CONIFEX

CONIFEX TIMBER INC.
SECOND QUARTER 2023

MANAGEMENT'S DISCUSSION AND ANALYSIS

August 8, 2023

*This 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 June 30, 2023, relative to the quarters ended March 31, 2023 and June 30, 2022. This interim MD&A should be read together with our unaudited condensed consolidated interim financial statements for the quarters ended June 30, 2023 and 2022, and our MD&A and our audited consolidated financial statements and notes thereon for the year ended December 31, 2022, which have been prepared in accordance with International Financial Reporting Standards ("**IFRS**") and filed on SEDAR+ at www.sedarplus.com.*

In this MD&A, reference is made to "EBITDA". EBITDA represents earnings before finance costs, taxes, depreciation and amortization. We disclose EBITDA as it is a measure used by analysts and by our management to evaluate our performance. As EBITDA is not a generally accepted earnings measure under IFRS and does not have a standardized meaning prescribed by IFRS, it may not be comparable to EBITDA calculated by other companies. In addition, EBITDA is not a substitute for net earnings or cash flow, as determined in accordance with IFRS, and therefore readers should consider those measures in evaluating our 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 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, including the build-out of any high-performance computing or data center operations; the growth and future prospects of our business; 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; fluctuations in stumpage rates; our ability to supply our manufacturing operations with wood fibre and our expected cost of wood fibre; our expectation for market volatility associated with, among other things, the softwood lumber dispute with the United States of America; potential negative impacts of duties or other protective measures on our products, such as antidumping duties or countervailing duties on softwood lumber; continued positive relations with Indigenous 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; our ability to receive, under our insurance policies, full reimbursement of losses suffered from the disruption of operations at our Mackenzie power plant**;** the* *outcome of the labour dispute at the Ports of Vancouver and Prince Rupert; the outcome of any actual or potential litigation; the availability and use of credit facilities or proceeds therefrom; future capital expenditures; expectations regarding our liquidity levels; and our expectations for U.S. dollar benchmark prices.*

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 and maintain required governmental and community approvals; the impact of changing government regulations and shifting political climates; that the US housing market will continue to improve; that transportation services by third party providers will continue uninterrupted; our ability to ship our products in a timely manner; that there will be no additional unforeseen disruptions affecting the operation of our Mackenzie power 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 2022 annual information form dated March 30, 2023 and our 2022 annual MD&A dated March 7, 2023 available on SEDAR+ at www.sedarplus.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.

BUSINESS OVERVIEW

We are a British Columbia forestry and independent power company operating in lumber and bioenergy. Our lumber operations are primarily involved in the manufacture, sale and distribution of dimension lumber through our sawmill located in Mackenzie, British Columbia. Our bioenergy facility is located adjacent to our Mackenzie sawmill.

We operate a two-line sawmill in Mackenzie, British Columbia (the “**Mackenzie Mill**”). We hold a forest licence in the timber supply area ("**TSA**") in and around Mackenzie with an allowable annual cut ("**AAC**") of 632,500 cubic metres, and own 50% of a joint venture which holds a forest licence with an AAC of 300,000 cubic metres in the same TSA. Our Mackenzie Mill has approximately 240 million board feet of annual lumber capacity on a two-shift basis.

We operate a 36 megawatt biomass power generation plant in Mackenzie, British Columbia (the “**Power Plant**”), located at the site of our Mackenzie Mill. Our Power Plant's output capacity is in excess of 230 gigawatt hours ("**GWh**") of electricity per year. We have an electricity purchase agreement ("**EPA**") and a related load displacement agreement ("**LDA**") with the British Columbia Hydro and Power Authority ("**BC Hydro**"). Under the EPA, BC Hydro agreed to purchase approximately 200 GWh of electrical energy annually over a 20-year term for a fixed price, and under the LDA we agreed to supply the energy requirements of our Mackenzie mill over the same 20-year term.

While our core focus is the operation of our sawmill and biomass power facility, we are continuously reviewing strategic opportunities that may increase shareholder value.

RECENT DEVELOPMENTS

Director and Officer Changes

On May 9, 2023, Mr. Andrew McLellan was appointed President and Chief Operating Officer of Conifex.

On June 15, 2023, Mr. Trevor Pruden was appointed Chief Financial Officer of Conifex to replace Ms. Winny Tang. Mr. Pruden will also replace Ms. Tang as Corporate Secretary effective August 15, 2023. Also on June 15, 2023, Ms. Laura Necochea was appointed Vice President Corporate Services of Conifex.

AR4 Final Duty Rates

Subsequent to the end of the second quarter, the US Department of Commerce released the final duty rates related to the fourth administrative review. The combined duty rate applicable to Conifex was 7.99% as compared to the recent rate of 8.59%. Softwood lumber duty rates will now accrue at 7.99% until the completion of the next administrative review, which is scheduled to be completed in 2024. We estimate we will record an export duty recovery of approximately $1.8 million in the third quarter of 2023 related to the finalization of the fourth administrative review.

Annual Allowable Cut Determination

The Chief Forester must, subject to certain exceptions, determine the AAC for each TSA in British Columbia every ten years. The AAC is the maximum amount of timber that the Chief Forester determines is reasonable to harvest from a TSA. The Chief Forester determines the AAC for each TSA after considering various factors, including forest composition, expected rate of growth and length of time to re-establish a forest after harvesting, silviculture treatments, timber utilization standards, constraints on the extraction of timber, economic and social objectives of government and forest health. Tenure holders may vary harvest levels from year to year provided that the cumulative harvest within a five-year cut control period does not exceed the cumulative AAC for the period by more than 10 percent.

On May 4, 2023, the Chief Forester's *Rationale for Allowable Annual Cut (AAC) Determination for the Mackenzie TSA* was released. Effective from the release date, the new AAC for the Mackenzie TSA will be 2.39 million cubic metres per year. This AAC will remain in effect until a new AAC determination is made, which generally must take place within ten years of this determination.

The new AAC for the Mackenzie TSA is below the current AAC and the base case harvest projection released in July 2022. However, the actual harvest within the Mackenzie TSA over the past 20 years averaged 2.5 million cubic metres per year, which is in line with the current AAC determination. Further, the abolition of a biological or salvage partition means our harvest will be directed entirely at a "green" timber profile. The Chief Forester has also set a maximum of 1.17 million cubic metres that may be harvested in the southwestern area of the Mackenzie TSA (the area that is west of Williston Reservoir and south of Omineca Provincial Park and Omineca Arm). We believe the specified partition should assist the economic sustainability of our lumber manufacturing and power plant operations.

The harvest level determination also implies sawlog surpluses are likely to persist in Mackenzie relative to current local milling capacity and sawlog demand. This fact is unique compared to other TSAs in the BC interior, where sawlog availability is insufficient to support capacity operations at converting facilities. As a result, we have the potential to grow our traditional forestry business in Mackenzie by modernizing and expanding our sawmill complex once the Ministry of Forest's apportionment and related regulatory decisions, if any, are settled.

Revenue Diversification Opportunity

In March 2023, we entered into an agreement with Greenidge Generation Holdings Inc. ("**Greenidge**"), a NASDAQ listed datacenter and power generation company. Under the agreement, we agreed to facilitate the operation and maintenance of 750 miners at our 3-megawatt high-performance computing ("**HPC**") site located on our Mackenzie property. Our services include the supply, maintenance and operation of critical infrastructure and the performance of certain datacenter services related to security, safety, information technology and ongoing operations.

On December 21, 2022, the Lieutenant-Governor in Council for the Province of British Columbia ("**LGIC**") issued an order in council (the "**OIC**") directing the British Columbia Utilities Commission to, among other things, accept BC Hydro's request to suspend its obligation to supply service to certain new cryptocurrency mining projects in British Columbia for a period of 18 months.

Two of our proposed HPC projects were impacted by the OIC. As a result, in April 2023, we filed a petition in the Supreme Court of British Columbia seeking judicial review of the OIC. We believe that the OIC exceeds the statutory powers granted to the LGIC under the *Utilities Commission Act*, is discriminatory and breaches statutory and common law restraints on the LGIC's delegated power. We are seeking an order quashing and setting aside the OIC as unauthorized or otherwise invalid.

Concurrently, we filed a notice of civil claim against BC Hydro in the Supreme Court of British Columbia seeking an order requiring BC Hydro to supply service to our HPC projects. The claim also seeks general damages. The notice of civil claim alleges that BC Hydro's failure and refusal to supply service to our HPC projects is in breach of BC Hydro's common law obligation to supply electricity and unfairly discriminates against Conifex *vis-à-vis* other commercial customers.

Revolving Credit Facility

In March 2023, we executed an amended and restated secured revolving credit facility (the "**Revolving Credit Facility**") with Wells Fargo Capital Finance Corporation Canada. The amended and restated facility replaced our existing secured revolving credit facility with the same lender. The facility is in the principal amount of $25 million, is for a term of three years and remains substantially secured by our lumber operation's inventory, equipment and accounts receivable. The facility bears interest at CDOR or SOFR plus an applicable margin. We intend to utilize the facility for working capital, capital expenditures and general corporate purposes.

Sawmill Operational Update

Our Mackenzie Mill resumed lumber production operations on July 3, 2023 following a temporary curtailment which commenced on June 5, 2023. The unscheduled downtime was necessitated by low water levels forecasted in the Williston Reservoir and overall reduced demand for lumber products amid challenging economic conditions.

Normal Course Issuer Bid

We believe that the market price of our common shares does not reflect the value of our underlying business and future prospects. Therefore, we consider an allocation of capital to repurchase some of our common shares an attractive option.

In August 2022, we announced that we were implementing a normal course issuer bid ("**NCIB**") for our common shares. Under the NCIB, we are authorized to make purchases for a period of one year of up to 2,461,754 common shares, representing 10% of our "public float" at the commencement of the bid. The NCIB commenced on September 1, 2022 and will terminate on August 31, 2023, or earlier if we complete the maximum purchases permitted under the NCIB or if we otherwise determine that it is appropriate to suspend or terminate the bid. In the second quarter of 2023, we purchased a further 36,920 of our common shares and as of the date hereof, we have purchased a total of 480,020 common shares under the NCIB.

SUMMARY

The following table summarizes our operating results.

Selected Financial Information

(unaudited, in millions of dollars, except share and exchange rate information)	Q2 2023	Q1 2023	Q2 2022
Revenue			
Lumber – Conifex produced	18.8	26.0	66.4
Lumber – wholesale	1.0	1.0	2.3
By-products and other	2.7	8.4	11.6
Bioenergy	4.8	4.5	4.8
	27.2	39.9	85.1
Operating income (loss)	(11.0)	(11.5)	17.6
EBITDA(1)	(8.7)	(6.9)	20.1
Net income (loss)	**(9.2)**	**(8.1)**	**12.3**
Basic and diluted earnings (loss) per share	**(0.23)**	**(0.20)**	**0.31**
Cash dividends paid per share	**-**	**-**	**-**
Shares outstanding – weighted average (millions)	39.8	39.8	40.2
Reconciliation of EBITDA to net income (loss)			
Net income (loss)	(9.2)	(8.1)	12.3
Add: Finance costs	1.3	1.2	1.1
Amortization	2.4	2.5	2.0
Deferred income tax expense (recovery)	(3.2)	(2.5)	4.7
EBITDA(1)	(8.7)	(6.9)	20.1

Selected Operating Information

Production – WSPF lumber (MMfbm)(2)	32.5	41.2	51.4
Shipments – WSPF lumber (MMfbm)(2)	31.1	40.6	55.5
Shipments – wholesale lumber (MMfbm)(2)	1.1	1.0	1.2
Electricity production (GWh)	43.5	34.6	54.6
Average exchange rate –$/US$(3)	0.745	0.740	0.783
Average WSPF 2x4 #2 & Btr lumber price (US$)(4)	$363	$384	$827
Average WSPF 2x4 #2 & Btr lumber price ($)(5)	$487	$519	$1,056

(1) Conifex's EBITDA calculation represents earnings before finance costs, taxes, depreciation and amortization.
(2) MMfbm represents million board feet.
(3) Bank of Canada, www.bankofcanada.ca.
(4) Random Lengths Publications Inc.
(5) Average SPF 2x4 #2 & Btr lumber prices (US$) divided by average exchange rate.

REVIEW OF SECOND QUARTER 2023 FINANCIAL RESULTS

During the second quarter of 2023, we incurred a net loss of $9.2 million or $0.23 per share compared to a net loss of $8.1 million or $0.20 per share in the previous quarter and net income of $12.3 million or $0.31 per share in the second quarter of 2022.

North American lumber market prices continued to experience weakness in the second quarter of 2023. Canadian dollar-denominated benchmark Western Spruce/Pine/Fir ("**WSPF**") prices, which averaged $487 in the second quarter of 2023, decreased by 6% or $32 from the previous quarter and by 54% or $569 from the second quarter of 2022[1]. The market price decline in the second quarter of 2023 was primarily fueled by the continued overall reduced demand for lumber. US housing starts on a seasonally adjusted annual basis averaged 1,451,000 in the second quarter of 2023, up 2% from the previous quarter and down 13% from the second quarter of 2022.

[1] Source: Random Lengths Publications Inc.

Lumber Operations

Our lumber production in the second quarter of 2023 totalled approximately 32.5 million board feet, representing operating rates of approximately 54% of annualized capacity. Lumber production in the quarter reflected 20 days of unscheduled downtime to address low reservoir levels forecasted in the Williston Reservoir and an overall reduced demand for lumber amid challenging economic conditions. In the previous quarter, 41.2 million board feet of lumber was produced, which reflected a ten-day curtailment of the Mackenzie Mill, as well as production being affected by overall depressed operating rates. Lumber production in the second quarter of 2022, which was not impacted by shift reductions, was 51.4 million board feet or approximately 86% of annualized capacity.

Shipments of Conifex-produced lumber totaled 31.1 million board feet in the second quarter of 2023, representing a decrease of 23% from the 40.6 million board feet shipped in the previous quarter and a decrease of 4% from the 55.5 million board feet of lumber shipped in the second quarter of 2022. Shipments of Conifex-produced lumber in the second quarter of 2023 decreased relative to the previous quarter as a result of the aforementioned unscheduled downtime, and decreased relative to the second quarter of 2022 which period was not impacted by shift reductions and benefitted from a build up of dressed lumber that was drawn down during the quarter.

Our wholesale lumber shipments were generally consistent in the current quarter compared to each comparative period. Our wholesale lumber program shipped 1.1 million board feet in the second quarter of 2023, 1.0 million board feet in the previous quarter and 1.2 million board feet in the second quarter of 2022.

Revenues from lumber products were $19.8 million in the second quarter of 2023 representing a decrease of 27% from the previous quarter and a decrease of 71% from the second quarter of 2022. Compared to the previous quarter, lower shipment volumes and softer mill net realizations on lower lumber market prices contributed to the lower revenue. The revenue decrease in the current quarter over the same period in the prior year was largely the result of both weaker benchmark lumber prices and decreased lumber shipments.

Cost of goods sold in the second quarter of 2023 decreased by 29% from the previous quarter and by 40% from the second quarter of 2022. The decrease in cost of goods sold from the prior quarter and the second quarter of 2022 is mainly due to lower shipment volumes in the current quarter. Unit manufacturing costs increased in comparison to each of the comparative quarters as a result of lower operating rates from the June downtime. We recorded inventory valuation reserves of -$0.7 million and $0.2 million in the current and previous quarter, respectively, compared to nil in the second quarter of 2022. Inventory valuation reserves decreased in comparison to the previous quarter due to a reduction in dressed lumber coupled with increased lumber prices.

We expensed countervailing ("**CV**") and anti-dumping ("**AD**") duty deposits of $1.0 million in the second quarter of 2023, $1.2 million in the previous quarter and $7.2 million in the second quarter of 2022. The duty deposits were based on a combined rate of 17.91% until August 8, 2022 and 8.59% thereafter. The export taxes during the second quarter of 2023 were lower than the previous quarter due to decreased lumber shipment volumes made to the US market in the current quarter, and were significantly lower than the second quarter of 2022 largely due to the decreased lumber market price and lower cash deposit rate in effect in the current quarter.

Bioenergy Operations

Our Power Plant sold 43.5 GWh of electricity under our EPA with BC Hydro in the second quarter of 2023 representing approximately 79% of targeted operating rates. Our Power Plant sold 34.6 and 54.6 GWh of electricity in the previous quarter and second quarter of 2022, respectively. Production in the second quarter of 2023 was higher than the first quarter of 2023 due to an increased number of operating days in the second quarter of 2023, and lower than the second quarter of 2022 due to annual maintenance scheduled in the second quarter of 2023.

Electricity production contributed revenues of $4.8 million in the second quarter of 2023, $4.5 million in the previous quarter and $4.8 million in the second quarter of 2022.

The Power Plant was temporarily shut down in July 2022 due to the discovery of damage to its turbine, and successfully recommissioned on January 31, 2023. We submitted an insurance claim for physical damage to our equipment and for loss of revenues from the interruption of operations as a result of the turbine damage. We expect to be fully reimbursed for capital expenditures related to the repair of the turbine, subject to deductible amounts, and for lost income for the period covered under our business interruption policy, being the period between the expiry of the waiting period and the recommencement of the Power Plant. We recognized $2.2 million as other income on our statement of net income and comprehensive income in the first quarter of 2023 and $9.6 million in 2022 to reflect the estimated settlement for lost income under our business interruption policy. Final settlements of the physical damage and business interruption claims are anticipated to be completed in the third quarter of 2023.

Selling, General and Administrative Costs

Selling, general and administrative ("**SG&A**") costs were comparable between the current quarter and each comparative period. SG&A costs were $3.3 million in the second quarter of 2023, $3.2 million in the previous quarter and $3.1 million in the second quarter of 2022.

Finance Costs and Accretion

Finance costs and accretion totaled $1.3 million in the second quarter of 2023, $1.2 million in the previous quarter and $1.1 million in the second quarter of 2022. Finance costs and accretion relate primarily to our term loan supporting our bioenergy operations (the "**Power Term Loan**").

Gain or Loss on Derivative Financial Instruments

From time to time, we may enter into lumber future contracts at times to manage our commodity lumber price exposures. Gains or losses on lumber derivative instruments are recognized as they are settled or as they are marked to market for each reporting period.

There were no outstanding futures contracts in place as at June 30, 2023.

Other Income

We did not recognize any other income in the second quarter of 2023 or in the second quarter of 2022. We recognized other income of $2.2 million in the first quarter of 2023 which primarily consisted of our business interruption claim in respect of the turbine failure at the Power Plant. See "*Review of Second Quarter 2023 Financial Results – Bioenergy Operations*" above for additional information on the Power Plant disruption.

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.

The US dollar averaged US$0.745 for each Canadian dollar during the second quarter of 2023, a level which represented a modest strengthening of the Canadian dollar over the previous quarter[2].

The foreign exchange translation impacts arising from the variability in exchange rates at each measurement period on cash and working capital balances resulted in a foreign exchange translation loss

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

of $0.3 million in the second quarter of 2023, compared to a foreign exchange translation loss of nil in the previous quarter and a gain of $0.5 million in the second quarter of 2022.

Income Tax

We recorded income tax recovery of $3.2 million in the second quarter of 2023, and income tax recovery of $2.5 million in the previous quarter and income tax expense of $4.7 million in the second quarter of 2022.

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. As at June 30, 2023, we have recognized a deferred income tax liability of $3.2 million.

SUMMARY OF FINANCIAL POSITION

(unaudited, in millions of dollars, unless otherwise noted)	**Q2 2023**	**Q1 2023**	**Q2 2022**
Cash	4.6	5.2	40.4
Cash – restricted	8.5	6.5	7.3
Operating working capital(1)	41.0	56.1	28.6
Operating loan	(11.5)	(12.5)	-
Current portion of long-term debt	(4.8)	(4.8)	(4.6)
Net current assets	37.8	50.5	71.7
Property, plant and equipment	129.0	128.6	124.9
Other long-term assets	33.6	34.1	27.7
	200.4	213.1	224.3
Non-interesting bearing long-term liabilities	20.3	23.6	25.5
Long-term debt – Power Term Loan	48.4	48.9	52.1
Long-term debt – other(2)	1.1	1.2	0.8
Shareholders' equity	130.6	139.4	145.9
	200.4	213.1	224.3
Ratio of current assets to current liabilities	2.2	2.2	2.9
Net debt to capitalization	32%	29%	6%
Net debt to capitalization excluding Power Term Loan	9%	8%	(30%)

(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 equipment and vehicle leases expiring between 2023 and 2026.

Operating working capital decreased by $15.1 million over the first quarter of 2023 due primarily to a decrease in trade receivables and a reduction in inventories, mainly related to unscheduled downtime at the sawmill and seasonal inventory drawdowns. Operating working capital increased by $12.4 million compared to the second quarter of 2022 due to an increase in prepaids and deposits and a decrease in trade payables.

Overall debt was $65.8 million at June 30, 2023 compared to $67.4 million at March 31, 2023 and $57.5 million at June 30, 2022. The decrease in overall debt between the second and first quarters of 2023 was mainly driven by the payment of $1.0 million against our Revolving Credit Facility in the second quarter of 2023. The increase in overall debt at June 30, 2023 relative to June 30, 2022 was due to an increase in the amount drawn against our Revolving Credit Facility of $11.5 million, partially offset by payments against our Power Term Loan and monthly lease payments. Our Power Term Loan, which is largely non-recourse to our lumber operations, represents substantially all of our outstanding long-term debt. At June 30, 2023, we had $52.2 million outstanding on our Power Term Loan, while our remaining long-term debt, consisting of leases, was $2.1 million.

The ratio of current assets to current liabilities was 2.2:1 at June 30, 2023 compared to 2.2:1 at March 31, 2023 and 2.9:1 at June 30, 2022. The year-over-year change was primarily attributable to the draw against the Revolving Credit Facility.

As at June 30, 2023, $100.2 million of our consolidated property, plant and equipment was attributable to our power operations, compared to $100.9 million at March 31, 2023 and $98.0 million at June 30, 2022.

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 capitalization is calculated as the sum of net debt and equity. Net debt at June 30, 2023 increased by $5.6 million to $61.2 million from $55.6 million at March 31, 2023. The net debt to capitalization ratio was approximately 32% at June 30, 2023, 29% at March 31, 2023 and 6% at June 30, 2022.

LIQUIDITY AND CAPITAL RESOURCES

Summary of Cash Flows

(millions of dollars, unaudited)	**Q2 2023**	**Q1 2023**	**Q2 2022**
Cash generated from (used in)			
Operating activities	4.9	(5.7)	36.5
Investing activities	(1.4)	(1.1)	(2.0)
Financing activities	(4.1)	3.6	(8.9)
Increase (decrease) in cash	(0.6)	(3.2)	25.6

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 Mill 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 utilized $13.9 million of cash in the second quarter of 2023, compared to $4.7 million in the first quarter of 2023 and net cash generation of $42.2 million in the second quarter of 2022. Changes in non-cash working capital generated $13.1 million of cash in the second quarter of 2023 compared to $1.0 million in the first quarter of 2023, and generated $1.6 million in the second quarter of 2022. The increase in operating cash flows in the second quarter of 2023 compared to the first quarter of 2023 primarily reflects a drawdown of trade receivables and inventories partially offset by a decrease in trade payables. The reduction in operating cash flows in the second quarter of 2023 compared to 2022 primarily reflects the negative earnings in the period arising from the market price of lumber, offset by the drawdown in log inventories and accounts receivable.

Investing Activities

Investing activities utilized cash of $1.4 million in the second quarter of 2023, $1.1 million in the first quarter of 2023 and $2.0 million in the second quarter of 2022. Investing activities consisted of investments in property, plant and equipment. Investments in property, plant and equipment in the second quarter of 2023 primarily related to improvements at our Power Plant and reservoir assets. In the first quarter of 2023, investments in property plant and equipment included improvements at our Mackenzie Mill, and in 2022, investments in property, plant and equipment included several key improvements to our sawmilling and finishing lines designed to improve our lumber production performance.

Financing Activities

Our financing activities used net cash of $4.1 million in the second quarter of 2023, generated $3.6 million in the previous quarter and used $8.9 million in the second quarter of 2022. The net cash provided from financing activities in the current quarter and comparative quarters largely relate to proceeds drawn against the Revolving Credit Facility less our Power Term Loan and operating lease payments and finance charges. Net cash usage in the previous quarter included purchases of our common shares under the NCIB of approximately $0.04 million.

Liquidity

Our principal sources of funds are cash on hand, cash flows from operations and cash available under our Revolving Credit Facility. As at June 30, 2023, we have drawn $11.5 million against the Revolving Credit Facility compared to $12.5 million at March 31, 2023.

Our principal uses of funds consist of operating expenditures, capital expenditures, interest payments and repayment of principal on our Power Term Loan.

At June 30, 2023, we had total liquidity of $18.1 million, compared to $17.7 million at March 31, 2023 and $55.4 million at June 30, 2022. Liquidity at June 30, 2023 was comprised of unrestricted cash of $4.6 million and unused availability of $13.5 million under the Revolving Credit Facility.

The increase in our liquidity in the second quarter of 2023 compared to the previous quarter was due primarily to an amendment to our Revolving Credit Facility which increased to $25.0 million in March 2023 from $15.0 million. This was largely offset by cash flows utilized for operating activities which reflected weaker lumber prices in the quarter and by changes in non-cash working capital. The decrease in liquidity in the second quarter of 2023 compared to the second quarter of 2022 was due primarily to our net loss in the current quarter. Our material contractual obligations remain substantially unchanged from those described in our 2022 annual MD&A and consolidated financial statements for the years ended December 31, 2022 and 2021.

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$32.6 million paid by us, net of sales of the right to certain refunds, since the inception of the trade dispute remain held in trust by the US pending administrative reviews and the conclusion of all appeals of US decisions. We expect future cash flows 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 and Revolving Credit Facility by regularly preparing rolling cash flow forecasts to consider upcoming operational requirements, debt service commitments and future business development. Our Power Term Loan also contains certain restrictions on the ability of our power subsidiaries to transfer funds outside of the power entities. We did not have any material commitments for capital expenditures at June 30, 2023. 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 our 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 June 30, 2023 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 in the event of failure to remit amounts owing to BC Hydro arising from default or termination of the agreements. The standby letters of credit are secured by customary performance bonds.

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 second quarter of 2023 or in the comparative quarters.

SELECTED QUARTERLY FINANCIAL INFORMATION

Quarterly Earnings Summary

(unaudited, in millions of dollars, unless otherwise noted)	2023 Q2	2023 Q1	2022 Q4	2022 Q3	2022 Q2	2022 Q1	2021 Q4	2021 Q3
Revenue	27.2	39.9	26.7	47.7	85.1	71.8	59.9	47.6
Operating income (loss)	(11.0)	(11.5)	(8.5)	1.3	17.6	17.1	(3.0)	(0.7)
Net income (loss)	(9.2)	(8.1)	(0.2)	0.9	12.3	11.4	(2.5)	(0.9)
Net income (loss) per share – basic and diluted	(0.23)	(0.20)	-	0.02	0.31	0.28	(0.06)	(0.02)
EBITDA (1)	(8.7)	(6.9)	2.3	4.2	20.1	20.1	1.0	3.3
Shares outstanding – weighted average (in millions)	39.8	39.8	39.9	40.2	40.2	40.1	43.8	44.6
Statistics (in millions, except rate and prices)								
Production – WSPF lumber	32.5	41.2	27.9	39.5	51.4	47.1	44.0	40.1
Shipments – WSPF lumber	31.1	40.6	31.6	44.7	55.5	42.5	44.7	34.1
Shipments – wholesale lumber	1.1	1.0	1.5	3.0	1.2	4.9	6.1	6.0
Electricity production – GWh	43.5	34.6	-	1.2	54.6	53.9	54.9	53.7
Average exchange rate – US$/$(2)	0.745	0.740	0.736	0.766	0.783	0.790	0.794	0.794
Average WSPF 2x4 #2 & Btr lumber price (US$)(3)	$363	$384	$402	$568	$827	$1,288	$739	$478
Average WSPF 2x4 #2 & Btr lumber price ($)(4)	$487	$519	$546	$742	$1,056	$1,631	$931	$602
Reconciliation of EBITDA to net income (loss)								
Net income (loss)	(9.2)	(8.1)	(0.2)	0.9	12.3	11.4	(2.5)	(0.9)
Add: Finance costs	1.3	1.2	1.0	1.1	1.1	1.1	1.2	1.1
Amortization	2.4	2.5	1.4	1.8	2.0	3.2	3.1	3.4
Deferred income tax expense (recovery)	(3.2)	(2.5)	0.1	0.4	4.7	4.3	(0.8)	(0.3)
EBITDA(1)	(8.7)	(6.9)	2.3	4.2	20.1	20.1	1.0	3.3

(1) Conifex's EBITDA calculation represents earnings before finance costs, taxes, and depreciation and amortization.
(2) Bank of Canada, 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.

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 Mill during the spring months when logging operations are generally largely curtailed due to unstable road and ground 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 in 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

We expect lumber markets to continue to experience weakness through the remainder of 2023 as global market conditions continue to evolve. The effect of inflationary pressures and higher interest rates affecting consumer spending in the housing and repairs and remodeling markets have resulted in weaker lumber market prices than seen in recent years and is expected to persist through the remainder of the year. While lagging US housing completions and tempered repair and remodeling activity, as well as elevated levels of offshore lumber imports have affected market demand for lumber products, demand and market prices are expected to see a gradual increase in the second half of 2023.

At our Mackenzie Mill, we expect to see an overall increase in lumber production over 2022, with the expectation of achieving annualized operating rates of approximately 85% for the remaining six months of 2023 on improved sawmill operating rates. We anticipate an overall improvement in operating costs in 2023 as a result of decreased unit fixed costs on higher lumber production volumes and availability of sufficient logs for continuous operations at our sawmill. Additionally, early in June 2023, stumpage rates decreased in British Columbia due to the monthly market-based adjustments related to lumber prices, the benefit of which was partially offset by higher fuel costs and inflationary pressures. Given the current commodity price environment, stumpage rates are expected to continue to decrease moderately through the third quarter of 2023 before increasing early in the fourth quarter of 2023 given the recent rise in commodity prices.

We expect that the volume of lumber shipments in 2023 will match our sawmill production as the transportation challenges faced in 2022 have largely been resolved. However, the labour dispute at the Ports of Vancouver and Prince Rupert that commenced on July 1, 2023 may have a negative impact on the already constrained logistics network in British Columbia.

Our Power Plant is forecasted to generate a steady and diversified source of cash flow throughout 2023 following its restart on January 31, 2023. We expect our Power Plant to average uptime in excess of 90% for the remainder of 2023. We anticipate that our Power Plant will largely be generating electricity continuously through the balance of 2023.

We anticipate maintaining high levels of working capital through the balance of 2023 and anticipate that operating cash flow levels and available liquidity will be supported by our working capital levels as we progress through the year. We continue to prioritize funding quick payback sawmill upgrades and continue exploring the potential development of our HPC business.

CRITICAL ACCOUNTING ESTIMATES

We did not make any significant changes to our critical accounting estimates during the quarter ended June 30, 2023. Our critical accounting estimates are described in our MD&A for the year ended December 31, 2022, filed on SEDAR+ at www.sedarplus.com.

RISKS AND UNCERTAINTIES

A comprehensive discussion of risk factors impacting our business, assets and operations is included in our 2022 annual information form dated March 30, 2023 and our 2022 annual MD&A dated March 7, 2023, and other filings with the Canadian regulatory authorities available on SEDAR+ at www.sedarplus.com.

OUTSTANDING SECURITIES

As at August 7, 2023, we had 40,072,689 common shares and 2,985,375 long-term incentive plan awards outstanding.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

During the quarter ended June 30, 2023, 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, including our annual information form dated March 30, 2023, is available on SEDAR+ at www.sedarplus.com.