	134.0	130.4
Lumber shipments - wholesale (MMfbm)	41.0	40.7	38.6	42.6	39.7	34.8	40.4	41.9
Electricity production - GWh	55.1	54.9	54.5	46.2	24.3	-	-	-
Average exchange rate - US\$/Cdn\$ (3)	0.776	0.727	0.749	0.764	0.813	0.806	0.881	0.918
Average WSPF 2x4 #2&Btr lumber price (US\$) (4)	\$310	\$272	\$262	\$271	\$269	\$309	\$340	\$357
Average WSPF 2x4 #2&Btr lumber price (Cdn\$)(5)	\$399	\$373	\$350	\$355	\$331	\$384	\$386	\$389

Reconciliation of Adjusted EBITDA to Net Income (Loss)

Net income (loss)	35.2	28.5	(0.3)	(5.6)	(13.0)	1.6	-	1.1
Add: Finance costs	2.3	2.5	2.6	2.6	2.1	1.3	1.4	1.4
Amortization	3.9	4.8	5.0	4.5	4.1	2.8	2.7	2.8
EBITDA (6)	41.4	35.8	7.3	1.5	(6.8)	5.7	4.1	5.3
Less: Gain on sale of assets	(19.0)	(29.0)	-	-	-	-	-	-
Less: Gain on revaluation of joint venture	(19.2)	-	-	-	-	-	-	-
Add: Impairment of property, plant and equipment	5.8	-	-	-	-	-	-	-
Adjusted EBITDA	9.0	6.8	7.3	1.5	(6.8)	5.7	4.1	5.3

- (1) If the conversion of convertible notes and/or the inclusion of outstanding warrants is anti-dilutive, it is excluded from the calculation of diluted net income per share.
- (2) The Company's adjusted EBITDA calculation represents earnings before finance costs, taxes, and depreciation and amortization, and gains or losses from sales, disposals or revaluations of assets.
- (3) Source: Bank of Canada, www.bankofcanada.ca.
- (4) Source: Random Lengths Publications Inc.
- (5) Average WSPF 2x4 #2&Btr lumber price (US\$) divided by average exchange rate.
- (6) The Company's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization.

Our quarterly financial results are impacted by a variety of market related factors, including fluctuations in lumber prices and prices of certain commodities related to by-product revenue and manufacturing inputs, changes in the export tax rate, stumpage rates, and foreign exchange rates. Other micro-level factors that influence quarterly financial trends include operating rates, shipment volumes, raw material and manufacturing costs, and transactions of a non-recurring nature. We rely primarily on third parties for transportation of our products, as well as delivery of raw materials, and any significant or prolonged disruption of services provided by third party carriers may adversely impact our 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. Our fibre inventories exhibit seasonal swings as we increase log

inventories during the fall and winter months to ensure adequate supply of fibre to our 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.

OUTLOOK AND STRATEGIC CAPITAL EXPENDITURES

Lumber Market Outlook

For the balance of 2016, we expect modest improvements in U.S. dollar benchmark prices and Canadian dollar exchange premiums compared to the first half of 2016. Offshore demand is less robust and competition from currency advantaged alternate suppliers is more intense. Despite these market conditions, we expect receipts from lumber shipments to China and Japan to be relatively unchanged from first half of 2016 levels. We expect the uncertainty related to the recent expiry of the Softwood Lumber Agreement will contribute to increased market volatility.

Strategic Capital Expenditures

Capital expenditure commitments for further optimization of our two B.C. sawmill complexes are expected to aggregate approximately \$10 million, of which we expect to spend approximately \$7 million in 2016 and the balance in early 2017.

Additionally, we are working towards finalizing capital plans to reconstruct and modernize our currently idled El Dorado, Arkansas sawmill complex. We believe the planned expansion into the U.S. South will provide an important source of revenue diversification and reduce cash flow volatility in our lumber segment. We expect to settle the construction schedule and budget, and subsequently the financing plan, upon completion of further engineering work and customary due diligence.

CRITICAL ACCOUNTING ESTIMATES

During the quarter ended June 30, 2016, the Company revalued its interest in the joint venture pursuant to the timber harvesting cooperation agreement to its fair value amount of \$20.0 million as discussed above and disclosed in note 6 of our condensed consolidated interim financial statements. The fair value of \$20.0 million was based upon consideration received for the remaining 50% interest in the joint venture. Additionally, the Company recorded an impairment charge of \$5.8 million related to certain currently idled assets in the lumber segment as described above and disclosed in note 9 of our condensed consolidated interim financial statements. There were no other significant changes to the Company's critical accounting estimates during the quarter ended June 30, 2016. Conifex's critical accounting estimates are described in its MD&A for the year ended December 31, 2015, filed under the Company's profile on SEDAR at www.sedar.com.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors is included in the Company's annual information form dated March 29, 2016, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

Softwood Lumber Agreement

On October 12, 2015, the Softwood Lumber Agreement expired. The SLA provides a standstill period of one year following the expiry of the SLA during which no trade actions may be imposed for the importation of softwood lumber from Canada to the U.S. It is uncertain whether a new agreement between the Governments of Canada and the U.S. will be reached. In the event no agreement is reached, there is a material risk of U.S. trade action being initiated against Canadian lumber producers which could result in the imposition of duties on lumber shipments to the U.S.

OUTSTANDING SECURITIES

As at August 2, 2016, the Company had the following outstanding securities: (i) 21,155,934 common shares; (ii) 100,000 options; (iii) 1,261,836 long-term incentive plan awards; (iv) 1,060,000 warrants; and (v) 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.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2016, there were no changes in the Company's internal controls over financial reporting that materially affected, or would be reasonably likely to materially affect, such controls.

ADDITIONAL INFORMATION

Additional information about the Company is available on SEDAR at www.sedar.com.