



CONIFEX

CONIFEX TIMBER INC.  
THIRD QUARTER 2020

## MANAGEMENT'S DISCUSSION AND ANALYSIS

November 10, 2020

*This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial condition and results of operations of Conifex Timber Inc. ("Conifex", "us", "we", or "our"), on a consolidated basis, for the quarter ended September 30, 2020 relative to the quarters ended June 30, 2020 and September 30, 2019. This interim MD&A should be read together with our unaudited condensed consolidated interim financial statements for the quarters ended September 30, 2020 and 2019, and our 2019 annual MD&A and our December 31, 2019 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](http://www.sedar.com).*

*In this interim MD&A, reference is made to "EBITDA" and "adjusted EBITDA". EBITDA represents earnings before finance costs, taxes, depreciation and amortization. Adjusted EBITDA is calculated to exclude unusual items that are not ongoing and do not reflect our ongoing operations. Adjusted EBITDA excludes foreign exchange translation gains or losses on long-term debt, restructuring costs, proceeds from insurance claims and gains or losses on sale of assets. We disclose EBITDA and adjusted EBITDA as it is a measure used by analysts and by our management to evaluate our performance. As EBITDA and adjusted EBITDA are not generally accepted earnings measures under IFRS, and neither has a standardized meaning prescribed by IFRS, they may not be comparable to EBITDA and adjusted EBITDA calculated by other companies. In addition, EBITDA and adjusted EBITDA are not substitutes for net earnings or cash flow, as determined in accordance with IFRS, and therefore readers should consider those measures in evaluating our performance.*

*In April 2019, we sold Lignum Forest Products LLP ("Lignum"), through which we operated a lumber marketing and distribution business, and in October 2019, we ceased operations at 0318587 B.C. Ltd. (previously Navcor Transportations Services Inc.) ("031 BC") through which we provided third party logistics services. In February 2020, we sold our US Sawmill Business (as defined herein). In accordance with IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations, the operating results previously reported for Lignum, 031 BC and the US Sawmill Business were restated as discontinued operations for the relevant periods and separated from our continuing operations. Unless otherwise indicated, our discussion and analysis herein reflects our continuing operations. In accordance with IFRS 8, Operating Segments, we also combined our previous reporting segments, including our lumber and bioenergy operating segments, into a single reportable segment. Accordingly, all previously segmented information has been restated to conform to the current presentation for all periods presented. For further information, refer to Note 6 to our unaudited condensed consolidated interim financial statements for the quarter ended September 30, 2020.*

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

### Forward-Looking Statements

*This interim MD&A contains certain forward-looking information that reflects our current views and/or expectations with respect to our 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: the realization of expected benefits of completed, current and any contemplated capital projects and the expected timing and budgets for such projects; the growth and future prospects of our business, including the impact of COVID-19 thereon; our expectations regarding our results of operations and performance; our planned operating format and expected operating rates; our perception of the industries or markets in which we operate and anticipated trends in such markets and in the countries in which we do business; our ability to supply our manufacturing operations with wood fibre and our expected cost for wood fibre; our expectation for market volatility associated with, among other things, the softwood lumber dispute with the U.S.; that we could be negatively impacted by the duties or other protective measures on our products, such as antidumping duties or countervailing duties on softwood lumber; continued positive relations with Aboriginal groups; the development of a longer-term capital plan and the expected benefits therefrom; demand and prices for our products; our ability to develop new revenue streams; the availability and use of credit facilities or proceeds therefrom; and future capital expenditures. Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements may include, but are not limited to, our future debt levels; that we will complete our projects in the expected timeframes and as budgeted; that we will effectively market our products; that capital expenditure levels will be consistent with those estimated by our management; our ability to obtain financing on acceptable terms, or at all; that interest and foreign exchange rates will not vary materially from current levels; the general health of the capital markets and the lumber industry and the general stability of the economic environments within the countries in which we operate or do business.*

*Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements may include, but are not limited to, our future debt levels; that we will complete our projects in the expected timeframes and as budgeted; that we will effectively market our products; that capital expenditure levels will be consistent with those estimated by our management; that the US housing market will improve; that there will be no unforeseen disruptions affecting the operation of our power generation plant and that we will be able to continue to deliver power therefrom; our ability to obtain financing on acceptable terms, or at all; that interest and foreign exchange rates will not vary materially from current levels; the general health of the capital markets and the lumber industry; and the general stability of the economic environments within the countries in which we operate or do 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 23, 2020 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. Conifex does not undertake any obligation to update any forward-looking information, except as required by applicable securities laws.*

## RECENT DEVELOPMENTS

### ***COVID-19 Pandemic***

In March 2020, the World Health Organization declared the spread of COVID-19 a pandemic. In late March 2020 we instituted certain measures to protect the health and safety of our employees. This included adopting a pandemic contingency plan which includes restricting access to our offices and operation sites, restricting business travel for employees, mandating self-isolation for any staff exhibiting symptoms or having been exposed to the virus, practicing appropriate social distancing at our premises and increasing the frequency and emphasis on cleaning and sanitizing.

COVID-19's initial impact resulted in a deterioration of global demand for forest products. In response, in early April, we temporarily curtailed operations at our Mackenzie, British Columbia sawmill. The curtailment, which was initially scheduled for two weeks, was extended to July 6, 2020. As global demand for forest products improved and outpaced available supply, benchmark lumber prices increased significantly towards the end of the second quarter and reached record levels during the third quarter of 2020. We recommenced sawmill operations on July 6, 2020 and ramped-up to normalized operating rates during the third quarter of 2020.

Given the continuing and dynamic nature of the COVID-19 pandemic, it is challenging to predict the ongoing impact on our business. The extent of any future impacts on our business will depend on new developments, including any resurgence of COVID-19 as restrictions are eased or lifted, actions taken to address its impact and new information that may emerge concerning the spread and severity of COVID-19.

### ***Normal Course Issuer Bid ("NCIB")***

On November 10, 2020, the Board of Directors of Conifex approved a NCIB for the purchase of up to such number of Common Shares equal to 10% of our public float. Subject to approval from the Toronto Stock Exchange, we expect to be permitted to make purchases under the NCIB commencing December 1, 2020.

### ***Revolving Credit Facility***

On October 13, 2020, we completed a \$10.0 million secured revolving credit facility with Wells Fargo Capital Finance Corporation Canada (the "**Revolving Credit Facility**"). The Revolving Credit Facility is available for a term of 3 years and is substantially secured by Conifex's lumber inventory, equipment, and accounts receivable. The Facility will bear interest at CDOR or LIBOR plus a margin of 3.5% and contains an accordion feature to increase the limit of the Facility to \$15.0 million, subject to certain conditions.

### ***Sale of US Sawmill Business***

In February 2020, we sold our US sawmill business, consisting of our El Dorado, Cross City and Glenwood sawmills and related operations (the "**US Sawmill Business**") for US\$172.8 million, including net working capital of US\$9.8 million.

We utilized a majority of the proceeds from the sale to retire our previous secured credit facility that supported our lumber mills (the "**Lumber Credit Facility**"). Our Conifex term loan supporting our electricity generation operations (the "**Power Term Loan**"), which is secured against our power assets and largely non-recourse to our lumber operations, represents substantially all of our remaining long-term debt.

## SUMMARY

Continuing operations for the comparative periods discussed in this MD&A primarily comprise operating results from our Mackenzie sawmill, power plant and our previously owned sawmill in Fort St. James, British Columbia, which was largely curtailed in May 2019 and sold in November 2019.

Operating and financial results in the second quarter of 2020 were materially impacted by the curtailment of our Mackenzie sawmill for most of the quarter, extending from April 6 to July 6, 2020.

### Selected Financial Information<sup>(1)</sup>

| (unaudited, in millions of dollars, except share and exchange rate information) | Q3<br>2020 | Q2<br>2020 | YTD<br>2020 | Q3<br>2019 | YTD<br>2019 |
|---|------------|------------|-------------|------------|-------------|
| <b>Sales</b>  |            |            |             |            |             |
| Lumber – Conifex produced   | 30.7       | 4.7        | 56.3        | 16.2       | 88.2        |
| Lumber – wholesale  | 0.5        | 1.2        | 1.7         | 0.2        | 15.5        |
| By-products   | 0.4        | 0.2        | 2.3         | 1.3        | 8.2         |
| Bioenergy   | 6.0        | 4.7        | 18.7        | 5.2        | 17.8        |
|   | 37.6       | 10.8       | 79.0        | 22.9       | 129.7       |
| Operating income (loss)   | 7.0        | (1.4)      | (1.2)       | (8.6)      | (28.8)      |
| Adjusted EBITDA from continuing operations                                      | 7.6        | (1.1)      | 7.0         | (7.0)      | (20.2)      |
| Net income (loss) from continuing operations                                    | 2.0        | (2.7)      | (8.9)       | (11.6)     | (20.2)      |
| Net income (loss) from discontinued operations                                  | -          | (0.3)      | 0.2         | (5.0)      | (17.4)      |
| <b>Net income (loss)<sup>(2)</sup></b>  | 2.0        | (3.0)      | (8.7)       | (16.6)     | (37.6)      |
| <b>Basic and diluted earnings (loss) per share</b>                              |            |            |             |            |             |
| Continuing operations   | 0.04       | (0.05)     | (0.19)      | (0.25)     | (0.43)      |
| Discontinued operations   | -          | (0.01)     | -           | (0.10)     | (0.37)      |
| Total basic and diluted earnings (loss) per share                               | 0.04       | (0.06)     | (0.19)      | (0.35)     | (0.80)      |
| Shares outstanding – weighted average (millions)                                | 47.0       | 46.9       | 47.0        | 46.9       | 46.6        |
| <b>Reconciliation of Adjusted EBITDA to net income (loss)</b>                   |            |            |             |            |             |
| Net income (loss) from continuing operations                                    | 2.0        | (2.7)      | (8.9)       | (11.6)     | (20.2)      |
| Add: Finance costs  | 1.2        | 1.2        | 5.9         | 7.0        | 20.4        |
| Amortization  | 2.9        | 1.1        | 6.9         | 1.8        | 8.4         |
| Deferred income tax   | 1.5        | (0.8)      | (1.0)       | (4.0)      | (7.0)       |
| EBITDA from continuing operations <sup>(4)</sup>                                | 7.6        | (1.2)      | 2.9         | (6.8)      | 1.6         |
| Add: Foreign exchange loss (gain) on long-term debt                             | -          | -          | 2.1         | 2.4        | (6.5)       |
| Restructuring costs   | -          | 0.1        | 2.0         | -          | -           |
| Gain on sale of assets  | -          | -          | -           | (2.6)      | (15.3)      |
| Adjusted EBITDA from continuing operations <sup>(5)</sup>                       | 7.6        | (1.1)      | 7.0         | (7.0)      | (20.2)      |

(1) Reflects results of continuing operations, except where otherwise noted.

(2) May not total due to rounding.

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

(4) Conifex's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization.

(5) Conifex's adjusted EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization, foreign exchange translation gains or losses on long-term debt, restructuring costs, proceeds from insurance claims and gains or losses on sale of assets.

During the third quarter of 2020, we generated net income from continuing operations of \$2.0 million, or \$0.04 per share, compared to a net loss from continuing operations of \$2.7 million or \$0.05 per share in the previous quarter and a loss of \$11.6 million or \$0.25 per share in the third quarter of 2019.

Our revenues totaled \$37.6 million in the third quarter of 2020, an increase of 248% from the prior quarter and an increase of 64% from the third quarter of 2019. The higher revenues were attributable to the restart and ramp-up of operations at our Mackenzie sawmill during the third quarter of 2020, following a 13-week curtailment in the prior quarter and significantly higher lumber prices. Revenues from the third quarter of 2019 included sales from our previously owned Fort St. James sawmill, which we sold in November 2019.

We recorded operating income of \$7.0 million in the third quarter of 2020, operating losses of \$1.4 million in the previous quarter and operating losses of \$8.6 million in the third quarter of 2019. Operating results included countervailing ("**CV**") and anti-dumping ("**AD**") duties expense of \$3.7 million in the third quarter of 2020, \$0.2 million in the second quarter of 2020 and \$1.3 million in the third quarter of 2019.

Selling, general and administrative ("**SG&A**") costs of \$1.8 million in the third quarter of 2020 reflected a decrease of 4% from the prior quarter and a decrease of 39% from the third quarter of last year. Compared to the third quarter of 2019, we significantly reduced SG&A costs by reducing management personnel and overhead costs to better align our corporate support functions with our operating footprint. We incurred restructuring costs of \$2.0 million in the first half of 2020 in relation to these cost reduction initiatives.

Finance costs were \$1.2 million in the third quarter of 2020, \$1.2 million in the previous quarter and \$7.0 million in the third quarter of 2019. Interest and finance costs were lower than in the third quarter of 2019 due to the repayment of the Lumber Credit Facility on February 1, 2020. Finance and interest costs subsequent to February 1, 2020 relate primarily to the Power Term Loan.

We recognized deferred income tax expense of \$1.5 million in the third quarter of 2020, a deferred income tax recovery of \$0.8 million in the previous quarter and \$4.0 million for the third quarter of 2019.

Adjusted EBITDA was \$7.6 million in the third quarter of 2020, negative \$1.1 million in the previous quarter and negative \$7.0 million in the third quarter of 2019. Adjusted EBITDA in the third quarter of 2020 benefited from the restart and ramp-up of Mackenzie sawmill operations, significantly higher lumber prices, continued positive results from bioenergy operations, offset partially by derivative losses of \$2.6 million.

### ***Discontinued Operations***

Net income from discontinued operations was approximately \$nil in the third quarter of 2020 compared to a net loss from discontinued operations of \$0.3 million and \$5.0 million in the previous quarter and the third quarter of 2019, respectively.

For further information on discontinued operations, see "Recent Developments – Sale of US Sawmill Business" above, and Note 6 to the unaudited condensed consolidated interim financial statements for the quarter ended September 30, 2020.

## REVIEW OF OPERATING RESULTS

### Selected Production and Statistical Information

|  | Q3<br>2020 | Q2<br>2020 | YTD<br>2020 | Q3<br>2019 | YTD<br>2019 |
|--|------------|------------|-------------|------------|-------------|
| <b>Statistics</b>  |            |            |             |            |             |
| Production – WSPF lumber (MMfbm) <sup>(1)</sup>              | 48.0       | 2.4        | 88.6        | 26.0       | 147.2       |
| Shipments – WSPF lumber (MMfbm) <sup>(1)</sup>               | 39.2       | 8.5        | 85.3        | 34.8       | 173.9       |
| Shipments – wholesale lumber (MMfbm) <sup>(1)</sup>          | 0.7        | 1.6        | 2.3         | 0.3        | 22.3        |
| Electricity production (GWh)                                 | 54.9       | 51.2       | 160.8       | 53.1       | 155.9       |
| Average exchange rate – US\$/\$( <sup>(2)</sup> )            | 0.751      | 0.722      | 0.739       | 0.757      | 0.752       |
| Average WSPF 2x4 #2 & Btr lumber price (US\$) <sup>(3)</sup> | 768        | 357        | 508         | 356        | 354         |
| Average WSPF 2x4 #2 & Btr lumber price (\$) <sup>(4)</sup>   | 1,023      | 494        | 684         | 470        | 471         |

(1) MMfbm represents million board feet.

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

(3) Random Lengths Publications Inc.

(4) Average SPF 2x4 #2 & Btr lumber prices (US\$) divided by average exchange rate.

Following the initial adverse economic impacts of the COVID-19 pandemic, North American lumber markets improved significantly during the third quarter of 2020. US housing starts on a seasonally adjusted annual basis averaged 1,430,000 in the third quarter of 2020, up 37% from the previous quarter and 12% from the third quarter of 2019. The increase in lumber demand, coupled with the impact of supply disruptions caused by the COVID-19 pandemic earlier in 2020, resulted in a significant increase to the benchmark Western SPF lumber price during the quarter to a record price of US\$955 per thousand board feet in September 2020.

The US dollar averaged US\$0.751 for each Canadian dollar during the third quarter of 2020, a level which represented a strengthening of the Canadian dollar over the previous quarter.<sup>1</sup> Canadian dollar-denominated benchmark Western SPF prices, which averaged \$1,023 in the third quarter of 2020, increased by 107% or \$529 from the previous quarter and by 117% or \$553 from the third quarter of 2019.

### Lumber Operations

Our lumber operating results in the third quarter of 2020 reflect the restart of operations at our Mackenzie sawmill on July 6, 2020, followed by the gradual ramp-up to normalized operating levels during the quarter. Lumber production for the current quarter totalled 48.0 million board feet, representing an annualized operating rate of 80% of capacity. In the previous quarter, 2.4 million board feet of lumber was produced during the single-week of operations prior to the 13-week curtailment period from April 6 to July 6, 2020. In the third quarter of 2019, 26.0 million board feet of lumber was produced as a result of reduced daily operating configuration and the incurrence of a five-week curtailment during the quarter.

Shipments of Conifex produced lumber totaled 39.2 million board feet in the third quarter of 2020. Shipments of lumber increased by 361% from the previous quarter and by 13% from the third quarter of 2019 as a result of increased production volumes, offset partially by an increase in inventory from the previous quarter. Our wholesale lumber program shipped 0.7 million board feet in the third quarter of 2020.

<sup>1</sup> Bank of Canada, [www.bankofcanada.ca](http://www.bankofcanada.ca).

Revenues from lumber products were \$31.2 million in the third quarter of 2020 and represented an increase of 429% from the previous quarter and an increase of 90% from the third quarter of 2019. Increased revenues were driven by higher shipment volumes and higher mill net realizations in the current quarter. Our lumber is typically sold 2-4 weeks in advance of its shipment date, resulting in a lag in our realized lumber prices when compared to concurrent reported lumber prices. As a result, a portion of the significant lumber price increase during September 2020 will be realized in the fourth quarter of 2020.

Overall operating costs in the third quarter of 2020 increased from prior quarters, driven by the restart of full operations at our Mackenzie sawmill. Cost of goods sold in the third quarter of 2019 included costs from previously owned sawmill in Fort St. James. We accessed the Canada Emergency Wage Subsidy ("**CEWS**") established by the federal government for approximately \$1.6 million of employee wage cost subsidies during the third quarter of 2020.

We recorded a positive inventory valuation adjustment of \$1.6 million in the third quarter of 2020 compared to \$0.4 million in the previous quarter and \$0.5 million in the third quarter of 2019.

We expensed CV and AD duty deposits of \$3.7 million in the third quarter of 2020, \$0.2 million in the previous quarter and \$1.3 million in the third quarter of 2019. The duty deposits were based on a combined rate of 20.23%.

### ***Bioenergy Operations***

Our Mackenzie power plant sold 54.9 gigawatt hours of electricity under our Electricity Purchase Agreement ("**EPA**") with BC Hydro and Power Authority ("**BC Hydro**") in the third quarter of 2020, representing approximately 99% of targeted operating rates.

The effective power rate is highest during the first and fourth quarters of each year. Electricity production contributed revenues of \$6.0 million in the third quarter of 2020, an increase of 27% from the previous quarter and an increase of 16% over the comparable quarter of 2019. In comparison to the third quarter of 2019, revenues were higher in the current quarter primarily due to a 3% increase in electricity production in the period and a higher electricity rate received for the dispatch period of 2020.

Our EPA with BC Hydro, similar to other electricity purchase agreements, provides BC Hydro with the option to "turn down" electricity purchased from us during periods of low demand by issuing a "dispatch order". BC Hydro issued a dispatch order for a period of approximately 117 days, from April 24 to August 19, 2020. In 2019, our power plant was dispatched for 114 days, commencing in early May to August 31, 2019. We continue to be paid revenues under the EPA based upon a reduced rate and on volumes that are generally reflective of contracted amounts. During any dispatch period, we continue to produce electricity to fulfill volume commitments under our Load Displacement Agreement with BC Hydro (the "**LDA**").

### ***Selling, General and Administrative Costs***

SG&A costs were \$1.8 million in the third quarter of 2020, \$1.9 million in the previous quarter and \$2.9 million in the third quarter of 2019. Compared to the third quarter of 2019, we significantly reduced SG&A costs by reducing management personnel and overhead costs to better align our corporate support functions with our operating footprint in 2020. We incurred restructuring costs of \$2.0 million in the first half of 2020 in relation to such initiatives.

### ***Interest Expense and Finance Costs***

Interest and finance costs totaled \$1.2 million in the third quarter of 2020, \$1.2 million in the previous quarter and \$7.0 million in the third quarter of 2019. Interest and finance costs were lower than in the third quarter of 2019 due to the repayment of the Lumber Credit Facility on February 1, 2020. Finance and interest costs subsequent to February 1, 2020 relate primarily to the Power Term Loan.

### ***Foreign Exchange Translation Gain or Loss***

The foreign exchange translation gain or loss recorded for each period on our statement of net income results from the revaluation of US dollar-denominated cash and working capital balances to reflect the change in the value of the Canadian dollar relative to the value of the US dollar. US dollar-denominated monetary assets and liabilities are translated using the period end rate. We recorded a foreign exchange translation gain of \$0.3 million in the third quarter of 2020, a loss of \$0.2 million in the previous quarter and a loss of \$0.2 million in the third quarter of 2019. In the third quarter of 2019, we also recorded a non-cash foreign exchange loss of \$2.4 million on our US dollar term loan under the Lumber Credit Facility due to the change in exchange rates during the period.

### ***Gain or Loss on Derivative Financial Instruments***

Gains or losses on lumber derivative instruments are recognized as they are settled or as they are marked to market for each reporting period. Conifex does not presently use derivatives for trading or speculative purposes. In the previous quarter, we entered into lumber futures contracts for downside price protection purposes on a small percentage of our estimated second-half 2020 production. Due to lumber market conditions characterized by rapidly rising prices from June to September of 2020, we recorded a loss from lumber derivative instruments of \$2.6 million in the third quarter of 2020 and \$0.7 million in the previous quarter. These futures contracts have been closed and there were no outstanding futures contracts in place as at September 30, 2020.

### ***Income tax***

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities on our balance sheet and the amounts used for income tax purposes. We recorded a deferred income tax expense of \$1.5 million in the third quarter of 2020, and a deferred income tax recovery of \$0.8 million and \$1.0 million in the previous quarter and third quarter of 2019, respectively. As at September 30, 2020, we have recognized deferred income tax assets of \$10.5 million.



## SUMMARY OF FINANCIAL POSITION

| (unaudited, in millions of dollars, unless otherwise noted) | <b>Q3<br/>2020</b> | <b>Q4<br/>2019</b> | <b>Q3<br/>2019</b> |
|---|--------------------|--------------------|--------------------|
| Cash  | 6.4                | 0.9                | 2.4                |
| Cash – restricted   | 3.7                | 6.7                | 6.3                |
| Operating working capital <sup>(1)</sup>                    | 14.9               | 2.8                | 14.5               |
| Current portion of revolver and long-term debt              | (4.4)              | (194.0)            | (157.7)            |
| Assets held for sale  | -                  | 236.5              | 25.6               |
| Liabilities held for sale                                   | -                  | (21.5)             | (3.4)              |
| Net current assets  | 20.6               | 31.4               | (112.3)            |
| Property, plant and equipment                               | 131.9              | 137.3              | 342.4              |
| Other long-term assets                                      | 38.6               | 38.0               | 196.7              |
|   | 191.1              | 206.7              | 426.8              |
| Non-interesting bearing long-term liabilities               | 15.1               | 18.8               | 16.8               |
| Long-term debt – Power Term Loan                            | 58.2               | 60.2               | 61.5               |
| Long-term debt – other <sup>(2)</sup>                       | 2.2                | 3.1                | 56.8               |
| Shareholders' equity  | 115.6              | 124.6              | 291.7              |
|   | 191.1              | 206.7              | 426.8              |
| Ratio of current assets to current liabilities              | 1.8                | 1.1                | 0.5                |
| Net debt to capitalization                                  | 32%                | 67%                | 48%                |
| Net debt (cash) to capitalization excluding Power Term Loan | (3%)               | 61%                | 42%                |

(1) Calculated as the aggregate of trade and other receivables, prepaid expenses and deposits and inventories less the aggregate of trade payables, accrued liabilities and other payables, the current portion of reforestation obligations and employee liabilities.

(2) Consists of leases in the third quarter of 2020 and fourth quarter of 2019.

Operating working capital increased by \$12.1 million over the first nine months of 2020 due primarily to a reduction in trade payables of \$19.2 million, offset partially by reduced prepaid expenses and deposits.

Overall debt was \$64.8 million at September 30, 2020 compared to \$257.2 million at December 31, 2019. The net reduction of \$192.4 million in debt comprised repayment in full of our previous Lumber Credit Facility of \$189.4 million, lease repayments of \$1.1 million and Power Term Loan payments of \$1.9 million. Our Power Term Loan, which is largely non-recourse to our lumber operations, represents substantially all of our outstanding long-term debt. At September 30, 2020, we had \$61.4 million outstanding on our Power Term Loan, while our remaining long-term debt, consisting of leases, was \$3.4 million.

The ratio of current assets to current liabilities was 1.8:1 at September 30, 2020 compared to 1.1:1 at December 31, 2019 and 0.5:1 at September 30, 2019. The year to date change was primarily attributable to the sale of the US Sawmill Business and the full repayment of our Lumber Credit Facility which was classified as a current liability as at December 31, 2019.

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 interest-bearing debt less cash. Total capital is calculated as the sum of net debt and equity. Net debt at September 30, 2020 decreased by \$194.9 million to \$54.7 million from \$249.6 million at December 31, 2019. The net debt to capitalization ratio was approximately 32% at September 30, 2020, 67% at December 31, 2019 and 48% at September 30, 2019.

## LIQUIDITY AND CAPITAL RESOURCES

### Summary of Cash Flows

| (millions of dollars, unaudited)     | Q3<br>2020   | Q2<br>2020   | YTD<br>2020 | Q3<br>2019   | YTD<br>2019   |
|--------------------------------------|--------------|--------------|-------------|--------------|---------------|
| <b>Cash generated from (used in)</b> |              |              |             |              |               |
| Operating activities                 | (4.0)        | 1.6          | (15.4)      | 17.2         | 47.8          |
| Investing activities                 | (1.2)        | (0.7)        | 222.3       | (0.6)        | 12.0          |
| Financing activities                 | (2.2)        | (2.0)        | (203.8)     | (23.0)       | (76.0)        |
| <b>Increase (decrease) in cash</b>   | <b>(7.4)</b> | <b>(1.1)</b> | <b>3.1</b>  | <b>(6.5)</b> | <b>(16.2)</b> |

### Operating Activities

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

Operating activities before changes in non-cash working capital generated \$2.4 million of cash in the first nine months of 2020, compared to net cash usage of \$4.8 million in the first nine months of 2019. Changes in non-cash working capital used \$17.8 million of cash in the first nine months of 2020 and generated \$52.6 million in the first nine months of 2019. Compared to the first nine months of 2019, the decrease in cash flow from non-cash working capital is due to the increased investment in operating working capital driven by the ramp-up of our Mackenzie sawmill in the third quarter of 2020.

### Investing Activities

Investing activities generated cash of \$222.3 million in the first nine months of 2020, comprised primarily of \$223.6 million from the sale of our US Sawmill Business. Investing activities in the first nine months of 2019 generated \$12.0 million, including net proceeds of \$14.7 million from the sale of Lignum.

### Financing Activities

Our financing activities used net cash of \$203.8 million in the first nine months of 2020 including \$191.8 million to repay in full our Lumber Credit Facility and finance expenses of \$8.8 million. In the first nine months of 2019, financing activities used net cash of \$76.0 million, comprised of Lumber Credit Facility revolver payments of \$30.9 million, term loan and capital lease payments of \$20.1 million and the payment of finance expenses of \$25.0 million.

### Liquidity

Our principal sources of funds are cash on hand and cash flow from operations. Our principal uses of funds consist of operating expenditures, capital expenditures, interest payments and repayment of principal on our Power Term Loan.

At September 30, 2020, we had total liquidity of \$6.4 million, compared to \$5.2 million at December 31, 2019 and \$8.0 million at September 30, 2019. Liquidity at September 30, 2020 was comprised of unrestricted cash of \$6.4 million.

The increase in our liquidity in the first nine months of 2020 was primarily from the net proceeds received from the sale of our US Sawmill Business in the first quarter of 2020, partially offset by the repayment in full of our Lumber Credit Facility and an investment in non-cash working capital as at September 30, 2020.

On October 13, 2020, we completed a \$10.0 million secured revolving credit facility with Wells Fargo Capital Finance Corporation Canada. The Revolving Credit Facility is available for a term of 3 years and is substantially secured by Conifex's lumber inventory, equipment and accounts receivable. Assuming the availability of our Revolving Credit Facility, as of September 30, 2020, our liquidity would have been \$16.4 million.

Like other Canadian lumber producers, we were required to begin depositing cash on account of softwood lumber duties imposed by the United States government in April 2017. Cumulative duties of US\$6.8 million paid by the Company, net of sales of the right to refunds, since the inception of the current trade dispute remain held in trust by the US pending the administrative reviews and conclusion of all appeals of US decisions. We expect future cash flow will continue to be adversely impacted by the CV and AD duty deposits to the extent additional costs on US destined shipments are not mitigated by higher lumber prices.

We monitor our expected liquidity levels and compliance with debt covenants under our Power Term Loan by regularly preparing rolling cash flow forecasts to consider upcoming operational requirements, debt service commitments and future business development. We did not have any material commitments for capital expenditures at September 30, 2020. Based on our current level of operations and our present expectations for future periods in light of the existing economic environment, we believe that cash flow from operations, flexibility in levels of investment in operating working capital and availability under the Revolving Credit Facility will be adequate to meet our obligations over the next twelve months.

#### ***Off-Balance Sheet Arrangements***

Our off-balance sheet arrangements as at September 30, 2020 were comprised of standby letters of credit totalling \$5.6 million posted by our subsidiary Conifex Power Limited Partnership. The standby letters of credit are issued to BC Hydro in connection with the EPA and the LDA.

#### ***Transactions Between Related Parties***

Other than transactions in the normal course of business with key management personnel, we had no transactions between related parties in the third quarter of 2020 or in the comparative quarters.

## SELECTED QUARTERLY FINANCIAL INFORMATION

### Quarterly Earnings Summary

| (unaudited, in millions of dollars, unless otherwise noted)                | 2020  |        |        |         | 2019   |        |        | 2018   |
|--|-------|--------|--------|---------|--------|--------|--------|--------|
|  | Q3    | Q2     | Q1     | Q4      | Q3     | Q2     | Q1     | Q4     |
| Sales  | 37.6  | 10.8   | 30.6   | 27.7    | 22.9   | 40.1   | 66.8   | 76.0   |
| Operating income (loss)  | 7.0   | (1.4)  | (6.8)  | (11.5)  | (8.6)  | (11.7) | (8.5)  | (7.8)  |
| Net income (loss) from continuing operations                               | 2.0   | (2.7)  | (8.2)  | (10.2)  | (11.6) | (1.1)  | (7.4)  | (20.2) |
| Net income (loss) – total operations                                       | 2.0   | (3.0)  | (7.7)  | (162.6) | (16.6) | (9.1)  | (11.9) | (23.1) |
| Net income (loss) per share – basic and diluted from continuing operations | 0.04  | (0.05) | (0.18) | (0.22)  | (0.25) | (0.02) | (0.16) | (0.43) |
| Net income (loss) per share – basic and diluted – total operations         | 0.04  | (0.06) | (0.17) | (3.47)  | (0.35) | (0.19) | (0.25) | (0.49) |
| Adjusted EBITDA from continuing operations <sup>(1)</sup>                  | 7.6   | (1.1)  | 0.5    | (3.9)   | (7.0)  | (9.1)  | (4.0)  | (5.0)  |
| Shares outstanding – weighted average (in millions)                        | 47.0  | 46.9   | 46.9   | 46.9    | 46.9   | 46.6   | 46.6   | 46.6   |
| <b>Statistics</b> (in millions, except rate and prices)                    |       |        |        |         |        |        |        |        |
| Production – WSPF lumber   | 48.0  | 2.4    | 38.2   | 37.8    | 26.0   | 47.6   | 73.5   | 93.5   |
| Shipments – WSPF lumber  | 39.2  | 8.5    | 37.6   | 38.0    | 34.8   | 60.4   | 78.7   | 99.9   |
| Shipments – wholesale lumber   | 0.7   | 1.6    | -      | -       | 0.3    | 5.4    | 16.6   | 12.8   |
| Electricity production – GWh   | 54.9  | 51.2   | 54.8   | 55.1    | 53.1   | 47.2   | 55.6   | 54.6   |
| Average exchange rate – US\$/\$( <sup>2</sup> )                            | 0.751 | 0.722  | 0.744  | 0.758   | 0.757  | 0.748  | 0.752  | 0.757  |
| Average WSPF 2x4 #2 & Btr lumber price (US\$) <sup>(3)</sup>               | 768   | 357    | 399    | 380     | 356    | 333    | 372    | 327    |
| Average WSPF 2x4 #2 & Btr lumber price (\$) <sup>(4)</sup>                 | 1,023 | 494    | 536    | 502     | 470    | 445    | 495    | 432    |
| <b>Reconciliation of Adjusted EBITDA to net income (loss)</b>              |       |        |        |         |        |        |        |        |
| Net income (loss) from continuing operations                               | 2.0   | (2.7)  | (8.2)  | (10.2)  | (11.6) | (1.1)  | (7.4)  | (20.2) |
| Add: Finance costs   | 1.2   | 1.2    | 3.5    | 21.7    | 7.0    | 7.4    | 6.0    | 6.5    |
| Amortization   | 2.9   | 1.1    | 2.9    | 4.8     | 1.8    | 2.5    | 4.1    | 3.9    |
| Deferred income tax expense (recovery)                                     | 1.5   | (0.8)  | (1.7)  | (3.8)   | (4.0)  | (0.9)  | (2.1)  | (6.5)  |
| EBITDA <sup>(5)</sup>  | 7.6   | (1.2)  | (3.5)  | 12.5    | (6.8)  | 7.9    | 0.6    | (16.3) |
| Add: Foreign exchange (gain) loss on long-term debt                        | -     | -      | 2.1    | (2.4)   | 2.4    | (4.4)  | (4.5)  | 11.3   |
| Restructuring costs  | -     | 0.1    | 1.9    | 2.6     | -      | -      | -      | -      |
| Proceeds from insurance claim  | -     | -      | -      | (1.1)   | -      | -      | -      | -      |
| Gain on sale of assets   | -     | -      | -      | (15.5)  | -      | -      | (0.1)  | -      |
| Gain on sale of right to duty refunds                                      | -     | -      | -      | -       | (2.6)  | (12.6) | -      | -      |
| Adjusted EBITDA from continuing operations                                 | 7.6   | (1.1)  | 0.5    | (3.9)   | (7.0)  | (9.1)  | (4.0)  | (5.0)  |

(1) Conifex's adjusted EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization, foreign exchange translation gains or losses on long-term debt, restructuring costs, proceeds from insurance claims and gains or losses on sale of assets.

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

(3) Random Lengths Publications Inc. (Western Spruce/Pine/Fir, per thousand board feet).

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

(5) Conifex's EBITDA calculation represents earnings before finance costs, taxes, and 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 softwood lumber duty deposits rates on shipments to the US, 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 help maintain adequate supply of fibre to our Mackenzie sawmill 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 application of a "time of delivery factor" to the fixed price provided under the EPA generally results in a seasonal effect and considerable variability on quarterly revenues from electricity deliveries, 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 considerably between the strongest and weakest quarters. As a major portion of electricity production costs, as well as interest charges, are fixed in nature, quarterly bioenergy operating results reflect the variability in revenues.

## **OUTLOOK**

Following the restart and ramp-up of our Mackenzie sawmill operations in the third quarter, we expect that we will achieve annualized operating rates of approximately 90% in the fourth quarter of 2020. We expect lumber markets to remain strong, despite recent volatility, supported by robust demand from US housing starts and continued strength in the repair and remodeling sector. Our Mackenzie power plant is forecasted to operate at full capacity in the fourth quarter and continue to generate a steady and diversified source of cash flow in the upcoming seasonal high period of revenue under the EPA.

Our liquidity has been strengthened with the addition of the new Revolving Credit Facility and we are positioned to manage further market volatility that may arise in the coming months.

## **CRITICAL ACCOUNTING ESTIMATES**

We did not make any significant changes to our critical accounting estimates during the quarter ended September 30, 2020. Our critical accounting estimates are described in our MD&A for the year ended December 31, 2019, filed on SEDAR at [www.sedar.com](http://www.sedar.com).

## **RISKS AND UNCERTAINTIES**

A comprehensive discussion of risk factors impacting our business, assets and operations is included in our annual information form dated March 23, 2020, and other filings with the Canadian regulatory authorities available on SEDAR at [www.sedar.com](http://www.sedar.com).

### ***COVID-19 Pandemic***

The impact of COVID-19, and the world-wide response to fight the pandemic, has significantly disrupted global economic activity and caused significant volatility in financial markets. While various countries, including Canada, the United States and Japan, have introduced monetary and other fiscal stimulus to lessen the impact of the pandemic, the impact on global economic activity and markets remains highly unknown.

As demand for lumber products has, historically, been principally driven by global macro-economic conditions, demand and prices for lumber have typically decreased substantially during economic slowdowns. A significant economic downturn may adversely affect our sales and profitability and may also adversely affect our customers and suppliers. Additionally, significant disruptions and volatility in financial markets could have a negative impact on our ability to access capital in the future.

In early April, in response to COVID-19, we temporarily curtailed operations at our Mackenzie sawmill. The curtailment, which was initially scheduled for two weeks, was extended to July 6, 2020 as the impacts of COVID-19 on global macroeconomic conditions remained uncertain. We may experience additional business interruption, including suspended or reduced operations at our Mackenzie sawmill and power plant, expenses and delays relating to COVID-19 which could have a material adverse impact on our business, operating results, financial condition and the market for our securities.

The magnitude and duration of business disruption internationally and the related financial impact of COVID-19 remains uncertain. We will continue to closely monitor the COVID-19 situation and its impact on our business and operations.

## **OUTSTANDING SECURITIES**

As at November 9, 2020, we had 47,036,089 common shares, 100,000 options, 2,079,507 long-term incentive plan awards and 3,500,000 warrants outstanding.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

During the quarter ended September 30, 2020, there were no changes that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **ADDITIONAL INFORMATION**

Additional information about our company is available on SEDAR at [www.sedar.com](http://www.sedar.com).