Condensed consolidated interim financial statements of

# Conifex Timber Inc.

September 30, 2018
(Unaudited)

# Conifex Timber Inc.

Condensed consolidated balance sheets
as at September 30, 2018 (unaudited)

| (thousands of Canadian dollars) | Notes | **As at September 30, 2018** | As at December 31, 2017 |
|---|---|---|---|
| | | **$** | $ |
| **Assets** | | | |
| *Current assets* | | | |
| Cash | | **17,648.8** | 16,860.4 |
| Cash - restricted | 8 | **8,042.6** | 9,280.8 |
| Trade and other receivables | | **52,231.3** | 38,235.4 |
| Prepaid expenses and deposits | | **25,165.3** | 11,644.9 |
| Inventories | 5 | **76,984.6** | 61,904.9 |
| **Current assets** | | **180,072.6** | 137,926.4 |
| Goodwill | 14 | **161,479.3** | 3,310.5 |
| Intangible assets | | **5,221.7** | 5,232.4 |
| Property, plant and equipment | 6 | **375,204.3** | 272,950.0 |
| Long-term investments and other | 15 | **25,774.5** | 25,398.8 |
| **Total assets** | | **747,752.4** | 444,818.1 |
| **Liabilities** | | | |
| *Current liabilities* | | | |
| Trade payables, accrued liabilities and other payables | | **41,237.0** | 34,813.2 |
| Current portion of reforestation obligations | | **5,625.8** | 5,286.6 |
| Employee liabilities | | **2,933.3** | 1,915.1 |
| Operating loan | 7 | **1,600.0** | 1,600.0 |
| Current portion of long-term debt | 8 | **16,928.7** | 5,874.9 |
| **Current liabilities** | | **68,324.8** | 49,489.8 |
| Reforestation obligations | | **8,194.2** | 7,785.2 |
| Environmental liabilities | | **1,326.8** | 1,339.1 |
| Other long-term liabilities | | **10,639.6** | 11,136.5 |
| Long-term debt | 8 | **267,040.9** | 68,137.5 |
| Revolving credit facilities | 9 | **35,897.5** | 94,180.9 |
| Deferred income tax liabilities | 11 | **8,336.4** | 3,105.5 |
| **Non-current liabilities** | | **331,435.4** | 185,684.7 |
| **Total liabilities** | | **399,760.2** | 235,174.5 |
| **Equity** | | | |
| Share capital | 10 | **295,802.7** | 174,282.0 |
| Contributed surplus | | **16,596.1** | 11,444.6 |
| Retained earnings | | **39,922.7** | 23,917.0 |
| Accumulated other comprehensive loss | | **(4,329.3)** | - |
| **Total equity** | | **347,992.2** | 209,643.6 |
| **Total liabilities and equity** | | **747,752.4** | 444,818.1 |

**Subsequent event** (note 16)

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

# Conifex Timber Inc.

Condensed consolidated statements of net income and comprehensive income (loss)
period ended September 30, 2018 (unaudited)

| (thousands of Canadian dollars) | Notes | Three months ended September 30, 2018 | 2017 | Nine months ended September 30, 2018 | 2017 |
|---|---|---|---|---|---|
| | | **$** | $ | **$** | $ |
| **Revenue** | | **182,139.6** | 120,335.2 | **513,270.4** | 337,097.6 |
| **Costs and expenses** | | | | | |
| Cost of goods sold | | **140,997.4** | 87,762.5 | **393,615.3** | 254,583.6 |
| Freight and distribution costs | | **18,481.3** | 14,894.8 | **48,996.6** | 42,936.1 |
| Softwood lumber duties | 15 | **6,369.2** | 3,442.0 | **20,863.9** | 8,015.4 |
| Selling, general and administrative | | **6,170.4** | 5,428.1 | **16,699.9** | 14,867.2 |
| | | **172,018.3** | 111,527.4 | **480,175.7** | 320,402.3 |
| **Operating income** | | **10,121.3** | 8,807.8 | **33,094.7** | 16,695.3 |
| Gain (loss) on disposal of assets | | **-** | - | **7.5** | (14.0) |
| Interest expense and accretion | | **(6,513.2)** | (1,645.9) | **(10,709.2)** | (6,014.6) |
| Gain (loss) on derivative financial instruments | | **2,018.7** | (34.7) | **(1,589.5)** | 312.6 |
| Foreign exchange gain (loss) | | **1,827.2** | (969.5) | **2,575.8** | (1,995.2) |
| Acquisition costs | | **(2,141.3)** | - | **(2,141.3)** | - |
| | | **(4,808.6)** | (2,650.1) | **(11,856.7)** | (7,711.2) |
| Income before taxes | | **5,312.7** | 6,157.7 | **21,238.0** | 8,984.1 |
| Income tax expense: | 11 | | | | |
| Current | | **1.4** | - | **1.4** | - |
| Deferred | | **1,019.3** | - | **5,230.9** | - |
| | | **1,020.7** | - | **5,232.3** | - |
| **Net income for the period** | | **4,292.0** | 6,157.7 | **16,005.7** | 8,984.1 |
| **Other comprehensive loss** | | | | | |
| Foreign exchange translation of foreign operations, net of tax | | **(5,375.7)** | - | **(4,329.3)** | - |
| **Other comprehensive loss, net of tax** | | **(5,375.7)** | - | **(4,329.3)** | - |
| **Total comprehensive income (loss) for the period** | | **(1,083.7)** | 6,157.7 | **11,676.4** | 8,984.1 |
| **Net income per share, basic and diluted** (in dollars) | | **0.09** | 0.23 | **0.49** | 0.36 |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

# Conifex Timber Inc.

Condensed consolidated statements of changes in equity
period ended September 30, 2018 (unaudited)

| (thousands of Canadian dollars) | Share capital | Conversion option on convertible notes | Contributed surplus | Retained earnings | Accumulated other comprehensive loss | Total equity |
|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | $ |
| Balance at December 31, 2016 | 158,601.8 | 326.4 | 11,634.7 | 6,945.6 | - | 177,508.5 |
| Net income for the nine months ended September 30, 2017 | - | - | - | 8,984.1 | - | 8,984.1 |
| Cash settlement of subordinated convertible notes | - | (326.4) | 326.4 | - | - | - |
| Public offering and private placement of common shares, net of issue costs | 14,201.4 | - | - | - | - | 14,201.4 |
| Issue of common shares upon vesting of share-based payment | 1,456.3 | - | (1,415.4) | - | - | 40.9 |
| Recognition of share-based payments | - | - | 631.5 | - | - | 631.5 |
| Balance at September 30, 2017 | 174,259.5 | - | 11,177.2 | 15,929.7 | - | 201,366.4 |
| Net income for the period from October 1, 2017 to December 31, 2017 | - | - | - | 7,987.3 | - | 7,987.3 |
| Issue of common shares upon vesting of share-based payment | 22.5 | - | (22.5) | - | - | - |
| Recognition of share-based payments | - | - | 289.9 | - | - | 289.9 |
| Balance at December 31, 2017 | 174,282.0 | - | 11,444.6 | 23,917.0 | - | 209,643.6 |
| **Net income for the nine months ended September 30, 2018** | **-** | **-** | **-** | **16,005.7** | **-** | **16,005.7** |
| **Public offering of common shares, net of issue costs** | **60,668.7** | **-** | **-** | **-** | **-** | **60,668.7** |
| **Issue of common shares on acquisition of Glenwood and Cross City Mills** | **60,276.4** | **-** | **-** | **-** | **-** | **60,276.4** |
| **Issue of warrants on acquisition of Glenwood and Cross City Mills** | **-** | **-** | **4,969.3** | **-** | **-** | **4,969.3** |
| **Issue of common shares upon vesting of share-based payment** | **575.6** | **-** | **(548.4)** | **-** | **-** | **27.2** |
| **Recognition of share-based payments** | **-** | **-** | **730.6** | **-** | **-** | **730.6** |
| **Foreign exchange translation of foreign operations, net of tax** | **-** | **-** | **-** | **-** | **(4,329.3)** | **(4,329.3)** |
| **Balance at September 30, 2018** | **295,802.7** | **-** | **16,596.1** | **39,922.7** | **(4,329.3)** | **347,992.2** |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

# Conifex Timber Inc.

Condensed consolidated statements of cash flows
as at September 30, 2018 (unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|---|---|---|---|
| (thousands of Canadian dollars) | **2018** | 2017 | **2018** | 2017 |
| | **$** | $ | **$** | $ |
| **Cash flows from operating activities** | | | | |
| Net income | **4,292.0** | 6,157.7 | **16,005.7** | 8,984.1 |
| Items not affecting cash: | | | | |
| Amortization and depreciation | **7,013.1** | 4,279.5 | **16,986.3** | 13,482.1 |
| Change in mark-to-market value of lumber price derivatives | **(1,216.5)** | 166.9 | **(1,475.9)** | 191.0 |
| Change in reforestation obligations | **(288.2)** | (359.4) | **748.2** | 455.6 |
| Interest expense and accretion | **6,513.2** | 1,645.9 | **10,709.2** | 6,014.6 |
| Income tax expense | **1,020.7** | - | **5,232.3** | - |
| Share-based compensation | **227.1** | 241.6 | **757.8** | 672.4 |
| LDA accretion | **(156.8)** | (156.9) | **(470.5)** | (470.3) |
| Loss (gain) on disposal of assets | **-** | - | **(7.5)** | 14.0 |
| Foreign exchange gain on long-term debt | **(2,508.0)** | - | **(2,508.0)** | - |
| | **14,896.6** | 11,975.3 | **45,977.6** | 29,343.5 |
| Change in: | | | | |
| Trade and other receivables | **659.7** | (9,871.0) | **(1,752.3)** | (9,082.3) |
| Prepaid expenses and deposits | **1,823.5** | 2,576.3 | **(1,998.2)** | 729.1 |
| Inventories | **(9,925.1)** | (5,977.5) | **(4,982.3)** | (852.9) |
| Accounts payable, accrued liabilities and other payables | **(4,131.0)** | 7,814.7 | **2,896.4** | 7,536.5 |
| Environmental liabilities | **(10.8)** | (49.8) | **(12.2)** | (78.7) |
| Employee liabilities | **(429.5)** | 984.3 | **879.9** | 1,224.0 |
| **Net cash provided from (used in) operating activities** | **2,883.4** | 7,452.3 | **41,008.9** | 28,819.2 |
| **Cash flows from investing activities** | | | | |
| Additions to property, plant and equipment | **(5,304.4)** | (22,029.8) | **(23,140.9)** | (63,336.7) |
| Acquisition of Glenwood and Cross City Mills (note 14) | **(221,711.0)** | - | **(221,711.0)** | - |
| Proceeds on disposal of assets, net | **-** | - | **55.1** | 183.3 |
| **Net cash used in investing activities** | **(227,015.4)** | (22,029.8) | **(244,796.8)** | (63,153.4) |
| **Cash flows from financing activities** | | | | |
| Proceeds of senior secured revolving credit facility | **43,182.9** | - | **43,182.9** | - |
| Proceeds of public offering | **60,670.2** | 8.9 | **60,668.7** | 14,201.4 |
| Proceeds of term loan facility | **216,100.5** | - | **216,100.5** | - |
| Proceeds (repayment) of capital leases | **204.1** | 4,589.4 | **(424.3)** | 5,129.5 |
| Repayment of mortgage | **-** | - | **-** | (10,440.8) |
| Repayment of senior secured notes | **-** | - | **-** | (20,300.0) |
| Repayment of operating loan | **-** | - | **-** | (26,598.7) |
| Repayment of term loan | **(922.3)** | (597.2) | **(3,696.7)** | (3,421.7) |
| Proceeds (repayment) of revolving credit facility (note 9(b)) | **(93,838.6)** | 4,027.5 | **(97,487.1)** | 87,108.4 |
| Financing fees | **(4,240.4)** | 17.2 | **(6,358.9)** | (1,760.5) |
| Interest paid | **(4,307.4)** | (1,550.0) | **(8,573.7)** | (5,510.5) |
| **Net cash provided from financing activities** | **216,849.0** | 6,495.8 | **203,411.4** | 38,407.1 |
| **Net increase (decrease) in cash** | **(7,283.0)** | (8,081.7) | **(376.5)** | 4,072.9 |
| **Foreign exchange effect on cash** | **(78.4)** | - | **(73.3)** | - |
| **Cash, beginning of period** | **33,052.8** | 35,114.2 | **26,141.2** | 22,959.6 |
| **Cash, end of period** | **25,691.4** | 27,032.5 | **25,691.4** | 27,032.5 |

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

In these notes, "Conifex" or the "Company" means Conifex Timber Inc. and its subsidiaries.

## 1. NATURE OF OPERATIONS

The primary business of Conifex in its lumber segment includes timber harvesting, reforestation, forest management, processing logs into lumber and wood chips, and value added lumber finishing. Conifex's lumber products are sold in the United States, Chinese, Canadian and Japanese markets. The primary activity in its bioenergy segment is the production of electricity for external sale under an Electricity Purchase Agreement and internal supply under a Load Displacement Agreement at the power generation plant at Mackenzie, British Columbia ("BC"), Canada.

Conifex is a publicly traded company listed on the Toronto Stock Exchange under the symbol CFF. The Company is incorporated under the *Canada Business Corporations Act* and is headquartered in Vancouver, BC, Canada.

The address of its registered office is 1000 Cathedral Place, 925 West Georgia Street, Vancouver, BC V6C 3L2.

## 2. BASIS OF PREPARATION

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* ("IAS 34"), and do not include all of the information required for full annual financial statements. The condensed consolidated interim financial statements should be read in conjunction with the annual financial statements for the year ended December 31, 2017, which have been prepared in accordance with International Financial Reporting Standards ("IFRS").

Certain comparative amounts for the prior year have been reclassified to conform to the current period's presentation.

## 3. SIGNIFICANT ACCOUNTING POLICIES

These condensed consolidated interim financial statements have been prepared using the significant accounting policies and methods of computation consistent with those applied in the Company's December 31, 2017 annual consolidated financial statements.

### (a) Foreign currency translation

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency.

Foreign currency denominated monetary assets and liabilities of the Company are translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Gains or losses on translation of these items are included in earnings.

Foreign operations with a functional currency that differs from the Company's presentation currency have their assets and liabilities translated using the rate of exchange prevailing at the reporting date. Revenues and expenses are measured at average rates during the period. Foreign exchange differences are recognized in other comprehensive income.

### (b) Changes in accounting standards

Effective January 1, 2018, the Company has adopted IFRS 15, *Revenue from Contracts with Customers*, using the full retrospective method. The new standard for revenue replaces IAS 18, *Revenue*, IAS 11, *Construction Contracts*, and the related interpretations. The standard provides a new framework to determine the timing of revenue recognition and the measurement of revenue. The adoption of this standard had no significant impact on the Company's condensed consolidated interim financial statements.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

The Company has adopted IFRS 9, *Financial Instruments* effective January 1, 2018. IFRS 9 supersedes IAS 39, *Financial Instruments: Recognition and Measurement*. The new standard includes amended guidance for the classification and measurement of financial assets. It also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management and contains a new impairment model which could result in earlier recognition of losses. The adoption of IFRS 9 had no significant impact on the Company's condensed consolidated interim financial statements.

**(c) Accounting standard issued and not yet adopted**

In January 2016, the International Accounting Standards Board issued IFRS 16, *Leases*, which replaces the existing lease accounting guidance. IFRS 16 requires all leases to be reported on the balance sheet unless certain criteria for exclusion are met. IFRS 16 is effective for the year beginning on or after January 1, 2019 with early adoption permitted if IFRS 15 is also adopted at the same time.

The Company will be applying the modified retrospective approach upon adoption of IFRS 16 on January 1, 2019. Under this approach, the right-of-use asset will be initially measured at an amount equal to the lease liability discounted at the Company's incremental borrowing rate. The Company continues to assess the quantitative impact of adoption of this new standard on the Company's consolidated financial statements. Based on the lease information available to date, the adoption of IFRS 16 will not have a significant impact on the Company's consolidated financial statements.

## 4. SEASONALITY OF OPERATIONS

The Company's fibre inventories exhibit seasonal swings as the Company increases log inventories during the fall and winter months to ensure adequate supply of fibre to its Canadian mills during the spring months when logging operations are largely curtailed due to road conditions.

The operating results of the bioenergy segment will experience variability as a result of the application of a "time of delivery factor" to electricity pricing which adds a seasonal effect to quarterly revenues. The lowest revenues are expected to be generated in the spring months and the highest in the fall and winter months of each year.

## 5. INVENTORIES

| | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| | **$** | $ |
| Logs | **18,598.6** | 22,196.2 |
| Lumber | **45,638.1** | 32,795.3 |
| Supplies | **12,153.0** | 6,492.1 |
| By-products | **594.9** | 421.3 |
| | **76,984.6** | 61,904.9 |

The above inventory balances are stated after inventory write-downs from cost to net realizable value. Inventory has been written down at September 30, 2018 by $2.63 million (December 31, 2017 – $0.85 million). Write-downs are included in cost of goods sold when incurred.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

## 6. PROPERTY, PLANT AND EQUIPMENT

| | Land | Buildings / equipment | Capital work in progress | Power assets | Power capital work in progress | Total |
|---|---|---|---|---|---|---|
| | $ | $ | $ | $ | $ | **$** |
| *Cost* | | | | | | |
| At December 31, 2016 | 5,464.0 | 133,400.3 | 15,030.1 | 127,926.2 | - | **281,820.6** |
| Net additions | - | 11,696.2 | 65,537.0 | 725.9 | - | **77,959.1** |
| Disposals | - | (222.2) | - | - | - | **(222.2)** |
| At December 31, 2017 | 5,464.0 | 144,874.3 | 80,567.1 | 128,652.1 | - | **359,557.5** |
| Net additions | - | 88,709.1 | (72,883.5) | 1,878.2 | 284.0 | **17,987.8** |
| Acquisition of Glenwood and Cross City Mills (note 14) | 1,674.4 | 101,545.9 | - | - | - | **103,220.3** |
| Disposals | - | (151.1) | - | - | - | **(151.1)** |
| Effect of foreign exchange revaluation | (69.1) | (1,128.3) | (910.5) | - | - | **(2,107.9)** |
| **At September 30, 2018** | **7,069.3** | **333,849.9** | **6,773.1** | **130,530.3** | **284.0** | **478,506.6** |
| *Accumulated depreciation* | | | | | | |
| At December 31, 2016 | - | (58,650.3) | - | (9,831.3) | - | **(68,481.6)** |
| Depreciation charge for the year | - | (13,255.5) | - | (4,896.1) | - | **(18,151.6)** |
| Disposals | - | 25.7 | - | - | - | **25.7** |
| At December 31, 2017 | - | (71,880.1) | - | (14,727.4) | - | **(86,607.5)** |
| Depreciation charge for the year | - | (13,559.9) | - | (3,263.2) | - | **(16,823.1)** |
| Disposals | - | 103.5 | - | - | - | **103.5** |
| Effect of foreign exchange revaluation | | 24.8 | **-** | **-** | **-** | **24.8** |
| **At September 30, 2018** | **-** | **(85,311.7)** | **-** | **(17,990.6)** | **-** | **(103,302.3)** |
| *Carrying amount* | | | | | | |
| At December 31, 2017 | 5,464.0 | 72,994.2 | 80,567.1 | 113,924.7 | - | **272,950.0** |
| **At September 30, 2018** | **7,069.3** | **248,538.2** | **6,773.1** | **112,539.7** | **284.0** | **375,204.3** |

## 7. OPERATING LOAN

Conifex Power Limited Partnership ("CP Partnership"), a wholly-owned subsidiary of the Company, has a $1.75 million revolving operating facility in connection with the project financing secured in November 2013 (note 8(b)).

As of June 30, 2018, CP Partnership has drawn $1.60 million of the revolving operating facility (December 31, 2017 – $1.60 million).

Subsequent to the end of the quarter, the outstanding revolving operating facility balance was fully repaid and the revolving operating facility was extinguished (note 16).

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

## 8. BORROWINGS

| | **September 30, 2018** | December 31, 2017 |
|---|---|---|
| | **$** | $ |
| **Non-current** | | |
| Capital leases (a) | **5,310.7** | 5,635.2 |
| Term loan (b) | **58,817.3** | 62,502.3 |
| Senior secured term loan (c) | **202,912.9** | - |
| | **267,040.9** | 68,137.5 |
| **Current** | | |
| Current portion of capital leases (a) | **1,957.7** | 1,571.9 |
| Current portion of term loan (b) | **4,291.4** | 4,303.0 |
| Current portion of senior secured term loan (c) | **10,679.6** | - |
| | **16,928.7** | 5,874.9 |
| Total borrowings | **283,969.6** | 74,012.4 |

### (a) Capital leases

Capital leases are for mobile and other equipment. The capital leases expire between 2018 and 2022. The principal balance outstanding at September 30, 2018 was $7.27 million (December 31, 2017 – $7.21 million).

### (b) Term loan

CP Partnership secured project financing (the "Project Financing") with a syndicate of institutional lenders led by a Canadian chartered bank in November 2013. The Project Financing was for an aggregate of up to $102.7 million and included a development and construction loan facility of up to $82 million (the "Construction Facility"). On July 30, 2015, CP Partnership converted the Construction Facility into an amortized term loan (the "Term Loan") that matures on December 1, 2019. The balance of the Project Financing is in the form of an $18.95 million letter of credit facility and a $1.75 million revolving operating facility. The letter of credit facility is utilized primarily to secure certain obligations of CP Partnership under its Load Displacement Agreement ("LDA") and a debt service reserve fund.

The Project Financing comprises floating rate and fixed rate tranches. Interest rates on the floating rate tranche borrowings are based on either banker's acceptances or the Canadian chartered bank prime rate, at CP Partnership's option, plus an applicable margin. The fixed rate tranche bears an interest rate largely consistent with the floating rate tranche. The Company has entered into an interest rate swap on the floating rate tranche.

The Project Financing is primarily secured by a first priority security interest on existing and after acquired assets of CP Partnership.

As at September 30, 2018, CP Partnership has issued letters of credit totaling $12.74 million (December 31, 2017 – $12.74 million) under the letter of credit facility provided under the Project Financing.

For the quarter ended September 30, 2018, CP Partnership recorded interest and financing expense of $1.17 million (year ended December 31, 2017 – $4.68 million). CP Partnership repaid $0.82 million of the floating rate tranche and $0.10 million of the fixed rate tranche during the quarter (year ended December 31, 2017 – $4.53 million and $1.28 million respectively).

As at September 30, 2018, CP Partnership held $8.04 million of cash in restricted accounts (December 31, 2017 – $9.28 million). Funds from restricted accounts are distributed in accordance with the terms of the Project Financing.

Subsequent to the end of the quarter, CP Partnership entered into a new $70 million term loan. The new term loan was used to fully repay the balance owing on the Term Loan (note 16).

### (c) Senior secured term loan

On July 9, 2018, the Company entered into a five-year US$165 million senior secured term loan facility (the "Senior Term Loan") with a syndicate of institutional lenders. The Senior Term Loan was primarily used to fund the acquisition of the Glenwood and Cross City Sawmill Assets. Interest is payable at floating rates based on US commercial lending rates or LIBOR, at the Company's option, plus an applicable margin.

The Senior Term Loan is primarily secured by a first priority security interest on substantially all existing and after acquired assets of the lumber segment. The Company is subject to customary covenants, including a fixed charge coverage ratio and a maximum total leverage ratio.

For the quarter ended September 30, 2018, the Company recorded interest and financing expense of $3.73 million (year ended December 31, 2017 – nil).

## 9. REVOLVING CREDIT FACILITIES

### (a) Senior secured revolving asset backed credit facility

The Company entered into a five-year US$60 million senior secured revolving asset backed credit facility (the "Facility") with a leading US commercial bank and a syndicate of other institutional lenders in July 2018. Under the terms of the Facility, amounts drawn and to be repaid are determined by a borrowing base calculation that fluctuates with eligible accounts receivable and inventory balances, net of specific reserves. Borrowings can be in Canadian or US dollars. Interest rates on borrowings against the Facility are based on either the Canadian Dollar Offered Rate ("CDOR") or the London Interbank Offered Rate ("LIBOR") plus an applicable margin.

The Facility is primarily secured by a first priority security interest on substantially all existing and after acquired assets of the lumber segment. The Company is subject to customary covenants, including a fixed charge coverage ratio and a maximum total leverage ratio.

The Company primarily uses the Facility to finance working capital in its lumber segment and a portion of the Facility was utilized to pay and retire the Revolving Facility (note 9(b)).

As at September 30, 2018, the Company has drawn $41.58 million of the Facility (December 31, 2017 – nil) and deferred financing costs netted against the Facility was $5.68 million (December 31, 2017 – nil).

### (b) $130 Million revolving credit facility

In January 2017, the Company entered into a five-year $130 million secured revolving asset based credit facility (the "Revolving Facility") with a syndicate of institutional lenders. Under the terms of the Revolving Facility, amounts drawn and to be repaid were determined by a borrowing base calculation that fluctuated with eligible accounts receivable and inventory balances, plus appraised values of certain forestry licences, net of specific reserves. Borrowings could be in Canadian or US dollars. Interest rates on borrowings against the Revolving Facility were based on either CDOR or LIBOR plus an applicable margin.

As at September 30, 2018, the Company has repaid in full and extinguished the Revolving Facility (balance at December 31, 2017 – $94.18 million, net of financing costs). The remaining deferred financing costs associated with the Revolving Facility of $1.50 million has been written off to interest expense and accretion in the quarter.

## 10. SHARE CAPITAL

Common share activity of the Company is as follows:

| | Number of common shares (in thousands) | Amount |
|---|---|---|
| | | $ |
| Balance at December 31, 2016 | 21,203 | 158,601.8 |
| Public offering and private placement of common shares, net of issue costs | 5,050 | 14,201.4 |
| Shares vested under share-based compensation plan during the nine months ended September 30, 2017 | 181 | 1,456.3 |
| Balance at September 30, 2017 | 26,434 | 174,259.5 |
| Shares vested under share-based compensation plan during the period from October 1, 2017 to December 31 2017 | 4 | 22.5 |
| Balance at December 31, 2017 | 26,438 | 174,282.0 |
| **Public offering of common shares, net of issue costs** | **10,806** | **60,668.7** |
| **Issue of common shares on acquisition of Glenwood and Cross City Mills** (note 14) | **9,273** | **60,276.4** |
| **Shares vested under share-based compensation plan during the nine months ended September 30, 2018** | **83** | **575.6** |
| **Balance at September 30, 2018** | **46,600** | **295,802.7** |

## 11. INCOME TAX

The components of income tax expense for operations are as follows:

| | **Three months ended Sept 30,** | | **Nine months ended Sept 30,** | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| | **$** | $ | **$** | $ |
| Current | **1.4** | - | **1.4** | - |
| Deferred | **1,019.3** | - | **5,230.9** | - |
| | **1,020.7** | - | **5,232.3** | - |

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

The reconciliation of income taxes calculated at the statutory rate to the actual income tax provision is as follows:

| | Three months ended Sept 30, | | Nine months ended Sept 30, | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| | **$** | $ | **$** | $ |
| Income before taxes | **5,312.7** | 6,157.7 | **21,238.0** | 8,984.1 |
| Income tax expense at corporation rate of 27.0% (2016 – 26.0%) | **1,434.5** | 1,601.1 | **5,734.3** | 2,335.9 |
| Non-deductible (non-taxable) items for tax purposes | **(408.2)** | 93.5 | **(421.2)** | 280.4 |
| Effect on deferred balances due to tax rate changes | **-** | - | **-** | (33.1) |
| Change in deferred tax assets not recognized | **-** | (1,703.8) | **(52.9)** | (2,610.7) |
| Rate differentials between jurisdictions | **4.4** | - | **-** | - |
| Other | **(10.0)** | 9.2 | **(27.9)** | 27.5 |
| Total income tax expense | **1,020.7** | - | **5,232.3** | - |

Beginning December 31, 2017, deferred income tax assets have been recognized to the extent of the related tax benefit based on management's best estimate of future circumstances and events. Previously, no deferred tax assets had been recognized due to the uncertainty as to realization.

## 12. SEGMENT AND GEOGRAPHICAL INFORMATION

The Company is organized into business units based on its products and services and has two reportable segments as follows:

- Lumber – The main activities of the lumber segment include timber harvesting, reforestation, forest management, processing logs into lumber and wood chips, and value added lumber finishing. The Company markets and distributes its lumber products through its wholly-owned subsidiaries, Conifex Fibre Marketing Inc. ("CFMI"), Lignum Forest Products LLP ("Lignum"), and Navcor Transportation Services Inc. ("Navcor"). CFMI, Lignum, and Navcor generate additional revenue from third party transactions.

- Bioenergy – The primary activities of the bioenergy segment are the generation of electrical power and the development of other opportunities in bioenergy and bioproducts which are complementary to the Company's harvesting and manufacturing operations.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

Summary by segment:

| | Lumber | Bioenergy | Corporate & other | Consolidated |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| **Three months ended September 30, 2018** | | | | |
| **Sales to external customers** | **175,980.8** | **6,158.8** | **-** | **182,139.6** |
| **Operating income (loss)** | **9,331.3** | **2,816.3** | **(2,026.3)** | **10,121.3** |
| **Interest expense and accretion** | **-** | **(1,174.9)** | **(5,338.3)** | **(6,513.2)** |
| **Gain on derivative financial instruments** | **2,018.7** | **-** | **-** | **2,018.7** |
| **Foreign exchange gain (loss)** | **-** | **(2.6)** | **1,829.8** | **1,827.2** |
| **Acquisition costs** | **-** | **-** | **(2,141.3)** | **(2,141.3)** |
| **Income tax expense** | **-** | **-** | **(1,020.7)** | **(1,020.7)** |
| **Net income (loss)** | **11,350.0** | **1,638.8** | **(8,696.8)** | **4,292.0** |
| **Amortization and depreciation** | **6,316.6** | **663.3** | **33.2** | **7,013.1** |
| **Acquisition of Glenwood and Cross City Mills** (note 14) | **103,220.3** | **-** | **-** | **103,220.3** |
| **Capital expenditures** | **3,142.2** | **1,159.4** | **128.5** | **4,430.1** |
| **Identifiable assets** | **407,570.6** | **127,442.2** | **212,739.6** | **747,752.4** |
| Three months ended September 30, 2017 | | | | |
| Sales to external customers | 114,224.0 | 6,111.2 | - | 120,335.2 |
| Operating income (loss) | 8,503.8 | 2,550.4 | (2,246.4) | 8,807.8 |
| Interest expense and accretion | - | (1,168.9) | (477.0) | (1,645.9) |
| Other expense | (34.7) | - | - | (34.7) |
| Foreign exchange loss | - | (0.1) | (969.4) | (969.5) |
| Net income (loss) | 8,469.1 | 1,381.4 | (3,692.8) | 6,157.7 |
| Amortization and depreciation | 3,519.0 | 727.2 | 33.3 | 4,279.5 |
| Capital expenditures | 21,902.5 | - | 127.2 | 22,029.7 |
| Identifiable assets | 271,375.2 | 132,052.5 | 25,710.2 | 429,137.9 |

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

| | Lumber | Bioenergy | Corporate & other | Consolidated |
|---|---|---|---|---|
| | **$** | **$** | **$** | **$** |
| **Nine months ended September 30, 2018** | | | | |
| **Sales to external customers** | **494,496.1** | **18,774.3** | **-** | **513,270.4** |
| **Operating income (loss)** | **32,190.0** | **6,191.8** | **(5,287.1)** | **33,094.7** |
| **Gain on disposal of assets** | **7.5** | **-** | **-** | **7.5** |
| **Interest expense and accretion** | **-** | **(3,326.7)** | **(7,382.5)** | **(10,709.2)** |
| **Loss on derivative financial instruments** | **(1,589.5)** | **-** | **-** | **(1,589.5)** |
| **Foreign exchange gain (loss)** | **-** | **(6.6)** | **2,582.4** | **2,575.8** |
| **Acquisition costs** | **-** | **-** | **(2,141.3)** | **(2,141.3)** |
| **Income tax expense** | **-** | **-** | **(5,232.3)** | **(5,232.3)** |
| **Net income (loss)** | **30,608.0** | **2,858.5** | **(17,460.8)** | **16,005.7** |
| **Amortization and depreciation** | **13,594.8** | **3,275.6** | **115.9** | **16,986.3** |
| **Acquisition of Glenwood and Cross City Mills** (note 14) | **103,220.3** | **-** | **-** | **103,220.3** |
| **Capital expenditures** | **15,538.3** | **2,233.1** | **216.4** | **17,987.8** |
| **Identifiable assets** | **407,570.6** | **127,442.2** | **212,739.6** | **747,752.4** |
| Nine months ended September 30, 2017 | | | | |
| Sales to external customers | 319,403.2 | 17,694.4 | - | 337,097.6 |
| Operating income (loss) | 17,454.2 | 4,675.5 | (5,434.4) | 16,695.3 |
| Loss on disposal of assets | (14.0) | - | - | (14.0) |
| Interest expense and accretion | - | (3,537.0) | (2,477.6) | (6,014.6) |
| Other income | 312.6 | - | - | 312.6 |
| Foreign exchange loss | - | (4.0) | (1,991.2) | (1,995.2) |
| Net income (loss) | 17,752.8 | 1,134.5 | (9,903.2) | 8,984.1 |
| Amortization and depreciation | 10,093.6 | 3,298.6 | 89.9 | 13,482.1 |
| Capital expenditures | 62,770.5 | 73.0 | 317.9 | 63,161.4 |
| Identifiable assets | 271,375.2 | 132,052.5 | 25,710.2 | 429,137.9 |

Revenues by geographic area were as follows:

| | **Three months ended Sept 30,** | | **Nine months ended Sept 30,** | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| | **$** | $ | **$** | $ |
| United States | **124,115.3** | 69,159.5 | **327,243.8** | 195,447.0 |
| Canada | **27,523.4** | 27,728.3 | **104,982.4** | 73,995.1 |
| Japan | **16,261.0** | 10,841.6 | **41,240.2** | 26,743.7 |
| China | **9,527.8** | 9,518.2 | **28,653.3** | 30,627.0 |
| Other | **4,712.1** | 3,087.6 | **11,150.7** | 10,284.8 |
| | **182,139.6** | 120,335.2 | **513,270.4** | 337,097.6 |

The Company’s harvesting, manufacturing and power generation operations are located in the interior of British Columbia, Canada and in Arkansas and Florida, United States.

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

## 13. FINANCIAL INSTRUMENTS

The Company's financial assets, with the exception of certain derivative instruments, and financial liabilities are measured at amortized cost subsequent to initial recognition. Cash and cash equivalents and derivative instruments are measured at fair value through profit and loss.

Financial assets and liabilities that are measured subsequent to initial recognition at fair value are classified within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

The following table summarizes the Company's financial instruments measured at fair value at September 30, 2018 and December 31, 2017, and shows the level within the fair value hierarchy in which they have been classified:

| | Fair value hierarchy level | **September 30, 2018** | December 31, 2017 |
|---|---|---|---|
| | | **$** | $ |
| **Financial assets** | | | |
| Derivative financial instruments | Level 2 | **1,878.1** | 1,665.9 |
| | | **1,878.1** | 1,665.9 |

## 14. ACQUISITION OF GLENWOOD AND CROSS CITY MILLS

On July 9, 2018, the Company completed the acquisition of all the outstanding membership interests of Suwannee Lumber Holding Company LLC, Suwannee Timber Management LLC and Caddo River Forest Products LLC (collectively, the "BW Group") pursuant to a Securities Purchase Agreement (the "SPA") with BW SLC Holdings LLC and the minority shareholders of Caddo River Forest Products LLC (together, the "Vendors"). The total purchase price under the transaction was (i) cash consideration of US$153.16 million plus US$16.93 million, representing the net working capital of the BW Group at closing, (ii) $60.28 million through the issuance of 9,273,291 common shares of the Company (the "Shares") to the Vendors at a price of $6.50 per Share, and (iii) 3.5 million warrants to purchase Shares for a period of five years (subject to extension in certain circumstances for a one-year period) at an exercise price of $8.78 per Share.

The cash portion of the purchase price was paid by the Company using the net proceeds from its recently completed $64.8 million offering of subscription receipts (the "Subscription Receipts") and borrowings under the Company's new Senior Term Loan (note 8(c)). A total of 10,806,332 Shares were issued to the holders of the Subscription Receipts.

The BW Group operations include a sawmill in Cross City, Florida (the "Cross City Mill") and a sawmill in Glenwood, Arkansas (the "Glenwood Mill"), which both primarily produce Southern Yellow Pine softwood lumber and specialty products. The Cross City Mill and Glenwood Mill each have an annual dimension lumber capacity of 185 million board feel on a two-shift basis. Both the Cross City Mill and Glenwood River Mill have had significant modernization capital projects in recent years.

The Acquisition has been accounted for as a business combination using the acquisition method, with the Company being the acquirer and BW Group being the acquiree, and where the assets and liabilities assumed are recorded at their fair values at the Acquisition date. Balances that required significant fair value adjustments for the purchase price accounting included inventory, property, plant and equipment and goodwill. The Company has allocated the purchase price based on preliminary estimated fair values of the assets acquired and the liabilities assumed as follows:

(Tabular amounts expressed in thousands of Canadian dollars except per share amounts)

| | Preliminary Allocation (US dollars) | **Preliminary Allocation** |
|---|---|---|
| | $ | **$** |
| Net assets acquired | 219,904.2 | **288,008.5** |
| Less: cash acquired | (803.1) | **(1,051.8)** |
| Net non-cash assets acquired | 219,101.1 | **286,956.7** |
| Allocation of net non-cash assets: | | |
| Current assets | 25,129.4 | **32,912.0** |
| Current liabilities | (6,490.1) | **(8,500.1)** |
| Property, plant and equipment | 77,700.2 | **101,764.0** |
| Other assets | 826.0 | **1,081.8** |
| Capital lease obligations | (249.6) | **(327.0)** |
| Goodwill | 122,185.2 | **160,026.0** |
| | 219,101.1 | **286,956.7** |

Factors contributing to goodwill include the workforce at each of the Glenwood and Cross City Mills, assets that are geographically complementary to our existing facility and offer close access to large markets, the favourable timber basket and multiple outlets for residuals. This transaction strengthens our core lumber business in the US and gives us increased scale and geographical diversification.

The following table summarizes the results of the Glenwood and Cross City Mills operations and the estimated pro-forma consolidated results for the nine months ended September 30, 2018 as if the Acquisition occurred on January 1:

| | Glenwood and Cross City Mills | Pro forma consolidated |
|---|---|---|
| | $ | $ |
| Revenue | 149,352.4 | 626,061.3 |
| Net income for the period | 15,437.5 | 25,156.2 |

Acquisition costs of $2.14 million have been expensed in the statement of net income and comprehensive income in the quarter ended September 30, 2018.

## 15. SOFTWOOD LUMBER DISPUTE

On November 25, 2016, a coalition of US lumber producers petitioned the US Department of Commerce (“USDOC”) and the US International Trade Commission (“USITC”) to investigate alleged subsidies to Canadian producers by the Federal and provincial governments and to therefore levy countervailing (“CVD”) and antidumping (“ADD”) duties against Canadian imports of softwood lumber. CVD and ADD duties have been imposed against Canadian softwood lumber imports beginning in 2017. See note 27 of the Company's 2017 annual consolidated financial statements filed on SEDAR for additional information.

For the three months ended September 30, 2018, the Company expensed CVD and ADD deposits totaling $6.37 million (year ended December 31, 2017 – $9.9 million), based on the final “all other” CVD rate of 14.19% and ADD rate of 6.04%, on shipments of softwood lumber to the US. The difference between cash deposits paid based on the preliminary rates and the amounts expensed in 2017 of $2.27 million are included in deposits and long-term receivables.

The duty rates are subject to change based on administrative reviews and appeals available to the Company. Notwithstanding the deposit rates assigned under the investigations, the Company's final liability for the assessment of CVD and ADD will not be determined until each annual administrative review process is complete and related appeal processes are completed.

Like other Canadian forest product companies, the Federal Government and Canadian provincial governments, the Company denies the US allegations and disagrees with the final determinations made by the USDOC and USITC, and collectively continues to aggressively defend the Canadian industry in this trade dispute. The Federal Government has initiated dispute proceedings with the North American Free Trade Agreement panels and the World Trade Organization.

## 16. SUBSEQUENT EVENT

On October 30, 2018, CP Partnership completed a $70 million secured term loan (the "Loan") with a syndicate of private lenders to refinance the existing revolving operating facility and Term Loan (notes 7 and 8(b)). The Loan is for a term of 15 years and bears interest at a rate of 6.10% per annum. The Loan is secured by substantially all of the power segment assets. The Loan is non recourse to the Company's other operations.