CONIFEX

CONIFEX TIMBER INC.
FIRST QUARTER 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of May 12, 2017

This interim Management's Discussion and Analysis ("MD&A") provides a review of the financial condition and results of operations of Conifex Timber Inc.(the "Company", "Conifex", "us", "we", or "our"), on a consolidated basis, for the quarter ended March 31, 2017 relative to the quarters ended December 31, 2016 and March 31, 2016. This interim MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the quarters ended March 31, 2017 and 2016, as well as the 2016 annual MD&A and the December 31, 2016 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", "adjusted EBITDA", and "adjusted EBITDA margin". 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 and the proceeds from our business insurance claim settlement. "Adjusted EBITDA margin" is defined as adjusted EBITDA as a percentage of sales. The Company discloses EBITDA, adjusted EBITDA and adjusted EBITDA margin, as it is a measure used by analysts and by Conifex's management to evaluate the Company's performance. As EBITDA, adjusted EBITDA and adjusted EBITDA margin are non-GAAP measures, they may not be comparable to EBITDA, adjusted EBITDA and adjusted EBITDA margin calculated by others. In addition, EBITDA, adjusted EBITDA and adjusted EBITDA margin 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 United States dollars.

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 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, countervailing or anti-dumping duty rate, if any, 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; our expectation for market volatility associated with the softwood lumber dispute with the U.S.; that we could be negatively impacted by the imposition of duties or other protective measures on our customers, such as anti-dumping duties or countervailing duties on softwood lumber; our expectations for U.S. dollar benchmark prices; 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 regarding the Mackenzie Plant power

production; use of proceeds of financing operations; and the anticipated benefits, cost, timing and completion dates for projects, including the El Dorado Mill upgrade.
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 28, 2017 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 FIRST QUARTER OF 2017

Completion of $130 million secured revolving credit facility

In January, 2017, we completed a $130 million secured revolving credit facility (the "Credit Facility") with a syndicate of institutional lenders. The Credit Facility is available for a term of 5 years and is secured by substantially all of our assets, other than our bioenergy segment assets. The Credit Facility bears interest at CDOR or LIBOR plus a margin of between 2.5% and 3.0%, depending upon our leverage ratio.

A portion of the Credit Facility was used to repay in full drawn amounts under our existing lumber segment credit facilities and our secured notes, which generally carried higher interest rates. We are primarily utilizing the Credit Facility to finance working capital in our lumber segment and a portion of the capital expenditures related to the modernization and re-start our sawmill complex in El Dorado, Arkansas (the "El Dorado Mill").

The Credit Facility provides for calculation of availability on an expanded borrowing base, relative to our previous lumber segment revolving credit facilities, which enhances liquidity. Total liquidity was $61.6 million at March 31, 2017 compared to $22.2 million at December 31, 2016.

Completion of bought deal offering and private placement

In March, 2017, we completed a bought deal offering (the "Offering") of 3,450,000 common shares, including 450,000 common shares on exercise in full by the underwriters of their over-allotment option, at a price of $3.05 per share and resulting in aggregate gross proceeds of approximately $10.5 million. The next day, we completed a non-brokered private placement of 1,600,000 common shares with an existing shareholder at a price of $3.05 per share for aggregate gross proceeds of approximately $4.9 million.

The net aggregate proceeds of $14.2 million from the Offering and the private placement were initially used to partially repay outstanding indebtedness under the Credit Facility.

SUMMARY OF OPERATING RESULTS

Selected Financial Information

(millions of dollars except share and per share amounts and exchange rate information, unaudited)	**Q1 2017**	**Q4 2016**	**Q1 2016**
Sales by Segment			
Lumber	93.5	94.4	91.8
Bioenergy	6.8	7.6	7.7
	100.3	102.0	99.5
Operating Earnings (Loss) by Segment			
Lumber	1.8	2.9	1.2
Bioenergy	1.3	5.2	2.6
Corporate and other unallocated items	(1.6)	(1.5)	(0.8)
	1.5	6.7	3.0
Adjusted EBITDA by Segment			
Lumber	5.1	6.1	4.5
Bioenergy	2.8	4.4	4.2
Corporate and other unallocated items	(1.8)	(1.2)	(1.8)
	6.1	9.3	6.8
Net income (loss)	(1.4)	5.1	28.5
Net income (loss) per share - basic	(0.06)	0.24	1.35
Net income (loss) per share - diluted (1)	(0.06)	0.24	1.24
Shares outstanding - weighted average (millions)	22.5	21.2	21.1
Average exchange rate - US$/Cdn$ (2)	0.756	0.750	0.727
Reconciliation of adjusted EBITDA to Net Income (Loss)			
Net income (loss)	(1.4)	5.1	28.5
Add: Finance costs	2.6	2.1	2.5
Amortization	4.9	4.6	4.8
EBITDA (3)	6.1	11.8	35.8
Less: Gain on sale of asset	-	-	(29.0)
Less: Net proceeds from insurance settlement	-	(2.5)	-
Adjusted EBITDA (4)	6.1	9.3	6.8

(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 and the proceeds from our business interruption insurance claim settlement.

Revenues of $100.3 million in the first quarter of 2017 were generally consistent with the comparative quarters.

First quarter lumber segment operating income of $1.8 million represented a decline of $1.1 million from the prior quarter and an improvement of $0.6 million over the first quarter of 2016. The bioenergy segment contributed operating earnings of $1.3 million in the current quarter compared to $5.2 million in the previous quarter and $2.6 million in the same quarter last year. Bioenergy segment operating income for the previous quarter included net proceeds of $2.5 million from the settlement of a business interruption insurance claim. Corporate costs of $1.6 million were similar to the prior quarter and increased by $0.8 million over the first quarter of 2016, during which we recorded a positive adjustment related to compensation related provisions. Excluding the gain from the net proceeds of the insurance settlement in 2016, operating earnings were $1.5 million for the current quarter compared to $4.2 million in the previous quarter and $3.0 million in the first quarter of 2016.

Net loss for the first quarter of 2017 was $1.4 million, or $0.06 per basic share, compared to net income of $5.1 million or $0.24 per basic and diluted share in the previous quarter and net income of $28.5 million or $1.35 per basic and $1.24 diluted share in the first quarter of 2016. Net income for the first quarter of 2016 included a net gain on the sale of assets of $29.0 million resulting from the redemption of our outstanding payment-in-kind note. Excluding this unusual item and the aforementioned gain on settlement of the insurance claim, normalized net income was $2.6 million in the previous quarter and net loss was $0.5 million in the first quarter of 2016.

Adjusted EBITDA was $6.1 million in the first quarter of 2017 compared to $9.3 million in the fourth quarter of 2016 and $6.8 million in the first quarter of 2016. Compared to the previous quarter, lumber segment adjusted EBITDA declined by $1.0 million and bioenergy segment adjusted EBITDA by $1.6 million. Compared to the first quarter of 2016, lumber segment adjusted EBITDA improved by $0.6 million and bioenergy segment adjusted EBITDA declined by $1.4 million.

Net debt at March 31, 2017 was $131.6 million compared to $108.8 million at December 31, 2016 and $131.2 million at March 31, 2016. The increase of $22.8 million from December 31, 2016 was due primarily to an increase in non-cash working capital of $14.4 million and capital expenditures related to the El Dorado Mill partially offset by net proceeds from the Offering and private placement. The net debt to capitalization ratio was 41% at March 31, 2017 compared to 38% at December 31, 2016.

Excluding the effects of borrowings by Conifex Power Limited Partnership, which are non-recourse to our other operations, the net debt to capitalization ratio was 24% compared to 16% at December 31, 2016.

REVIEW OF OPERATING RESULTS BY BUSINESS SEGMENT

Lumber Segment

(millions of dollars, other than statistical and exchange rate information and lumber prices, unaudited)	Q1 2017	Q4 2016	Q1 2016
Sales -Lumber - Conifex produced	56.7	61.6	57.0
- Lumber - wholesale	28.4	24.6	25.1
- By-products	5.4	5.7	6.5
- Logistics services	3.0	2.5	3.2
Total Sales	93.5	94.4	91.8
Adjusted EBITDA	5.1	6.1	4.5
Amortization and other	3.3	3.2	3.3
Operating income	1.8	2.9	1.2
Statistics (in millions, other than exchange rate and lumber prices)			
Lumber production (MMfbm)	123.7	118.7	135.8
Lumber shipments - Conifex product (MMfbm)	110.7	124.4	127.0
Lumber shipments - Wholesale (MMfbm)	41.0	40.5	40.7
Average exchange rate - US$/Cdn$ (1)	0.756	0.750	0.727
Average WSPF 2x4 #2&Btr lumber price (US$) (2)	$345	$316	$272
Average WSPF 2x4 #2&Btr lumber price (Cdn$) (3)	$456	$421	$373
Price range: WSPF 2x4 #2&Btr lumber price (US$) (2)	$306-$389	$302-$325	$245-$303

(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 1.25 million units over the first quarter of 2017, a level which was consistent with the previous quarter and represented an increase of approximately 9% over the first quarter of 2016. Single-family housing starts accounted for 67% of total first quarter 2017 U.S. housing starts, a level similar to the previous quarter and an increase in units of 6% over the first quarter of 2016. Lumber consumption per unit in single-family housing starts is generally considered to be two to three times greater than in multi-family units.

Prices for the bell-weather WSPF #2 & Btr product averaged US$345 during the first quarter of 2017, an improvement of 9% over the previous quarter and 27% over the first quarter of 2016.[1] The uncertainty surrounding possible countervailing duties being imposed on Canadian lumber shipments destined to the U.S. contributed to heightened lumber price volatility, as evidenced by the broader range in benchmark prices during the quarter.

The Canadian dollar strengthened against the U.S. dollar during the first quarter of 2017 and averaged US$0.756, an appreciation of 1% over the previous quarter and 4% over the same quarter last year.[2] Canadian dollar-denominated benchmark lumber prices averaged $456 in the first quarter of 2017, an increase of $35 or 8% over the previous quarter and $83 or 22% over the first quarter of 2016.

The U.S. and China remained our principal markets and accounted for approximately 79% of total lumber shipments in each of the comparative quarters while shipments to Japan remained steady at approximately 8%. Shipments to other offshore markets averaged 5% of total volumes during the current and previous quarters. The balance of lumber shipments were directed to the Canadian market.

Revenue from Conifex produced lumber was $56.7 million in the first quarter of 2017. The decline of 8% from the previous quarter was mostly attributable to 11% lower shipment volumes which were somewhat offset by an improvement in sales realizations. Lumber shipments were hampered by lower production volumes and challenging weather conditions which constrained availability of railcars and trucks in Western Canada. The gain in sales realizations generally reflected stronger benchmark lumber prices. Lumber revenues were relatively flat compared to the same quarter last year as an improvement in sales realizations of 14% was largely offset by lower shipment volumes. The higher sales realizations in the most recent quarter were due primarily to stronger benchmark prices which were somewhat offset by a stronger Canadian currency.

The increase in wholesale lumber revenues of approximately 14% over the comparative quarters was largely attributable to gains in sales realizations as shipment volumes were similar in each quarter. The improvement in sales realization is attributable to higher lumber prices and favorable variation in product mix.

The decline in revenues from wood chips and other by-products of 17% from the first quarter of 2016 was largely due to lower chip sales volumes and, to a lesser extent, a decline in chip prices due to adverse weather conditions in the current quarter.

Lumber production totalled 124 million board feet during the first quarter of 2017 and represented an annualized operating rate of 94% (excluding production capacity attributed to the idled Mackenzie Site I sawmill) compared to 90% in the previous quarter and 103% in the same quarter last year. Production in the first quarter of 2017 and the previous quarter was reduced by planned downtime taken in late

[1] As quoted in Random Lengths Publications Inc.

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

December at the Mackenzie sawmill for an upgrade of the log line, and the completion and ramp up of the new log line in the current quarter and to a lesser extent, was hampered by inclement weather conditions.

Unit log costs increased by 4% over the previous quarter and 15% over the same quarter last year. The higher log costs were mainly attributable to higher market based stumpage and purchased log costs.

Unit cash conversion costs increased by 6% from the previous quarter as the benefits of an improved operating rate were more than offset by higher energy, labour and weather related maintenance costs. An increase in unit cash conversion costs of 17% over the first quarter of 2016 was due primarily to lower operating rates and higher energy costs.

Per unit freight and distribution costs related to shipments of Conifex produced lumber were generally consistent in each of the comparative quarters.

The lumber segment recorded operating income of $1.8 million in the first quarter of 2017 compared to $2.9 million in the previous quarter and $1.2 million in the first quarter of 2016. Compared to the previous quarter, lumber segment operating results were impeded by lower shipment volumes and higher unit manufacturing costs which outweighed the benefit of improved sales realizations from higher benchmark lumber prices. Compared to the first quarter of 2016, current quarter operating results were adversely impacted by higher unit manufacturing costs and lower revenues from residual sales. The impact of revenues from Conifex produced lumber were neutral as improved sales realizations largely offset the impact of lower shipment volumes.

Lumber segment adjusted EBITDA was $5.1 million in the first quarter of 2017 compared to $6.1 million in the previous quarter and $4.5 million in the first quarter of 2016.

Bioenergy Segment

(millions of dollars, other than statistical information, unaudited)	**Q1 2017**	**Q4 2016**	**Q1 2016**
Electricity sales under EPA - GWh	46.3	53.0	54.9
Electricity revenues	6.8	7.6	7.7
Adjusted EBITDA	2.8	4.4	4.2
Amortization	1.5	1.7	1.6
Operating income - adjusted (1)	1.3	2.7	2.6

(1) For comparative purposes, operating income for Q4 2016 has been adjusted to exclude net proceeds of $2.5 million from the settlement of our business interruption insurance claim.

The Mackenzie power generation plant (the “Mackenzie Plant”) commenced commercial operations in May 2015.

The Mackenzie Plant sold 46.3 gigawatt hours of electricity under our Electricity Purchase Agreement with BC Hydro (“EPA”) and operated at approximately 85% of targeted operating rates in the first quarter of 2017, compared to 97% in the previous quarter and 100% in the first quarter of 2016. Electricity sales and plant operating costs in the first quarter of 2017 were adversely impacted by several unplanned outages and challenging weather conditions earlier in the quarter, which impacted feedstock quality and deliverability. The unplanned outages contributed to increased maintenance related expenses including the use of outside service contractors.

Electricity revenues were lower by $0.8 million compared to the previous quarter and $0.9 million compared to the first quarter of 2016, and cash operating costs were higher by $0.8 million and $0.5 million, respectively. Bioenergy segment adjusted EBITDA was lower by $1.6 million compared to the previous quarter and $1.4 million compared to the same quarter last year and reflected adjusted EBITDA margin of 41% compared to approximately 56% in the comparative quarters. Adjusted EBITDA margin is defined as adjusted EBITDA as a percentage of sales.

Dispatch Notice

The EPA, similar to other electricity purchase agreements, 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 2017, BC Hydro issued a dispatch order with respect to, among others, the Mackenzie Plant advising of a dispatch period of 122 days, encompassing the months of April, June, July and August. Last year, the Mackenzie Plant, among others, was dispatched for 61 days in the second quarter. During the dispatch period, we will only produce electricity to fulfill volume commitments under our Load Displacement Agreement with BC Hydro. We will continue to be paid revenues based upon a reduced rate and on volumes that are generally reflective of contracted amounts. Although the dispatch period is similar to the dispatch period in the same quarter of 2016, we expect year-over-year operating results to be somewhat lower in the second quarter of 2017 due to planned maintenance days. We expect an improvement in year-over-year operating results in the third quarter of 2017, as operating results in the third quarter of last year were hampered by maintenance downtime.

The Mackenzie Plant achieved average hourly production of 105% of our operating target over the first twelve months of commercial operations. We expect the improvements to be made during the planned maintenance days in June 2017 will result in operating rates approaching historic levels.

Corporate Costs

Corporate costs, which comprise corporate, head office and general and administrative expenses, were $1.6 million in the first quarter of 2017, $1.5 million in the previous quarter and $0.8 million in the first quarter of 2016. Corporate costs for the first quarter of 2017 and the previous quarter included professional fees related to the softwood lumber trade dispute. In the first quarter of 2016, we recorded a positive adjustment related to compensation related provisions which resulted in lower than typical corporate costs for the period.

Interest Expense and Finance Costs

Finance costs related to debt issuance are amortized over the remaining term of each respective credit facility. Interest and finance costs totalled $2.7 million in the first quarter of 2017, $2.1 million in the previous quarter and $2.5 million in the first quarter of 2016. The increase in finance costs of $0.6 million over the prior quarter was mainly attributable to finance costs related to the Credit Facility and the accelerated amortization of finance costs related to early repayment of our senior secured notes, somewhat offset by a modest reduction in interest expense..

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. Gain 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 $nil in the first quarter of 2017 and $0.1 million in the previous quarter and the first quarter of 2016.

The term loan provided under the power project financing consists of a floating rate tranche and a fixed rate tranche. Our subsidiary, Conifex Power Limited Partnership, 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. Losses of $0.3 million on the interest rate swap instruments were recorded as interest expense in each of the comparative quarters.

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 U.S. dollar-denominated debt, 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$0.752 at March 31, 2017, US$0.745 at December 31, 2016 and US$0.770 at March 31, 2016.[3] The foreign exchange translation loss was $0.2 million in the first quarter of 2017 and $1.1 million in the first quarter of 2016 compared to a foreign exchange translation gain of $0.3 million in the previous quarter.

Income tax

At December 31, 2016, the Company had unused non-capital tax losses carried forward totalling $20.0 million and unrecognized deferred tax assets totalling $2.3 million. Although the Company expects to realize the full benefit of the loss carry forwards and unrecognized deferred tax assets, due to the cyclical nature of the wood products industry and the economic conditions over the last several years, the Company has not recognized the benefits of its deferred tax assets available to reduce taxable income.

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

SUMMARY OF FINANCIAL POSITION

The following table summarizes the Company's financial position as at the end of each of the comparative quarters:

(millions of dollars, unaudited)	Q1 2017	Q4 2016	Q1 2016
Cash	13.8	12.7	7.4
Cash - restricted	10.5	10.3	10.4
Operating working capital	77.2	62.8	59.7
Operating loans	(1.6)	(28.2)	(23.8)
Current portion of convertible notes	-	-	(11.8)
Current portion of mortgage	-	(10.5)	(11.2)
Current portion of long-term debt	(4.6)	(4.4)	(4.0)
Net current assets	95.3	42.7	26.7
Long-term assets related to power project	117.2	118.7	122.7
Long-term assets - lumber segment and corporate	148.9	124.8	106.0
	361.4	286.2	255.4
Non-interest bearing long-term liabilities	21.1	20.0	22.3
Long-term debt - power project construction loan	67.3	68.4	73.5
Revolving credit facility	82.4	-	-
Long-term debt - other	-	20.3	24.6
Shareholders' equity	190.6	177.5	135.0
	361.4	286.2	255.4
Ratio of current assets to current liabilities	3.3	1.5	1.3
Net debt to capitalization	41%	38%	49%
Net debt to capitalization (1)	24%	16%	28%

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

The ratio of current assets to current liabilities at March 31, 2017 was 3.3:1 compared to 1.5:1 at December 31, 2016 and 1.3:1 at March 31, 2016. In the current quarter, the ratio was most significantly impacted by the relatively longer tenor of the Credit Facility, from which advances were drawn to repay and extinguish lumber segment operating loans and the El Dorado mortgage, which had been classified as current liabilities.

We manage capital with the objective of maintaining a strong balance sheet that helps ensure adequate capital resources to support operations, sustain future development and facilitate access to capital markets at competitive rates. 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, and the mortgage, less cash. Total capital is calculated as "equity" as shown in the consolidated balance sheet plus net debt.

Net debt at March 31, 2017 was $131.6 million. The increase of $22.8 million from December 31, 2016 was due primarily to an increase in non-cash working capital of $14.4 million and capital expenditures related to the El Dorado Mill, somewhat offset by net proceeds from the Offering and private placement. The net debt to capitalization ratio was 41% at March 31, 2017 compared to 38% at December 31, 2016.

Excluding the effects of borrowings by Conifex Power Limited Partnership, the net debt to capitalization ratio was 24% compared to 16% at December 31, 2016.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	**Q1 2017**	**Q4 2016**	**Q1 2016**
Cash generated from (used in)			
Operating activities	(4.6)	7.5	0.7
Financing activities	33.5	(0.1)	(0.3)
Investing activities	(27.6)	(6.8)	(1.1)
Increase (decrease) in cash	1.3	0.6	(0.7)

<u>Operating Activities</u>
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 the payment of payables 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 $8.1 million and consumed cash of $12.7 million in incremental working capital in the first quarter of 2017. The change in non-cash working capital included increases in log inventories of $6.8 million and lumber inventories of $5.0 million. The increase in log inventories was due to the seasonal build-up of logs in anticipation of curtailed log deliveries during the spring months. Lumber inventories were at unusually elevated levels as shipments during the quarter were constrained by challenging weather conditions which tightened supply of railcars and trucks in Western Canada.

We generated cash from operations before working capital changes of $12.8 million and used cash of $5.3 million in incremental working capital in the fourth quarter of 2016. The change in non-cash working capital was largely comprised of increases in prepaid expenses and inventories.

We generated cash from operations before working capital changes of $8.6 million and consumed cash of $7.9 million in incremental working capital in the first quarter of 2016. The change in non-cash working capital included an increase in log inventories of $7.0 million, an increase in lumber inventories of $3.2 million and an increase in accounts payable of $2.7 million.

<u>Financing Activities</u>
Financing activities provided net cash of $33.5 million in the first quarter of 2017 and included net proceeds from operating loans of $55.8 million and the Offering and private placement of $14.2 million. Cash outflows included repayment in full of senior secured notes of $20.3 million and the El Dorado mortgage of $10.4 million, partial repayment of our term loan of $1.8 million, and the payment of finance expenses of $4.1 million. The comparative increase in cash finance expenses was mainly attributable to costs related to the completion of the Credit Facility.

Financing activities consumed net cash of $0.1 million in the fourth quarter of 2016 and were primarily comprised of net proceeds from operating loans of $18.8 million, full repayment of convertible notes of $12.0 million, partial repayment of other long-term debt of $4.7 million, and the payment of finance expenses of $2.1 million.

Financing activities consumed net cash of $0.3 million in the first quarter of 2016 and were primarily comprised of net proceeds from operating loans of $5.4 million, debt repayments of $2.9 million, and the payment of finance expenses of $3.0 million.

Investing Activities

Investing activities consumed cash of $27.6 million in the first quarter of 2017 and consisted of $2.4 million on capital improvements in the lumber segment, $0.1 million related to the power generation plant and $24.9 million on the capital upgrades at the El Dorado Mill. Lumber segment capital expenditures for our Canadian mills were primarily related to the completion of the upgrade of a log line at the Mackenzie Site II sawmill, a project which was initiated in December 2016. The El Dorado Mill capital project is discussed further under "El Dorado Mill Capital Project" below.

Investing activities consumed cash of $6.8 million in the fourth quarter of 2016 and were mainly comprised of capital expenditures of $3.6 million in the lumber segment and $6.0 million on the capital upgrades at the El Dorado Mill, offset by receipt of proceeds from the insurance claim settlement of $2.9 million.

Investing activities consumed cash of $1.1 million in the first quarter of 2016 and included $0.5 million on capital improvements in the lumber segment, $0.2 million related to the power generation plant and $0.3 million in pre-development costs related to the El Dorado Mill.

Liquidity

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

Total liquidity is comprised of unrestricted cash and available credit under our revolving credit facilities. At March 31, 2017, we had total liquidity of $61.6 million, compared to $22.2 million at December 31, 2016 and $18.7 million at March 31, 2016. Liquidity at March 31, 2017 was comprised of unrestricted cash of $13.8 million and unused availability under our revolving credit facilities of $47.8 million. Availability under the Credit Facility is determined by periodic borrowing base calculations that fluctuate with eligible accounts receivable and inventory balances, plus the appraised values of certain forest licences, net of specific reserves.

Our investment in operating working capital was at a seasonal peak at the end of March 31, 2017 due to the build in log inventories and higher than typical lumber inventories. In the second quarter of 2017, liquidity is expected to be positively impacted by the drawing of log inventories to seasonal lows and more normalized lumber inventory levels. We expect to be required to begin depositing cash on account of softwood lumber export duties imposed by the U.S. in May 2017. The timing of deposits required for retroactive duties is currently unclear and therefore creates some uncertainty for our cash flows going forward. We expect future cash flow will be adversely impacted by the countervailing and anti-dumping duty deposits, to the extent the additional costs on U.S. destined shipments are not mitigated by higher lumber prices. A further discussion of the softwood lumber dispute is provided under "Subsequent Event" below.

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 cash flow from operations and available cash, together with available borrowings under our revolving credit facilities, will be adequate to meet our obligations in 2017. We expect liquidity for the balance of the year to remain generally consistent with 2016 levels, after taking into account budgeted capital expenditures for our Canadian mills and the El Dorado Mill upgrade which we expect to complete by or about the end of the third quarter or early in the fourth quarter of this year.

In the future, we may make acquisitions of businesses or assets or commitments to additional capital projects. To achieve the 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 as at March 31, 2017 were comprised of standby letters of credit totalling $18.75 million posted by our subsidiary, 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,	**2017**		**2016**				**2015**	
statistical and exchange rate information and lumber prices)	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2
Sales - lumber segment	93.5	94.4	99.2	98.7	91.8	92.7	80.0	79.2
Sales - electricity	6.8	7.6	4.9	5.0	7.70	7.8	5.9	2.6
Operating income (loss)	1.5	6.7	3.3	5.1	3.0	1.6	(4.5)	(9.8)
Net income (loss)	(1.4)	5.1	1.4	35.2	28.5	(0.3)	(5.6)	(13.0)
Net income (loss) per share - basic	(0.06)	0.24	0.07	1.67	1.35	(0.01)	(0.26)	(0.62)
Net income (loss) per share - diluted (1)	(0.06)	0.24	0.07	1.54	1.24	(0.01)	(0.26)	(0.62)
Adjusted EBITDA (2)	6.1	9.3	8.5	9.0	6.8	7.3	1.5	(6.8)
Shares outstanding - weighted average (millions)	22.5	21.2	21.2	21.1	21.1	21.1	21.1	21.0
Statistics (in millions, other than exchange rate and lumber prices)								
Lumber production (MMfbm)	123.7	118.7	136.2	134.7	135.8	131.1	112.3	118.1
Lumber shipments - Conifex produced (MMfbm)	110.7	124.4	132.3	138.4	127.0	139.4	107.6	116.0
Lumber shipments - wholesale (MMfbm)	41.0	40.5	39.6	41.0	40.7	38.6	42.6	39.7
Electricity production - GWh	46.3	53.0	37.6	55.1	54.90	54.5	46.2	24.3
Average exchange rate - US$/Cdn$ (3)	0.756	0.750	0.766	0.776	0.727	0.749	0.764	0.813
Average WSPF 2x4 #2&Btr lumber price (US$) (4)	$345	$316	$321	$310	$272	$264	$267	$271
Average WSPF 2x4 #2&Btr lumber price (Cdn$)(5)	$456	$421	$418	$399	$373	$353	$349	$333
Reconciliation of Adjusted EBITDA to Net Income (Loss)								
Net income (loss)	(1.4)	5.1	1.4	35.2	28.5	(0.3)	(5.6)	(13.0)
Add: Finance costs	2.6	2.1	2.3	2.3	2.5	2.6	2.6	2.1
Amortization	4.9	4.6	4.8	3.9	4.8	5.0	4.5	4.1
EBITDA (6)	6.1	11.8	8.5	41.4	35.8	7.3	1.5	(6.8)
Less: Gain on sale of assets	-	-	-	(19.0)	(29.0)	-	-	-
Less: Gain on revaluation of joint venture	-	-	-	(19.2)	-	-	-	-
Less: Net proceeds from insurance settlement	-	(2.5)	-	-	-	-	-	-
Add: Impairment of property, plant and equipment	-	-	-	5.8	-	-	-	-
Adjusted EBITDA	6.1	9.3	8.5	9.0	6.8	7.3	1.5	(6.8)

(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, depreciation and amortization, gains or losses from asset sales, disposals or revaluation and proceeds from business interruption insurance claim settlement.
(3) Source: Bank of Canada website 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 more company specific factors that influence quarterly financial trends include operating rates, shipment volumes, raw material and manufacturing costs, and transactions of a non-recurring nature. 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.

The application of a “time of delivery factor” to the fixed price provided under the EPA produces a seasonal effect on and considerable variability on quarterly revenues from electricity deliveries with the lowest revenues generally 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.

OUTLOOK AND STRATEGIC CAPITAL EXPENDITURES

Operations and Lumber Market Outlook

Through the remainder of 2017, we expect benchmark lumber prices for Western SPF to average approximately 10% higher than the levels achieved in the first quarter of 2017. We expect the imposition of duties on U.S. lumber shipments will lead to greater volatility in pricing and erode a portion of the increase in mill nets resulting from higher prices. We expect prices on the premium grade and lower grade products shipped to Japan and China, respectively, will be primarily determined by traditional supply and demand factors and will not be materially impacted by duties imposed by the U.S. We expect demand and pricing to continue to remain solid in the Japanese and Chinese markets through the balance of the year. We expect our mill net price realizations from the sale of construction grade lumber to the Canadian and other non-U.S. markets will be somewhat discounted as a result of the duty impositions on U.S. exports.

In the lumber segment, we expect a sequential improvement in lumber shipments as weather related transportation delays are largely alleviated and lumber inventories return to normalized levels. We expect higher operating rates for the balance of the year due to the completion in the current quarter of the ramp up phase of the new log line at Mackenzie and improved weather conditions. We expect productivity gains to result in lower quarter-over-quarter unit conversion costs. Overall in 2017, we expect higher log costs and modest improvements in unit cash conversion costs and grade outturns.

Strategic Capital Expenditures

El Dorado Mill Capital Project

Upon completion of the Credit Facility in January 2017, we commenced the construction phase of our capital project to modernize and re-start our El Dorado Mill (the "Project"). Upon completion, the Project is planned to incorporate significant capital upgrades to the log processing yard and sawmill and planer and add two continuous dry kilns. The Project has been designed to maximize both log recovery and lumber grade yield and quality. Upon completion, the El Dorado Mill is expected to have approximately

180 million board feet of annual lumber capacity on a two-shift basis. We expect to complete the Project by or about the end of the third quarter or early in the fourth quarter of this year.

We currently estimate that the Project will require capital expenditures of approximately US$50 million, consisting of approximately US$27 million for equipment and materials, US$16 million in subcontract costs and US$7 million for indirect costs, including engineering, construction management, freight and project contingency. At March 31, 2017, approximately 57% of budgeted expenditures had been committed. The Project is currently within management's budgeted amounts and progressing as scheduled.

We believe our planned expansion into the U.S. South will provide an important source of revenue diversification and reduce cash flow volatility in our lumber segment, particularly in light of punitive trade actions on Canadian softwood lumber recently initiated by the U.S.

SUBSEQUENT EVENT

Softwood Lumber Dispute

On November 25, 2016, a petition was filed by the U.S. Lumber Coalition to the U.S. Department of Commerce ("DOC") and the U.S. International Trade Commission ("ITC") requesting an investigation into alleged subsidies provided to Canadian lumber producers, an assertion the Canadian industry and Provincial and Federal Governments deny and have successfully disproven in international courts in the past.

On April 24, 2017, the DOC announced its preliminary determination and imposed a preliminary countervailing duty rate of 19.88% for "all other" Canadian lumber producers, including Conifex. The countervailing duty is to be posted by cash deposits or bonds on the exports of softwood lumber to the U.S. effective April 28, 2017 for a period of 120 days, in accordance with U.S. law.

The DOC also made a preliminary determination that critical circumstances existed, which result in countervailing duty on sales of softwood lumber applying retroactively effective 90 days prior to April 28, 2017. We have estimated that our 90-day retroactive countervailing duty obligations arising from the DOC's preliminary finding is USD $5.75 million.

The DOC is expected to announce its preliminary anti-dumping duty determination on June 23, 2017. The DOC also made a preliminary determination that critical circumstances existed, which will result in anti-dumping duties on sales of softwood lumber applying retroactively effective 90 days prior to publication of the preliminary anti-dumping duty determination in the Federal Register. The final countervailing and anti-dumping duties determinations will be aligned for DOC administrative purposes. This alignment could result in the suspension of preliminary countervailing duty cash deposit requirements after the initial four month period has expired and until an aligned final determination decision is established. Conifex continues to cooperate with the Provincial and Federal Governments of Canada who have indicated they will vigorously defend the interests of the industry.

For accounting purposes, the Company has not accrued any retroactive countervailing duty in the current quarter. Management believes that the critical circumstances finding by the DOC will not be upheld by either the DOC or the ITC in their final determinations, consistent with the result of past softwood lumber disputes. The Company expects that it will be required to pay these amounts in trust pending final determinations by the DOC and ITC and will record the retroactive duties as deposits receivable when made. Any adjustments to management's estimates will be made prospectively if assumptions or conclusions change due to new information warranting a change in the estimates.

CRITICAL ACCOUNTING ESTIMATES

There were no significant changes to the Company's critical accounting estimates during the quarter ended March 31, 2017. Conifex's critical accounting estimates are described in its management's discussion and analysis for the year ended December 31, 2016, 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 28, 2017, and other filings with the Canadian Regulatory Authorities available on SEDAR at www.sedar.com.

See "Subsequent Events" for discussion regarding the expiry of the Softwood Lumber Agreement.

OUTSTANDING SECURITIES

As at May 12, 2017, the Company had 26,337,519 issued and outstanding common shares, 100,000 options granted, 1,107,936 long-term incentive plan awards, and 1,060,000 warrants.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended March 31, 2017, 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.