Second Quarter of Fiscal 2019

For the 13-week and 26-week periods ended June 28, 2019 and June 29, 2018

Management's Discussion & Analysis

Pinnacle.
RENEWABLE ENERGY INC.

GENERAL INFORMATION AND CAUTIONARY STATEMENTS

Introduction

The following management's discussion and analysis ("MD&A") dated August 12, 2019 provides information concerning the financial condition and results of operations of Pinnacle Renewable Energy Inc. (formerly Pinnacle Renewable Holdings Inc. and, collectively with its consolidated subsidiaries, the "Company", "Pinnacle", "we", "us" or "our"). This MD&A provides the reader with a view and analysis, from the perspective of management, of the Company's financial and operating results for the 13-week and 26-week periods ended June 28, 2019 ("Q2 2019"). This MD&A should be read in conjunction with our unaudited interim condensed consolidated financial statements and accompanying notes for Q2 2019 (the "Consolidated Financial Statements"), as well as our audited consolidated financial statements and accompanying notes for Fiscal 2018 (as defined herein) as prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), and the related MD&A available on the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com, or the Company's website at www.pinnaclepellet.com.

Basis of Presentation

Our audited annual consolidated financial statements and accompanying notes have been prepared in accordance with IFRS, using the accounting policies described therein. Our interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. We manage our business on the basis of one operating and reportable segment.

All references in this MD&A to "Fiscal 2016" are to our 53-week period ended December 30, 2016 all references to "Fiscal 2017" are to our 52-week period ended December 29, 2017 all references to "Fiscal 2018" are to our 52-week period ended December 28, 2018 all references to "Fiscal 2019" are to our 52-week period ending December 27, 2019 all references to "Fiscal 2020" are to our 53-week period ending December 25, 2020 and all references to "Fiscal 2021" are to our 52-week period ending December 31, 2021. All references in this MD&A to "Q2 2019" are to our 13-week period ended June 28, 2019 references to "Q2 2018" are to our 13-week period ended June 29, 2019 references to "YTD 2019" are to our 26-week period ended June 28, 2019 and references to "YTD 2018" are to our 26-week period ended June 30, 2018. Our fiscal year is the 52 or 53-week period ending the last Friday of the calendar year. The last 53-week fiscal year occurred in Fiscal 2016.

In this MD&A, unless otherwise indicated, all dollar amounts are expressed in Canadian dollars. The term "dollars" and the symbols "$" and "CDN$" refer to Canadian dollars and the term "U.S. dollars" and the symbol "US$" refer to United States dollars. In this MD&A, the term "tonne" and the symbol "MT" refer to a metric tonne and the term "ton" or the symbol "ST" refer to a short ton, a measure of weight equal to 0.9072 metric tonne. Use of these symbols is in accordance with industry practice.

The information in this report is as of August 12, 2019 which is the date of filing in conjunction with our press release announcing our results for Q2 2019. Disclosure contained in this document is current to August 12, 2019 unless otherwise stated.

Forward-Looking Information

This MD&A contains "forward-looking information" within the meaning of applicable securities laws in Canada. Forward-looking information may relate to our future financial outlook and anticipated events or results and may include information regarding our financial position, business strategy, growth strategies, budgets, operations, financial results, taxes, dividend policy, plans and objectives. Particularly, information regarding our expectations of future results, performance, achievements, prospects or opportunities or the markets in which we operate is forward-looking information. Some of the specific forward-looking information contained herein include, but are not limited to, statements with respect to: our expectations regarding growth in biomass-based fuel sources within the European and Asian power generating portfolio; growth in global demand for wood pellets; our expectations regarding accretive free cash flow per share on an annualized basis as a result of our purchase of a 70% stake in the Aliceville Facility (as defined herein); our expectations regarding operational efficiency at the Smithers Facility (as defined herein); anticipated supply delivery times under our off-take contracts; anticipated capital cost and maintenance capital expenditures required by our facilities; estimated capital cost to run-rate EBITDA ratio of production facility upgrades; anticipated production from our facilities; and the timing and extent of our ability to recover the costs associated with the Entwistle Incident through our insurance policies and our other contractual rights.

In some cases, forward-looking information can be identified by the use of forward-looking terminology such as "plans", "targets", "expects" or "does not expect", "is expected", "an opportunity exists", "budget", "scheduled", "estimates", "outlook", "forecasts", "projection", "prospects", "strategy", "intends", "anticipates", "does not anticipate", "believes", or variations of such words and phrases or state that certain actions, events or results "may", "could", "would", "might", "will", "will be taken", "occur" or “be achieved”. In addition, any statements that refer to expectations, intentions, projections or other characterizations of future events or circumstances contain forward-looking information. Statements containing forward-looking information are not historical facts but instead represent management’s expectations, estimates and projections regarding future events or circumstances. There can be no assurance that such information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such information.

Many factors could cause our actual results, level of activity, performance or achievements or future events or developments to differ materially from those expressed or implied by forward-looking statements, including, without limitation, the factors discussed in the “Financial Risk Factors” section of this MD&A and in the “Risk Factors” section of our Annual Information Form (“AIF”) dated March 19, 2019, which can be accessed under the Company’s profile on SEDAR at www.sedar.com. The Company cautions that the list of risk factors and uncertainties described herein and in the AIF are not intended to represent a complete list of the factors that could affect us. Readers are urged to consider such risks, uncertainties and factors carefully in evaluating the forward-looking information, and are cautioned to not place undue reliance on such information.

The forward-looking information contained in this MD&A represents our expectations as of the date of this MD&A (or as of the date they are otherwise stated to be made) and are subject to change after such date. However, we disclaim any intention or obligation or undertaking to update or revise any forward-looking information whether as a result of new information, future events or otherwise, except as required under applicable securities laws in Canada.

In addition, this MD&A contains future-oriented financial information and financial outlook information (collectively, “FOFI”) about Pinnacle’s Adjusted EBITDA estimates for Fiscal 2019, which estimates are subject to the same assumptions, risk factors, limitations, and qualifications as set forth above. FOFI contained in this document was made as of the date hereof and was provided for the purpose of providing shareholders with information on Pinnacle’s financial outlook. Pinnacle disclaims any intention or obligation to update or revise any FOFI contained in this document, whether as a result of new information, future events or otherwise, unless required pursuant to applicable securities laws in Canada. Readers are cautioned that the FOFI contained in this document should not be used for purposes other than for which it is disclosed herein.

Non-IFRS Financial Measures

This MD&A makes reference to certain non-IFRS measures. These measures are not recognised measures under IFRS, and do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of our results of operations from management’s perspective. Accordingly, these measures should not be considered in isolation nor as a substitute for analysis of our financial information reported under IFRS. We use non-IFRS measures including “EBITDA”, “Adjusted EBITDA”, “Adjusted EBITDA per MT”, “Adjusted Gross Margin”, “Adjusted Gross Margin per MT”, “Adjusted Gross Margin Percentage”, and “Free Cash Flow”. These non-IFRS measures are used to provide investors with supplemental measures of our operating performance and thus highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS measures. We also believe that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers. Our management also uses non-IFRS measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and forecasts and to determine components of management compensation. As required by Canadian securities laws, we reconcile these non-IFRS measures to the most comparable IFRS measure in this MD&A. For definitions and reconciliations of these non-IFRS measures to the relevant reported measures, see “Non-IFRS Measures” and “Results of Operations”.

COMPANY OVERVIEW, HISTORY, STRATEGY AND OBJECTIVES

Company Overview

Pinnacle produces renewable fuel for electricity generation in the form of industrial wood pellets, which are used by global utilities and large-scale power generators to produce renewable and reliable baseload power. We are a trusted supplier to our customers, who require reliable, high quality fuel supply to maximize utilization of their facilities.

As one of only three large global suppliers, we currently operate nine production facilities and have one in construction with a combined run-rate production capacity in excess of 2.5 million metric tons per annum ("MTPA"). We believe that we are well-positioned to support growing global demand through the construction of new production capacity and the strategic acquisition of existing production facilities. On June 29, 2018 we commenced commercial production at our wholly-owned facility located in Entwistle, Alberta (the "Entwistle Facility") (400,000 MTPA) and are currently operating at a reduced capacity while we work to return the Entwistle Facility to its commissioning curve following the fire and explosion described under the heading "Recent Developments – Entwistle Facility". On October 15, 2018 we acquired a 70% interest in an operating industrial wood pellet production facility located in Aliceville, Alabama (the "Aliceville Facility") (270,000 MTPA). Early in Fiscal 2019, we commenced commercial production at a wood pellet production facility located in Smithers, B.C. (the "Smithers Facility") (125,000 MTPA). Upgrades at our facility in Williams Lake, B.C. (the "Williams Lake Facility") and Meadowbank, B.C. (the "Meadowbank Facility") commenced in Q2 2019. The upgrades will improve the fibre processing abilities of the two facilities and increase our overall production capacity by approximately 80,000 MTPA. We expect to commence commissioning of the Williams Lake and Meadowbank Facilities by the end of the fourth quarter of Fiscal 2019. On July 4, 2019 we entered into a limited partnership agreement with Tolko Industries Ltd. ("Tolko") to build and operate Northern Pellet Limited Partnership, a new industrial wood pellet production facility in High Level, Alberta (the "High Level Facility") that is expected to have a run-rate production capacity of 170,000 to 200,000 MTPA. For additional information regarding these facilities, see "Recent Developments – New and Expanded Production Facilities and Rail Infrastructure".

We have entered into long-term take-or-pay contracts with our customers, whereby the buyer has a firm obligation to purchase a fixed quantity of pellets at specific prices, that represent an average of 106% of our production capacity through 2026 on an aggregated basis, including new production capacity from the Aliceville, Entwistle, Smithers, and High Level Facilities, and expanded Williams Lake and Meadowbank Facilities. As at June 28, 2019 our total Contracted Backlog (as defined herein) was $6.9 billion with a weighted average remaining term of approximately nine years.

History

Founded in 1989, Pinnacle was one of the first wood pellet producers in the industry. In 2004, we identified the significant growth potential for the industrial wood pellet sector as a new form of renewable energy to meet the emerging needs of European power generators. By 2008, we were primarily focused on utility-grade wood pellets ("industrial wood pellets"), having constructed four industrial wood pellet production facilities ("production facilities") and completed the acquisition of an existing production facility in B.C. to satisfy growing demand. Concurrently, we broadened our management team and implemented processes and systems that contributed to our becoming a leading operator in the global industrial wood pellet industry.

On February 6, 2018 we completed an initial public offering (the "IPO") of our common shares (the "Common Shares"). The IPO included a treasury offering by the Company and a secondary offering by certain of our shareholders. Pursuant to the IPO, we sold 6,223,889 Common Shares for total gross proceeds of approximately $70.0 million and the selling shareholders sold 9,111,361 Common Shares for total gross proceeds of approximately $102.5 million. The Common Shares are listed for trading on the Toronto Stock Exchange ("TSX") under the symbol "PL".

On June 26, 2018 certain shareholders of the Company completed a secondary offering (the "Secondary Offering") of 4,186,000 Common Shares for total gross proceeds of approximately $58.0 million, further increasing our capital market liquidity.

On December 29, 2018 the Company completed a vertical short-form amalgamation (the "Amalgamation") under the Business Corporations Act (British Columbia) with its wholly owned subsidiary, Pinnacle Renewable Energy Inc. Shortly following the Amalgamation, we changed our name from "Pinnacle Renewable Holdings Inc." to "Pinnacle Renewable Energy Inc." Our Common Shares commenced trading under our new name at the opening of trading on January 4, 2019. There were no changes in our share capital and our TSX trading symbol remains "PL".

Strategy and Objectives

Through increasing capacity at our existing production facilities, including the recently acquired U.S.-based Aliceville Facility, the recently constructed Smithers Facility, the addition of other greenfield and brownfield projects, including the upgrades at our Williams Lake and Meadowbank Facilities, and the upcoming construction of the recently announced High Level Facility we believe we have an opportunity to continue growing our industrial wood pellet production proportionately with increasing global demand which is expected to more than double from 2016 to 2021.

Our production facility diversity and purchasing power offers a unique proposition with wood fibre suppliers as the entire residual basket (including sawdust, chips, bark, and harvest residues) can be acquired and optimally allocated amongst our multiple production facility locations for efficient processing. We have wood fibre supply contracts through 2021 for approximately eighty percent of our raw material needs.

We continue to collaborate with the Government, local communities, and First Nations to expand fibre availability and reduce costs with programs that enhance community fire protection, regional safety, and forest stewardship. The regions in B.C. in which we operate have experienced significant impacts from mountain pine beetles and forest fires, and unlike many primary manufacturers, this provides for additional timber salvage opportunities as we can consume this fibre without impacting the quality of our product. We are working with government agencies, First Nations, forest licensees and organizations like the Forests for Tomorrow Program and others to access this fibre and regenerate beetle and fire-damaged woodlands to support local communities, wildlife and the future forest sector. We are working with First Nations to develop opportunities for logging and chipping and to increase the value they receive from their tenures in areas impacted by wildfires and mountain pine beetle infestations and create more jobs within their communities. We continue to diversify our fibre basket with 35% of our production capacity now outside of B.C.

We are focused on operational excellence throughout our plant and logistics networks, specifically targeting improvements in safety, production and costs. We have developed capabilities to utilize a broad range of residual biomass in our industrial wood pellet making process. Through our investment in log chippers, destoners and other specialized biomass processing equipment, combined with the extensive operational knowledge we have developed in handling a diverse range of biomass feedstocks, we can process a broad spectrum of underutilized biomass residuals including whole logs, bush grind, and other harvest residuals, in addition to more traditional biomass residuals such as shavings and sawdust. We have access to a well-established rail infrastructure network in B.C. and Alberta, with all our Canadian production facilities accessible along CN rail lines. Our port infrastructure is a critical element of our supply chain and is comprised of our wholly owned Westview Terminal in Prince Rupert, B.C. and our access to the Fibreco Export Inc. terminal at the Port of Vancouver (the “Fibreco Terminal”) via a long-term throughput contract. At our Aliceville Facility, wood pellets are cost-effectively shipped by barge downriver to the port of Mobile, Alabama where they are loaded directly onto cargo ships.

In addition to organic growth opportunities, we will continue to evaluate and pursue acquisition opportunities or other strategic initiatives in Western Canada, in the U.S. Southeast, or in other jurisdictions, such as the U.S. Pacific Northwest and Eastern Canada, to further diversify our asset base, leverage our strong development and operational expertise and capture increased market share.

RECENT DEVELOPMENTS

Production, Wood Fibre and Forest Residuals

We experienced strong overall production growth in Q2 2019 relative to Q2 2018 driven by the contributions of our new Smithers, BC and Aliceville, AL pellet mills. These facilities are experiencing strong ramp ups that have resulted in production levels higher than our initial commissioning curves.

Our production growth has been moderated, however, by declines in production and increases in costs in certain of our legacy B.C. mills as a result of accelerated sawmill curtailments that reduced residuals from our long-term fibre suppliers. While sawmill residual availability will continue to be a challenge in B.C., we have sourced replacement harvest residuals. In the coming quarters, we anticipate the mix of fibre to stabilize and we will continue to work with our suppliers and use our operational experience to optimize production flows and reduce costs. As we achieve the improved produced volumes and costs in B.C. and ramp up our Alberta and Aliceville facilities, we expect to return to historical margin levels.

New Off-take Agreements

On June 28, 2019 we entered into a new long-term, take-or-pay contract with GS Global Corporation of South Korea for 100,000 MTPA commencing in 2022. To date, a total of three long-term, take-or-pay contracts for industrial wood pellets have been entered into in South Korea, all of which are with Pinnacle.

On July 12, 2019 we entered into a long-term, take-or-pay contract extension with Mitsubishi Corporation of Japan for up to 120,000 MTPA commencing in 2021. The Mitsubishi contract is our eighth contract signed with customers in Japan since the beginning of Fiscal 2018 as we continue to advance our strategy for sales growth into Japan.

As a result of these contracts, we now have an average of 106% of our production capacity contracted through 2026, on an aggregated basis, including production capacity of the Aliceville, Entwistle, and Smithers Facilities, and incremental production capacity of the Williams Lake and Meadowbank Facilities and new production capacity of the High Level Facility. The majority of the new volume demand commences in 2021 and beyond. Our Contracted Backlog as at June 28, 2019 was $6.9 billion, representing an 8% increase over our Contracted Backlog as at March 29, 2019 of $6.4 billion and a 28% increase over our Contracted Backlog as at March 29, 2018 ($5.4 billion).

For YTD 2019, our three largest customers represented 87% of total revenue, compared to 77% in YTD 2018. As at June 28, 2019, our contracts with customers in Japan, the U.K., South Korea, and Europe represent 44%, 36%, 18% and 2%, respectively, of our Contracted Backlog.

We continue our negotiations with various counterparties to secure long-term take-or-pay contracts in Asia and Europe to meet growing demand.

New and Expanded Production Facilities and Rail Infrastructure

Entwistle

Pinnacle continues to progress on the Entwistle recovery following the previously disclosed incident in the dryer area of the facility. On March 29, 2019 Pinnacle resumed partial operations at the Entwistle Facility at reduced levels with the production of pellets from dry fibre. The Company is currently rebuilding the dryer at an estimated capital cost in the range of $13.0 million to $15.0 million and remains on schedule to restart the dryer in the fourth quarter of Fiscal 2019. The other costs (the composition of which are explained in the notes below) are estimated to be in the range of $8.0 million to $10.0 million, of which $5.8 million has been incurred year-to-date. Pinnacle is actively working with customers and partners to mitigate the impacts of the anticipated 2019 production shortfall and continues to work with the Company's insurance providers to determine the insurance recoveries available for the Entwistle Incident. At the end of Q2, Pinnacle has recognized a total of $8.0 million (net of deductibles) in insurance recoverable related to property insurance and $4.5 million from the business interruption insurance. We expect substantially all costs incurred to be recoverable through insurance, subject to deductibles.

High Level

Effective July 4, 2019 the Company has entered into a limited partnership agreement with Tolko to build and operate the High Level Facility, a new industrial wood pellet production facility in High Level, Alberta. Pinnacle and Tolko will each own 50% in the facility which will be built on land owned by Tolko. Construction will begin in the third quarter of Fiscal 2019. Initial wood pellet production at the High Level Facility is expected to commence in the fourth quarter of Fiscal 2020. The capital cost of the High Level Facility is expected to be approximately $54.0 million, with 50% funded by Pinnacle and 50% by Tolko. The facility is expected to have a run-rate production capacity of 170,000 to 200,000 MTPA.

Williams Lake and Meadowbank

We commenced upgrades at our Williams Lake and Meadowbank Facilities in Q2 2019 which focused on the installation of new fibre drying and air filtration equipment, as well as improvements to access infrastructure. These upgrades will allow the two facilities to process a broader array of fibre sources available in the region and achieve a series of air system, safety and environmental advancements that are expected to increase our overall production capacity by approximately 80,000 MTPA, respectively. This strategic investment will enhance the operating flexibility of our Williams Lake and Meadowbank Facilities by enabling us to adapt to cyclical changes in wood fibre supply within the B.C. interior. Further, the equipment, technology and infrastructure improvements we are undertaking will result in improved facility operating efficiencies, lower emissions, local employment opportunities and greater overall facility safety. The capital cost of the upgrade is expected to be approximately $34.0 million, resulting in an estimated capital cost to run-rate EBITDA ratio of approximately 5.0x to 5.5x. We will fund the upgrades from draws on our amended senior secured debt facility (see "Debt Facility" below). As of June 28, 2019 $1.4 million has been spent on upgrades at Williams Lake. We expect the facility upgrades to be completed and to commence commissioning by the end of the fourth quarter of Fiscal 2019.

Canadian National Railway Rail Agreement

On May 1, 2019 we executed an agreement for rail rates for a five-year term for our operations in Western Canada with CN. This agreement provides rate and service stability for rail transport for a significant portion of our business. This continues to reinforce the collaboration between Pinnacle and CN to develop the wood pellet industry in Western Canada and demonstrates our collective strong ties to support Canadian exports.

Debt Facility

Effective June 14, 2019 we amended our senior secured debt facility (existing term loan, delayed draw term loan and revolving operating line) (the "Amended Facility"). The Amended Facility provides an up to \$280.0 million term loan, a \$185.0 million delayed draw term loan, and a \$65.0 million revolving operating line maturing on June 14, 2024. (See Liquidity and Capital Resources). We believe the Amended Facility strengthens our ability to evaluate and pursue acquisition opportunities or other strategic initiatives in Western Canada or the U.S. Southeast.

Executive Team

In recognition of his accomplishments and increasing responsibilities in the organization, effective July 2, 2019 Scott Bax assumed the role of Chief Operating Officer. Mr. Bax joined Pinnacle in 2013 and has been instrumental in the safe and cost-effective production of quality wood pellets from Pinnacle's facilities. Prior to joining Pinnacle, Mr. Bax acquired more than 20 years of forestry experience in various logging and wood manufacturing operations throughout Canada and the United States. Mr. Bax holds an MBA as well as a Masters of Forestry from the University of Alberta and a Bachelor of Science (Environment) from the University of Guelph.

Leroy Reitsma joined Pinnacle in 2007, was appointed President and Chief Operating Officer in 2011 and has had a significant impact on the development and growth of the business, employing endless drive and passion to his role. Mr. Reitsma has transitioned from his previous role of President and Chief Operating Officer to focus on U.S. development projects, and to continue to actively support the Pinnacle team during the transition. Mr. Reitsma has advised the Company that he remains a committed shareholder and will continue his role as an effective and important member of Pinnacle's board of directors.

As part of the ongoing strategic development of the business, Pinnacle has appointed Adnan Khan as Vice President, Strategic Capital. In this newly created position, Adnan will contribute to Pinnacle's strategy through the development of greenfield and brownfield projects, acquisitions and joint venture partnerships, with the overarching goal of strategically deploying capital to support the growth of the business and contribute to increasing shareholder value.

Andrew Meyer joined Pinnacle in 2019 as General Manager, Fibre Operations. He joined Pinnacle from Western Forest Products Inc. where he held the position of Regional Manager for three coastal harvesting business units based in Campbell River. Andrew has spent the last 27 years working in planning and harvesting operations as well as manufacturing in the B.C. forest industry. Andrew will be a critical part of the Fibre and Sustainability team to ensure stable and cost-effective fibre sources through managing execution of our fibre procurement and transportation strategies.

Implementation of IFRS 16 *Leases*

We adopted IFRS 16 Leases ("IFRS 16") at the beginning of Fiscal 2019. IFRS 16 introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Right-of-use assets will be initially measured at cost, which includes the initial measurement of the lease liabilities and other costs, less lease incentives. Lease liabilities will initially be measured at the present value of future lease payments and will subsequently be measured at amortized cost using the effective interest rate method.

We have elected to apply the modified retrospective approach upon adoption at December 29, 2018 measuring the right-of-use asset at an amount equal to the lease liability. The short-term and low-value recognition exemptions available under the standard were utilized, along with certain practical expedients. Accordingly, the comparative information presented for Fiscal 2018 has not been restated, i.e. it is presented, as previously reported, under IAS 17 Leases ("IAS 17") and related interpretations.

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, we recognised \$36.8 million of right-of-use assets and \$36.8 million of lease liabilities as at December 29, 2018.

Also, in relation to those leases under IFRS 16, we have recognised depreciation and interest costs, instead of operating lease expense. During Q2 2019, we recognized $2.1 million of depreciation charges and $0.6 million of interest costs from these leases, $1.7 million of depreciation charges and $0.6 million of interest costs were recognized in Q1 2019.

As a result of applying IFRS 16, Adjusted Gross Margin and Adjusted EBITDA for Q2 2019 have increased by $1.8 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Also in relation to applying IFRS 16, Free Cash Flow for Q2 2019 has increased by $1.2 million related to lease payment expenses that were previously classified as operating leases under IAS 17, partially offset by a decrease of $0.6 million related to interest costs (increase in net interest and finance costs includes interest payment expense on capital leases under IFRS 16 of $0.6 million).

MARKET UPDATE

Global demand for industrial wood pellets remains strong as the shift toward renewable power generation continues, largely motivated by the introduction of regulatory frameworks that set targets and create incentives for the reduction of greenhouse gas emissions. Several global, regional and local regulatory frameworks and policies have been put in place to facilitate this shift to a cleaner energy mix, such as the Paris Agreement (Global), the Climate Change Act (U.K.), the Renewable Energy Directive (E.U.), the Best Energy Mix (Japan) and the Renewable Portfolio Standard (South Korea).

Drax Group plc, one of the United Kingdom’s largest power utilities, has subsidy support for all four of its generating units at the Drax Power Station in the United Kingdom. This has allowed Drax to utilize wood pellets more continuously over its generating portfolio. The fourth generating unit has contributed to more stable combustion of wood pellets in Q2 2019.

In Japan, demand continues to grow as independent power producer (“IPP”) dedicated projects continue to develop their construction and financing plans and existing coal-fired plants explore co-firing with biomass. Hawkins Wright Biomass Demand Q2 2019 edition predicts that Japanese biomass demand will reach 15.3Mt in pellet equivalent terms by 2030, +10.0Mt (+188%) more than in 2017.

In the third quarter of 2018, the South Korean government clarified its program for biomass fired IPP projects with defined start and completion dates. This has generated increased demand in South Korea for long-term, secure fuel contracts. Four dedicated biomass-fired power plants are scheduled to commence operations in South Korea in 2020. South Korea’s wood pellet demand may double by 2023 if all dedicated and co-fired biomass plants come online. Hawkins Wright Biomass Demand Q2 2019 forecasts biomass demand in South Korea to reach 7.6Mt in pellet equivalent terms by 2030, +2.8Mt (+58%) more than in 2017.

The conversion of existing power generating units in the Netherlands to utilize wood pellets by Uniper SE and RWE AG, two of Europe’s largest power generators and energy traders, was completed in early 2019. The ramp-up of these power plants, along with other plants expected to begin co-firing in 2019 and 2020, are expected to increase demand for wood pellets in the Netherlands. We continue to monitor Germany and the greater European market for new developments in biomass policy.

OPERATIONAL UPDATE

Existing Production Facilities and Port Operations

Our Q2 2019 operating performance was impacted by the acceleration of sawmill curtailments in B.C., which caused fibre supply constraints at some of our B.C. facilities and impacted our overall production volume and operating costs. While we have proactively planned for the anticipated reduction in sawmill residual outputs in B.C., the depth and speed of temporary and permanent curtailments has been accelerated by the forest products companies as a result of reduced lumber prices, higher stumpage rates, and the imposition of trade tariffs. As a result, fibre sourcing at our Burns Lake, Meadowbank, Williams Lake, Houston and Smithers Facilities were impacted and constraints in fibre supply resulted in the acceptance of a wider volume of lower quality fibre. We also received higher moisture content fibre at our Aliceville facility which increased drying and fibre processing costs in the period.

We have historically focused on securing long-term contracts with major forestry companies to mitigate the impact of the cyclical B.C. fibre supply. These contracts offer a shift in the percentage of sawmill versus harvest residuals based on the operating level of the sawmill. As a result of the fibre challenges in B.C., we received a decreased supply of sawmill residuals and a higher supply of more expensive harvest residuals. We have proactively mitigated the impact of this shift by securing additional long-term fibre contracts for sawmill and harvest residuals, albeit at increased prices compared to Q2 2018. We have also advanced our fibre procurement mitigation strategy which included a strategic addition to our Fibre and Sustainability team to allow us to procure additional round wood and harvest residuals. During the first half of 2019, our team has more than tripled deliveries of salvage round wood (such as forest fire damaged trees) to our B.C. facilities in anticipation of the potential curtailments. While the sawmill curtailments have been impactful, our long-term fibre procurement strategy has ensured that we are able to continue consistent operation of all facilities. The map below shows that some of the permanent curtailments announced have impacted the supply of sawmill residuals to our mills, particularly Canfor Vavenby and West Fraser Chasm. We have replaced these sawmill residuals with round wood and harvest residuals. Other permanent curtailments, such as Mackenzie, are well outside of the 100 km supply radius of Pinnacle's facilities. We are closely monitoring the changing B.C. fibre basket and responding to changes as they impact us.

See *Exhibit A: A Map of BC Sawmill Permanent Curtailments* below that shows the locations of recently announced sawmill permanent curtailments to August 1, 2019 and the impact to Pinnacle facilities:

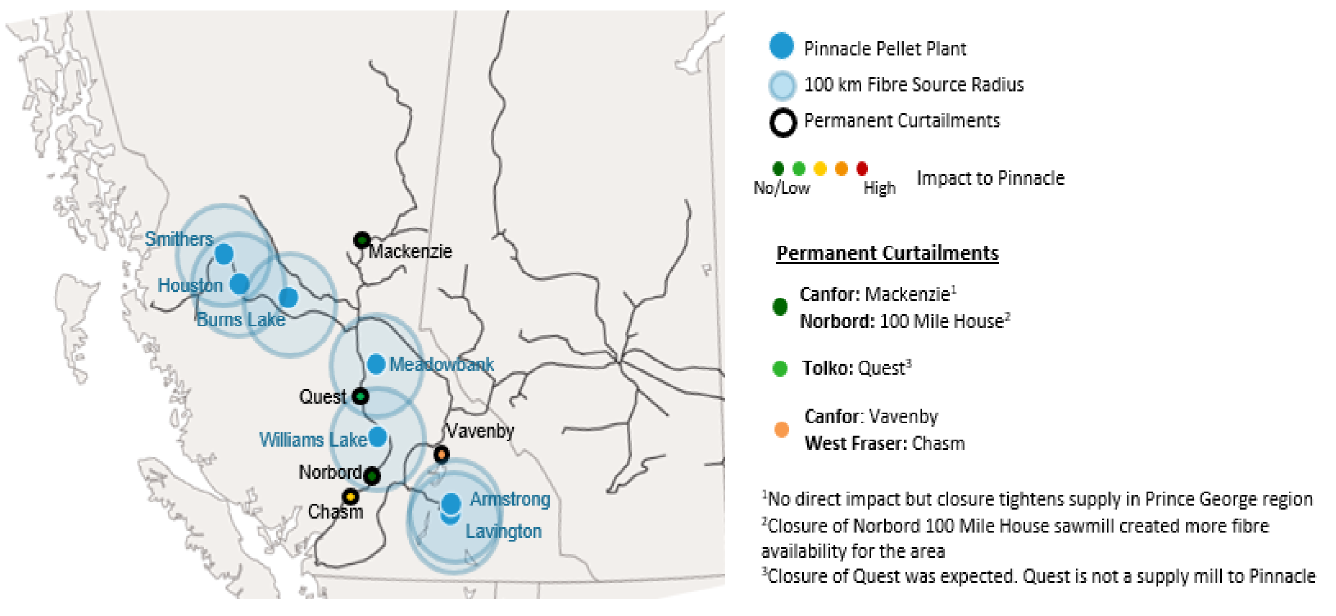

Exhibit A: A Map of BC Sawmill Permanent Curtailments

In addition to increased fibre costs in Q2 2019, we incurred higher cash conversion costs as a result of processing and transitioning fibre, including equipment rentals, repairs and maintenance, labor, and production downtime as we optimized fibre movement and production flow for different residuals composition. In the coming quarters, we expect to continue to be impacted by increased fibre and cash conversion costs as we work through higher percentages of fibre from salvage round logs and harvest residuals.

We have taken a number of proactive measures to mitigate the impact of increased fibre and processing costs. We are working closely with the forestry industry partners with whom we jointly own wood pellet production facilities, namely Canfor Corporation ("Canfor"), West Fraser, and Tolko as well as our other major suppliers, including Interfor Corporation and Weyerhaeuser Company to design and implement fibre procurement mitigation strategies. We expect that sourcing drier salvage material, achieving transportation efficiencies and reducing inventory and cash conversion costs will help to mitigate the expected higher cost of fibre. Further, we are taking proactive measures and investing in specialized equipment, such as log chippers and destoners, to strengthen our ability to process a wide range of wood fibre. Additionally, we are building and optimizing our fibre inventories at the Williams Lake and Meadowbank Facilities in anticipation of enhanced dryer capacity once the facility upgrades are completed. Finally, we have increased our run-rate production capacity outside of B.C. to 35% in order to improve fibre security and margin stability. As we continue to execute on operational improvements and optimize our fibre inventories, we expect the cash conversion costs per metric ton ("MT") to return to historical levels over the coming quarters.

To ensure long-term fibre security in B.C. we continue to collaborate with the Government, local communities, and First Nations to expand fibre availability and reduce costs with programs that enhance community fire protection, regional safety, and forest stewardship. The regions in which we operate have experienced significant impacts from mountain pine beetles and forest fires, and unlike many primary manufacturers, this provides for additional timber salvage opportunities as we can consume this fibre without impacting the quality of our product. We are working with government agencies, First Nations, forest licensees and organizations like the Forests for Tomorrow Program and others to access this fibre and regenerate beetle and fire-damaged woodlands to support local communities, wildlife and the future forest sector. We are working with First Nations to develop opportunities for logging and chipping and increase the value they receive from their tenures in areas impacted by wildfires and mountain pine beetle infestations and create more jobs within their communities. To ensure long-term fibre security and margin stability, we now have approximately 35% of our run-rate production capacity outside of B.C.

We updated agreements in 2019 with our partners for the Houston production facility (referred to as the “Houston Facility” and or the Houston Pellet Limited Partnership (“HPLP”)) for activities including sales, marketing and distribution of wood pellets on behalf of HPLP, thereby increasing the cost of wood pellets purchased from the partnership for Q1 2019 and future periods. The Houston Facility represents approximately 10% of our aggregate run-rate production volume. In exchange for increased costs, we were able to negotiate long-term extensions of the partnership agreements, ensuring security of volume through our Westview port and increased fibre security.

New and Expanded Production Facilities

High Level

Construction will begin in the third quarter of Fiscal 2019. Initial wood pellet production at the High Level Facility is expected to commence in the fourth quarter of Fiscal 2020.

Entwistle

On March 29, 2019 we resumed partial operations at the Entwistle Facility at reduced levels with production of pellets from dry fibre. Our plan to rebuild and restart the dryer in the fourth quarter of Fiscal 2019 remains on schedule. We anticipate all expenses incurred to repair the facility and return to its previous production commissioning curve will be recoverable through insurance, subject to deductibles.

We are making additional capital improvements at the Entwistle Facility that will reduce operating costs and increase production. This capital project is underpinned by a destoner system that will enable the Company to improve fibre flow and reduce downtime. $1.0 million has been spent on this project in Q2 2019 and is capitalized to construction in progress.

Smithers

The Smithers Facility has continued to exceed our initial production expectations through Q2. Fibre costs have been higher than anticipated in Q2 2019 because of the aforementioned sawmill curtailments. Full run-rate production of 125,000 MTPA is expected in the third quarter of Fiscal 2019.

Aliceville

The Aliceville Facility has been continually improving its production since acquisition. The most significant portion of the first phase of our planned capital improvement plan of US $10.0 million ($2.0 million spent in Q2 2019) was completed in July 2019 and is expected to further improve operations. Fibre costs have exceeded expectations as we work with fibre suppliers to manage deliveries to meet stable, increased production levels and moisture content requirements.

Williams Lake and Meadowbank

During Q2 2019, we commenced upgrades at our Williams Lake and Meadowbank Facilities in the Cariboo region of B.C. The upgrades are focused on installation of new fibre drying and air filtration equipment, as well as improvements to access infrastructure.

Production Capacity to Meet New and Extended Off-take Agreements

With the new long-term supply agreements contracted in 2019 we will require additional industrial wood pellet production capacity to meet our growing customer backlog. Through our continuous improvement programs, we expect to continue to increase production capacity at our existing facilities. Additionally, under our Development Blueprint (as defined herein), once we have new, committed large-volume sales contracts, we initiate the expansion of our production capacity by advancing development of greenfield or brownfield production facilities in our funnel of new growth projects. We may also fulfill new contracted volumes through the acquisition of existing industrial wood pellet production facilities.

Once the Williams Lake, Meadowbank, and High Level Facilities reach full run-rate production, our annual production capacity will have grown by 250,000 MTPA, an increase of 11%, from our annual run-rate production capacity at the beginning of Fiscal 2019.

FINANCIAL HIGHLIGHTS

We refer the reader to the section entitled “Key Performance Indicators” of this MD&A for the definition of the items discussed below and, when applicable, to the section entitled “Results of Operations” for reconciliations of non-IFRS measures with the most directly comparable IFRS measure.

Select financial highlights include the following:

(In millions)		**Q2 2019 13 weeks**		**Q2 2018 13 weeks**		**YTD 2019 26 weeks**		**YTD 2018 26 weeks**
Revenue	$	104.2	$	85.1	$	193.8	$	156.1
Production costs	$	69.9	$	53.9	$	136.5	$	102.4
Distribution costs	$	13.0	$	13.1	$	25.8	$	21.2
Selling, general and administration expenses	$	5.1	$	4.3	$	8.9	$	13.5
Net profit (loss)	$	2.4	$	6.5	$	(3.9)	$	(6.3)
Adjusted Gross Margin*	$	21.2	$	18.1	$	32.1	$	33.1
IFRS 16 impact	$	1.8	$	N/A	$	3.6	$	N/A
Entwistle Incident impact	$	1.8	$	N/A	$	(0.3)	$	N/A
Adjusted Gross Margin* (excl. above impact)	$	17.6	$	18.1	$	28.8	$	33.1
Adjusted Gross Margin Percentage*		20%		21%		17%		21%
Adjusted EBITDA*	$	16.1	$	14.9	$	24.4	$	26.8
IFRS 16 impact	$	1.8	$	N/A	$	3.6	$	N/A
Entwistle Incident impact	$	0.7	$	N/A	$	(1.4)	$	N/A
Adjusted EBITDA* (excl. above impact)	$	13.6	$	14.9	$	22.3	$	26.8
Free Cash Flow*	$	7.2	$	10.0	$	9.0	$	19.0
IFRS 16 impact	$	1.2	$	N/A	$	2.4	$	N/A
Entwistle Incident impact	$	(2.3)	$	N/A	$	(4.4)	$	N/A
Free Cash Flow* (excl. above impact)	$	8.2	$	10.0	$	11.0	$	19.0
(In billions)		**June 28, 2019**		**June 29, 2018**				
Contracted Backlog	$	6.9	$	5.1				

* See “Non-IFRS Measures”.

We believe that our performance and future success depends on a number of factors that present significant opportunities. These factors are also subject to a number of inherent risks and challenges. See the “Financial Risk Factors” section of this MD&A and the risk factors identified in our AIF.

CONTRACTED BACKLOG

We enter into long-term, take-or-pay off-take contracts with large and well capitalized counterparties or their affiliates.

"Contracted Backlog" represents the revenue to be recognised under existing contracts assuming deliveries occur as specified in the contracts. As a result of customer preferences or logistics management, there can be movement in the timing of deliveries that may result in revenue being recognised in either a preceding or following interim fiscal period.

Our expected future industrial wood pellet sales under our Contracted Backlog as of June 28, 2019 is as follows ($ billions):

Remainder of Fiscal 2019	$ 0.4
Fiscal 2020	0.5
Fiscal 2021 and thereafter	6.0
Total product sales under Contracted Backlog	**$ 6.9**

FACTORS IMPACTING COMPARABILITY OF OUR FINANCIAL RESULTS

Our future results of operations and cash flows may not be comparable to our historical consolidated results of operations and cash flows, principally for the following reasons:

Entwistle Incident

On March 29, 2019 we resumed partial operations at the Entwistle Facility at reduced levels with the production of pellets from dry fibre. We are currently rebuilding the dryer; our plan to restart the dryer in the fourth quarter of Fiscal 2019 remains on schedule. We are actively working with our customers and partners to mitigate the impact of the anticipated 2019 production shortfall. We are working with our insurance providers to determine the insurance recoveries available for the capital costs incurred to rebuild the dryer and the related damaged equipment, incident response costs, fixed overhead costs for the dryer side, and costs related to business continuity and lost profits from business interruption.

In Q1 2019, $9.4 million of asset impairment charges were recorded in connection with the Entwistle Incident, reducing property, plant and equipment on the statement of financial position and lowering net profit for the period. The net profit impact has been partially offset by property insurance proceeds recorded in net profit on the statement of profit (loss) of $5.0 million in Q2 2019 and $3.0 million (net of deductibles) in Q1 2019. The initial payment of $3.0 million recorded in Q1 2019 was received during the quarter. The second property insurance amount recoverable of $5.0 million recognised in Q2 2019 has been recorded in net profit and in accounts receivable on the statement of financial position as we expect to receive this amount in the third quarter of Fiscal 2019. An initial amount for business interruption insurance of $4.5 million was approved by the insurers for some of the business interruption impact prior to June 28, 2019. This amount was recognised in net income on the statement of profit (loss) and accounts receivable on the statement of financial position in Q2 2019.We expect to receive this amount in the third quarter of Fiscal 2019, positively impacting cash flow.

Total capital costs and other expenses required to replace the dryer and restore the Entwistle Facility to the planned operating run rate are estimated to be in the range of $21.0 million to $25.0 million. The capital asset portion of this amount is estimated to be $13.0 million to $15.0 million, of which $5.2 million has been incurred year-to-date. Of the $5.2 million of capital asset costs incurred year-to-date, $3.0 million was reflected in construction-in-progress in property, plant and equipment in Q2 2019 and $2.2 million was reflected in Q1 2019. The remaining $8.0 million to $10.0 million of costs relate to fixed overhead, other expenses, and incident response costs, of which $5.8 million has been incurred year-to-date. Of the $5.8 million of fixed overhead, other expenses and incident response costs incurred year-to-date, $2.7 million was recorded in Q1 2019 and $2.1 million was recorded in Q2 2019, and $1.0 million was reflected in other expenses in Q2 2019. The remaining amount will be incurred through to the end of Fiscal 2019 as we return the Entwistle Facility to its pre incident commissioning curve.

As part of business continuity activities while the Entwistle Facility produces reduced volumes, we will undertake mitigating activities and may incur additional costs as we purchase third party wood pellets, work with customers to repurchase wood pellet obligations, source additional dry fibre for the Entwistle Facility, and source additional fibre at our other facilities to increase production. Business continuity costs, as incurred, may reduce gross margin and net income in Fiscal 2019 until the Entwistle Facility resumes full operations (including the dryer area). Business continuity costs cannot be estimated at this time as they are subject to negotiation and market conditions.

While we expect substantially all of the capital and operational costs to be recoverable under our insurance policies (subject to applicable deductibles), the timing of these costs and their associated insurance recoveries may not match, which would result in fluctuations in other income, cost of goods sold, and net income from period to period. Given the likely timing mismatch, our results of operations and cash flows, as well as our non-GAAP financial measures, may not be comparable to those for previously reported periods.

Implementation of IFRS 16

Beginning in Fiscal 2019, we adopted IFRS 16. IFRS 16 was issued in January 2016 by the IASB as a replacement for IAS 17 and is effective for annual periods beginning on or after January 1, 2019. IFRS 16 introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Right-of-use assets will be initially measured at cost, which includes the initial measurement of the lease liabilities and other costs, less lease incentives. Lease liabilities will initially be measured at the present value of future lease payments and will subsequently be measured at amortized cost using the effective interest rate method.

We have elected to apply the modified retrospective approach upon adoption at December 29, 2018 measuring the right-of-use asset at an amount equal to the lease liability. The short-term and low-value recognition exemptions available under the standard were utilized, along with certain practical expedients. Accordingly, the comparative information presented for Fiscal 2018 has not been restated, i.e. it is presented, as previously reported, under IAS 17 and related interpretations. The details of the changes in accounting policies are disclosed in Note 2 to the Consolidated Financial Statements. Additional information is outlined the section “CRITICAL ACCOUNTING ESTIMATES AND ACCOUNTING STANDARDS - Recently Adopted Significant Accounting Standards”.

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, we recognised $36.8 million of right-of-use assets and $36.8 million of lease liabilities as at December 29, 2018.

Also, in relation to those leases under IFRS 16, we have recognised depreciation and interest costs, instead of operating lease expense. During Q2 2019, we recognised $2.1 million of depreciation charges and $0.6 million of interest costs from these leases.

As a result of applying IFRS 16, Adjusted Gross Margin and Adjusted EBITDA for Q2 2019 have increased by $1.8 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Also in relation to applying IFRS 16, Free Cash Flow for Q2 2019 has increased by $1.2 million related to lease payment expenses that were previously classified as operating leases under IAS 17, partially offset by a decrease of $0.6 million related to interest costs (increase in net interest and finance costs includes interest payment expense on capital leases under IFRS 16 of $0.6 million).

IPO and capital structure

We reorganised our capital structure in conjunction with the IPO on February 6, 2018. Q1 2018 included gains and losses on share and debt conversions and their related income tax impacts.

RESULTS OF OPERATIONS

Analysis of Results for Q2 2019 to Q2 2018

The following section provides an overview of our financial performance in Q2 2019 compared to Q2 2018.

(In thousands)	Q2 2019 13 weeks	Q2 2018 13 weeks	Q2 2019 vs. Q2 2018
MT of industrial wood pellets sold	**478**	**385**	**93**
Revenue	**$ 104,164**	**$ 85,084**	**$ 19,080**
Costs and expenses			
Production	69,921	53,893	16,028
Distribution	13,005	13,138	(133)
Selling, general and administration	5,147	4,265	882
Amortization	9,801	5,381	4,420
	97,874	**76,677**	**21,197**
Profit before finance costs and other expenses	**6,290**	**8,407**	**(2,117)**
Finance cost	(7,753)	(41)	(7,712)
Other income (expense)	4,991	320	4,671
	(2,762)	**279**	**(3,041)**
Net income before income taxes	**3,528**	**8,686**	**(5,158)**
Income tax (expense) recovery			
Deferred income taxes	(1,143)	(2,182)	1,039
Net profit (loss)	**$ 2,385**	**$ 6,504**	**$ (4,119)**
Impact of:			
IFRS 16**	(579)	N/A	(579)
Entwistle Incident*	4,182	N/A	4,182
Net profit (loss) (excluding above impact)	**$ (1,218)**	**$ 6,504**	**$ (7,722)**

* Tax effected at 27%.

** Q2 2019 results include the adoption of IFRS 16 *Leases*, from December 30, 2018, on a prospective basis. Comparative periods have not been restated.

Revenue

Revenue for Q2 2019 totaled $104.2 million, an increase of $19.1 million, or 22.4%, compared to $85.1 million for Q2 2018. This increase was primarily attributable to higher sales volume as we produced and sold higher volumes of pellets from Smithers and Aliceville Facilities in Q2 2019, each of which contributed no production volume to Q2 2018 sales.

Production cost

Production costs were $69.9 million for Q2 2019, an increase of $16.0 million, or 29.7% compared to $53.9 million for Q2 2018. The increase was primarily due to an increase in sales volume, higher fibre costs, higher cash conversion costs, and increased costs incurred for third party wood pellet purchases. An initial amount for business interruption insurance proceeds of $4.5 million for lost net profit from the Entwistle Incident was recorded in production costs. This amount partially offsets fixed overhead and incident response costs incurred from the Entwistle Incident of $2.7 million in Q2 2019 that are recorded in production costs.

As discussed above, higher fibre costs were primarily related to a shift in fibre mix due to a reduction in sawmill residuals during Q2 2019. Higher cash conversion costs were driven by fibre mix constraints which resulted in additional repairs and maintenance expenses for production equipment.

Distribution cost

Distribution costs were $13.0 million for Q2 2019, a decrease of $0.1 million compared to $13.1 million for Q2 2018. Distribution costs had a positive variance primarily as a result of lower CIF sales in Q2 2019 as compared to Q2 2018 net of negative variances for both port and demurrage costs as a result of rate increases at the ports and production volume delays respectively.

Selling, general and administration expense

SG&A expenses were $5.1 million for Q2 2019, an increase of $0.8 million compared to $4.3 million for Q2 2018. The increase was primarily due to an increase of $0.4 million for personnel costs, primarily due to the expansion of U.S. operations, $0.3 million for stock-based compensation, and an increase of $0.1 million for legal and insurance costs, offset by a decrease in IPO costs.

Amortization expense

Amortization expense was $9.8 million for Q2 2019, an increase of $4.4 million compared to $5.4 million for Q2 2018. The increase was primarily attributable to the commencement of amortization for property, plant and equipment related to: the start-up of commercial production at the Entwistle Facility at the end of Q2 2018, the acquisition of the Aliceville Facility in the third quarter of Fiscal 2018, and the commencement of commercial production at the Smithers Facility during Q1 2019. In addition, the implementation of IFRS 16 in Q1 2019 resulted in an additional $2.1 million of depreciation expense in Q2 2019 related to the recognition of right-of-use assets.

Finance cost

Finance cost was $7.8 million for Q2 2019, an increase of $7.75 million compared to $0.05 million for Q2 2018. Finance cost for Q2 2019 was primarily comprised of: interest on the revolver loan, term debt and delayed draw loan of $4.1 million, fair value loss on derivatives of $1.5 million, interest on lease liabilities and other of $1.6 million, unrealized loss on foreign exchange of $0.8 million, amortization of deferred finance fees of $0.2 million, and a realized loss on foreign exchange of $0.07 million, offset by a realized gain on derivatives of $0.5 million. Finance cost was not significant in Q2 2018 as interest on our credit facilities of $1.6 million was offset by fair value gains of $1.6 million on foreign exchange derivative contracts. Interest costs for Q2 2018 were reduced due to the capitalization of $1.0 million of interest costs for construction of the Entwistle Facility.

Other income

Other income was $5.0 million for Q2 2019, compared to $0.3 million for Q2 2018. The $4.7 million increase in other income from Q2 2018 was primarily due to an amount of $5.0 million for property insurance proceeds receivable for the Entwistle Incident, and $0.4 million of equity earnings from HPLP, offset by $1.0 million of other expenses related to the Entwistle Incident. In Q2 2018 other income of $0.3 million was primarily attributable to $0.4 million in equity earnings from HPLP, offset by impairment and curtailment costs.

Income taxes

Income tax expense was $1.1 million for Q2 2019, a decrease of $1.0 million compared to an income tax expense of $2.1 million for Q2 2018, primarily attributable to a decrease in net income before taxes. The income tax expense for Q2 2018 was a result of higher net profit.

Net profit (loss)

Net profit was $2.4 million in Q2 2019, a decrease of $4.1 million compared to net profit of $6.5 million in Q2 2018. The change in net profit is due to the factors discussed above. Excluding the impact of the Entwistle Incident and of the adoption of IFRS 16, net loss in Q2 2019 was $1.2 million.

Other comprehensive loss

Other comprehensive loss for Q2 2019 of $0.7 million was due to fluctuations in the US$ to CDN$ exchange rate.

Adjusted Gross Margin Percentage*

(In thousands except per MT amounts)	Q2 2019 13 weeks	Q2 2018 13 weeks	Q2 2019 vs. Q2 2018
Profit before finance costs and other income (expenses)	**$ 6,290**	**$ 8,407**	**$ (2,117)**
Selling, general and administration	5,147	4,265	882
Amortization	9,801	5,381	4,420
Equity earnings in HPLP	395	377	18
Non-controlling interests	(405)	(286)	(119)
Adjusted Gross Margin	**$ 21,228**	**$ 18,144**	**$ 3,084**
Adjusted Gross Margin per MT**	**$ 44.43**	**$ 47.13**	**$ (2.70)**
Adjusted Gross Margin Percentage	**20.4%**	**21.3%**	**(0.9%)**
Impact of:			
IFRS 16	1,798	N/A	1,798
Entwistle Incident	1,815	N/A	1,815
Adjusted Gross Margin (excluding above impact)	**$ 17,615**	**$ 18,144**	**$ (529)**

* See “Non-IFRS Measures”.

Adjusted Gross Margin was $21.2 million and Adjusted Gross Margin Percentage was 20.4% for Q2 2019 ($44.43/MT), compared to Adjusted Gross Margin of $18.1 million and Adjusted Gross Margin Percentage of 21.3% in Q2 2018 ($47.13/MT). The decrease in Adjusted Gross Margin Percentage in Q2 2019 is primarily due to a negative production cost variance of 6.5%, and a negative revenue variance of 1.1%. Production costs include $2.7 million of costs associated with fixed overhead and incident response costs for the Entwistle Incident (Q1 2019 - $2.1 million). These costs are offset by $4.5 million of business interruption insurance receivable recorded in Q2 2019. This amount is an initial advance to cover lost net profit. Incremental production costs were incurred at other facilities as a result of fibre mix constraints. The negative revenue variance is due to lower CIF contract sales than prior year. This is partially offset by a positive distribution cost variance of 3.1%.

As a result of applying IFRS 16, Adjusted Gross Margin for Q2 2019 has increased by $1.8 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Excluding the impact of IFRS 16, Adjusted Gross Margin in Q2 2019 was $19.4 million. Excluding the impact of the Entwistle Incident and of applying IFRS 16, Adjusted Gross Margin in Q2 2019 was $17.6 million.

*Adjusted EBITDA**

(In thousands except per MT amounts)	Q2 2019 13 weeks	Q2 2018 13 weeks	Q2 2019 vs. Q2 2018
MT of industrial wood pellets sold	**478**	**385**	**93**
Net profit	**$ 2,385**	**$ 6,504**	**$ (4,119)**
Income tax expense	1,143	2,182	(1,039)
Finance costs excluding shareholder debentures (1)	8,087	40	8,047
Amortization of equipment and intangible assets (2)	9,394	5,280	4,114
EBITDA	**$ 21,009**	**$ 14,006**	**$ 7,003**
EBITDA Adjustments			
Stock-based compensation expense	461	176	285
Loss on disposal of PP&E (3)	67	91	(24)
Insurance recovery on Entwistle Incident	(5,000)	-	(5,000)
Plant curtailment costs	-	61	(61)
Other items (4)	(401)	527	(928)
Total Adjustments	**(4,873)**	**855**	**(5,728)**
Adjusted EBITDA	**$ 16,136**	**$ 14,861**	**$ 1,275**
Adjusted EBITDA per MT**	**$ 33.77**	**$ 38.60**	**$ (4.83)**
Impact of:			
IFRS 16	1,798	N/A	1,798
Entwistle Incident	729	N/A	729
Adjusted EBITDA (excluding above impact)	**$ 13,609**	**$ 14,861**	**$ (1,252)**

* See “Non-IFRS Measures”.

Notes:

(1) Finance costs exclude realized (gain) loss on derivatives and foreign exchange.

(2) Amortization of property, plant, and equipment (“PP&E”) includes our share of HPLP and excludes the non-controlling interest’s share of LPLP, SPLP, and PWRHLLC.

(3) Loss on disposal and impairment of PP&E includes our share of HPLP and excludes the non-controlling interest’s share of LPLP and SPLP.

(4) Other items include professional fees incurred in connection with the IPO in Q1 2018, legal fees related to pursuing a damage claim, and deduction for the non-controlling interest’s share of LPLP, SPLP, and PWRHLLC.

Adjusted EBITDA for Q2 2019 was $16.1 million, an increase of $1.2 million from $14.9 million in Q2 2018. Increased revenue in Q2 2019 was offset by higher production costs, including fibre and conversion costs due principally to fibre mix constraints which increased repair and maintenance costs, partially offset by the impact of IFRS 16. Costs associated with the Entwistle Incident, as discussed above, were offset by an amount recoverable for business interruption insurance recognised in Q2 2019.

In Q2 2019, $3.7 million of expenses were incurred related to the Entwistle Incident for fixed overhead, other expense, and incident response. In Q2 2019, we also recognized $9.5 million of insurance proceeds receivable in connection with the Entwistle Incident, comprised of $5.0 million of property insurance proceeds that offset asset impairment costs of $9.4 million recorded in Q1 2019, and $4.5 million of business interruption insurance proceeds that offset production costs for lost net profit. Excluding the impact of the $3.7 million costs incurred in Q2 2019 associated with the Entwistle Incident related to fixed overhead and incident response costs and the $4.5 million of business interruption insurance proceeds recognised, Adjusted EBITDA was $15.4 million, or $32.25/MT.

As a result of applying IFRS 16, Adjusted EBITDA for Q2 2019 has increased by $1.8 million related to lease payment expenses that were previously classified as operating leases under IAS 17.

Excluding the impact of the Entwistle Incident and of applying IFRS 16, Adjusted EBITDA for Q2 2019 was $13.6 million, or $28.48/MT.

*Free Cash Flow**

(In thousands)	Q2 2019 13 weeks	Q2 2018 13 weeks	Q2 2019 vs. Q2 2018
Net profit and comprehensive income	**$ 2,385**	**$ 6,504**	**$ (4,119)**
Income tax expense [(1)]	1,143	2,182	(1,039)
Finance costs excluding shareholder debentures [(2)]	8,087	40	8,047
Amortization of equipment and intangible assets [(3)]	9,394	5,280	4,114
EBITDA	**$ 21,009**	**$ 14,006**	**$ 7,003**
Stock-based compensation expense	461	176	285
Loss on disposal of PP&E [(4)]	67	91	(24)
Insurance recovery on Entwistle Incident	(5,000)	-	(5,000)
Plant curtailment costs	-	61	(61)
Other items [(5)]	(401)	527	(928)
Adjusted EBITDA [(6)]	**$ 16,136**	**$ 14,861**	**$ 1,275**
Maintenance capital expenditures [(7)]	(4,829)	(1,279)	(3,550)
Interest and finance costs, net [(8)]	(4,132)	(1,564)	(2,568)
Mandatory amortization [(9)]	-	(2,000)	2,000
Free Cash Flow	**$ 7,175**	**$ 10,018**	**$ (2,843)**
Impact of:			
IFRS 16	1,211	N/A	1,211
Entwistle Incident	(2,271)	N/A	(2,271)
Free Cash Flow (excluding above impact)	**$ 8,235**	**$ 10,018**	**$ (1,783)**

* See "Non-IFRS Measures".

Notes:

(1) In recent years, we have accumulated significant net operating losses that will shield future earnings from taxes. As at December 28, 2018, we had unused non-capital loss carry forwards of $92.1 million. We do not anticipate a requirement to pay income tax before 2020.

(2) Finance costs exclude realized (gain) loss on derivatives and foreign exchange.

(3) Amortization of PP&E includes our share of HPLP and excludes the non-controlling interest's share of LPLP, SPLP, and PWRHLLC.

(4) Loss on disposal and impairment of PP&E includes our share of HPLP and excludes the non-controlling interest's share of LPLP and SPLP.

(5) Other items include professional fees incurred in connection with the IPO in Q1 2018, legal fees related to pursuing a damage claim, and deduction for the non-controlling interest's share of LPLP, SPLP, and PWRHLLC.

(6) See definition of Adjusted EBITDA in the section entitled "Key Performance Indicators" and reconciliation of Adjusted EBITDA to net income in "Results of Operations".

(7) "Maintenance capital expenditures" refers to cash expenditures to maintain long-term operating capacity or net income. Annual maintenance capital expenditure allows for the maintenance of long-term operating capacity or net income. We anticipate the recently commissioned Entwistle Facility and the Smithers Facility to require $3.6 million in annual maintenance capital expenditures.

(8) Reflects post-IPO capital structure, and therefore excludes interest and financing costs on historical credit facilities that were repaid in connection with the IPO.

(9) There were no mandatory amortization payments made in Q2 2019 due to the debt refinancing completed in June 2019. Refer to the section entitled "Material Contracts – Credit Agreement" in the AIF for details of our credit facilities.

Free Cash Flow for Q2 2019 was $7.2 million, a decrease of $2.8 million from $10.0 million in Q2 2018. The decrease is primarily due to an increase of $3.5 million in maintenance capital expenditures, and an increase in interest and finance costs of $2.6 million, offset by a decrease in mandatory amortization of $2.0 million, and an increase in Adjusted EBITDA of $1.2 million.

As a result of applying IFRS 16, Free Cash Flow for Q2 2019 has increased by $1.2 million related to lease payment expenses that were previously classified as operating leases under IAS 17, partially offset by a decrease of $0.6 million related to interest costs (increase in net interest and finance costs includes interest payment expense on capital leases under IFRS 16 of $0.6 million).

Excluding the impact of the Entwistle Incident and of applying IFRS 16, Free Cash Flow in Q2 2019 was $8.2 million.

Analysis of Results for YTD 2019 to YTD 2018

(In thousands)		**YTD 2019 26 weeks**		**YTD 2018 26 weeks**		**YTD 2019 vs. YTD 2018**
MT of industrial wood pellets sold		**880**		**713**		**167**
Revenue	**$**	**193,791**	**$**	**156,106**	**$**	**37,685**
Costs and expenses						
Production		136,456		102,413		34,043
Distribution		25,771		21,168		4,603
Selling, general and administration		8,940		13,482		(4,542)
Amortization		19,384		10,739		8,645
		190,551		**147,802**		**42,749**
Profit before finance costs and other income (expense)		**3,240**		**8,304**		**(5,064)**
Finance cost		(14,162)		(423)		(13,739)
Other income (expense)		5,797		(17,663)		23,460
		(8,365)		**(18,086)**		**9,721**
Net loss before income taxes		**(5,125)**		**(9,782)**		**4,657**
Income tax recovery						
Deferred		1,241		3,512		(2,271)
Net loss	**$**	**(3,884)**	**$**	**(6,270)**	**$**	**2,386**
Impact of:						
IFRS 16*		(771)		N/A		(771)
Entwistle Incident*		(2,106)		N/A		(2,106)
Net (loss) (excluding above impact)	**$**	**(1,007)**	**$**	**(6,270)**	**$**	**5,263**

* Tax-effected at 27%.

Revenue

Revenue for YTD 2019 totaled $193.8 million, an increase of $37.7 million, or 24.1%, compared to $156.1 million for YTD 2018. This increase was attributable to higher sales volume, and an increase in the average sales price per MT.

Distribution

Distribution costs were $25.8 million for YTD 2019, an increase of $4.6 million compared to $21.2 million for YTD 2018, reflecting a $2.1 million increase in shipping costs and a $2.5 million increase in port and demurrage costs as a result of higher shipment volumes, rate increases, and port delays.

Production

Production costs were $136.4 million for YTD 2019, an increase of $34.0 million from $102.4 million for YTD 2018, primarily due to an increase in sales volume, higher fiber and cash conversion costs and increased costs incurred for third party wood pellet purchases.

The Entwistle Incident resulted in $4.8 million of costs for fixed overhead and incident response costs in production costs for YTD 2019. These costs were offset by the receipt of $4.5 million of business interruption insurance in Q2 2019 for lost net profit, recognised in production costs.

Selling, general and administration

SG&A expenses decreased $4.6 million from $13.5 million for YTD 2018 to $8.9 million for YTD 2019. After normalizing SG&A for YTD 2018 to take into account $4.4 million related to incremental stock-based compensation expense incurred in connection with the IPO, $1.5 million of professional fees incurred in connection with the IPO and the Secondary Offering and $0.6 million of legal fees related to a damage claim against one of our equipment suppliers, SG&A expenses increased by approximately $1.9 million from YTD 2018, primarily as a result of increased personnel, wage increases, and related travel and general expense.

Amortization

Amortization expense increased by $8.7 million from $10.7 million in YTD 2018 to $19.4 million in YTD 2019. The increase was primarily attributable to the commencement of amortization for property, plant and equipment related to: the start-up of commercial production at the Entwistle Facility at the end of the second quarter of Fiscal 2018, the acquisition of the Aliceville Facility in the third quarter of Fiscal 2018, and the commencement of commercial production at the Smithers Facility during Q1 2019. In addition, the implementation of IFRS 16 in 2019 resulted in an additional $3.8 million of depreciation expenses in YTD 2019 related to the recognition of right-of-use assets. During YTD 2018, the majority of additions to property, plant and equipment related to construction-in-progress for the Entwistle and Smithers Facilities. Construction-in-progress is not subject to amortization until the assets are available for use.

Finance cost

Finance cost was $14.1 million in YTD 2019, an increase of $13.7 million from $0.4 million in YTD 2018. This increase was primarily due to a $6.9 million fluctuation in the fair value of foreign exchange derivative contracts (a $3.4 million fair value loss was recognised in YTD 2019, compared with a $3.5 million fair value gain recognised in YTD 2018), a $4.7 million increase in interest on our credit facilities (reflecting increased draw on credit facilities to fund production capacity growth and significant investment in the Entwistle, Aliceville, and Smithers Facilities), and a $1.7 million increase in other finance costs primarily related to interest on lease payments from the implementation of IFRS 16, partially offset by a $1.1 million fluctuation in realised gains on foreign exchange and interest swap derivative contracts. Interest costs in YTD 2018 were reduced due to the capitalization of $1.8 million of interest costs for construction of the Entwistle Facility.

Other income (expense)

Other income was $5.8 million in YTD 2019, an increase of $23.5 million compared to other expense of $17.7 million for YTD 2018. YTD 2019 other income includes an $8.0 million gain on insurance recovery related to the Entwistle Incident and a $6.5 million gain on the settlement of a legal claim against a former equipment supplier, offset by a $9.4 million loss on disposal of property, plant and equipment and $1.0 million of other expenses related to the Entwistle Incident. YTD 2018 other (expense) was primarily due to a $21.9 million loss on conversion of shareholders' debentures, offset by a $3.6 million gain on conversion of Class B and Class D common shares, upon pre-closing capital changes completed in connection with the IPO.

Income taxes

Income tax recovery was $1.2 million in YTD 2019. The YTD 2019 recovery was primarily attributable to deferred income tax recovery. Income tax recovery was $3.5 million in YTD 2018. The YTD 2018 recovery was primarily attributable to deferred income tax recovery on the loss on conversion of shareholders' debentures into Common Shares upon closing of the IPO.

Net profit (loss) and comprehensive income (loss)

Net loss and comprehensive loss was $5.1 million in YTD 2019, a decrease of $1.2 million compared to net loss and comprehensive loss of $6.3 million in YTD 2018. The variance was primarily due to a net decrease in net loss after income taxes of $2.4 million, as explained above, offset by $1.2 million in foreign exchange loss on foreign operations, net of tax.

*Adjusted Gross Margin Percentage**

(In thousands except per MT amounts)	YTD 2019 26 weeks	YTD 2018 26 weeks	YTD 2019 vs. YTD 2018
Profit before finance costs and other income (expenses)	**$ 3,240**	**$ 8,304**	**$ (5,064)**
Selling, general and administration	8,940	13,482	(4,542)
Amortization	19,384	10,739	8,645
Equity earnings in HPLP	707	673	34
Non-controlling interests	(128)	(145)	17
Adjusted Gross Margin	**$ 32,143**	**$ 33,053**	**$ (910)**
Adjusted Gross Margin per MT**	**$ 36.53**	**$ 46.36**	**$ (9.83)**
Adjusted Gross Margin Percentage	**16.6%**	**21.2%**	**(4.6%)**
Impact of:			
IFRS 16	3,596	N/A	3,596
Entwistle Incident	(285)	N/A	(285)
Adjusted Gross Margin (excluding above impact)	**$ 28,832**	**$ 33,053**	**$ (4,221)**

* See “Non-IFRS Measures”.

Adjusted Gross Margin was $32.1 million and Adjusted Gross Margin Percentage was 16.6% for YTD 2019 ($36.53/MT), compared to adjusted Gross Margin of $33.0 million and Adjusted Gross Margin Percentage of 21.2% in YTD 2018 ($46.36/MT). Production costs include $4.8 million of costs associated with fixed overhead and incident response costs for the Entwistle Incident, offset by an initial amount of $4.5 million for business interruption insurance receivable. Excluding the costs associated with the Entwistle Incident, net of insurance, Adjusted Gross Margin was $32.4 million or $36.85/MT in YTD 2019.

$0.3 million of the decrease in Adjusted Gross Margin was due to costs (net of insurance) associated with the Entwistle Incident, primarily consisting of fixed overhead and incident response costs without generating revenue.

As a result of applying IFRS 16, Adjusted Gross Margin for YTD 2019 has increased by $3.6 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Excluding the impact of IFRS 16, Adjusted Gross Margin in YTD 2019 was $28.5 million. Excluding the impact of the Entwistle Incident and of applying IFRS 16, Adjusted Gross Margin in YTD 2019 was $28.8 million.

*Adjusted EBITDA**

(In thousands except per MT amounts)	YTD 2019 26 weeks	YTD 2018 26 weeks	YTD 2019 vs. YTD 2018
MT of industrial wood pellets sold	**880**	**713**	**167**
Net loss	**$ (3,884)**	**$ (6,270)**	**$ 2,386**
Income tax (recovery)	(1,241)	(3,512)	2,271
Finance costs [1]	15,073	524	14,549
Amortization of equipment and intangible assets [2]	18,485	10,523	7,962
EBITDA	**$ 28,433**	**$ 1,265**	**$ 27,168**
EBITDA Adjustments			
Stock-based compensation expense	629	4,379	(3,750)
Loss on disposal and impairment of PP&E [3]	9,792	232	9,560
Insurance recovery on Entwistle Incident	(8,000)	-	(8,000)
Gain on settlement of legal claim	(6,461)	-	(6,461)
Plant curtailment costs	-	108	(108)
Loss on conversion of shareholder debentures	-	21,881	(21,881)
Revaluation of Class B and Class D common shares	-	(3,563)	3,563
Other items [4]	50	2,516	(2,466)
Total Adjustments	**(3,990)**	**25,553**	**(29,543)**
Adjusted EBITDA	**$ 24,443**	**$ 26,818**	**$ (2,377)**
Adjusted EBITDA per MT**	**$ 27.78**	**$ 37.61**	**$ (9.84)**
Impact of:			
IFRS 16	3,596	N/A	3,596
Entwistle Incident	(1,417)	N/A	(1,417)
Adjusted EBITDA (excluding above impact)	**$ 22,264**	**$ 26,818**	**$ (4,554)**

***** See “Non-IFRS Measures”.

Notes:

(1) Finance cost excluding shareholder debentures excludes realized (gain) loss on derivatives and foreign exchange.
(2) Amortization of PP&E includes ourshare of HPLP and excludes the non-controlling interest’s share of LPLP, SPLP and PWRHLLC.
(3) Loss on disposal of PP&E includes our share of HPLP and excludes the non-controlling interest’s share of LPLP and SPLP.
(4) Other items include professional fees incurred in connection with the IPO and Secondary Offering in YTD 2018 of $1.2 million and $0.3 million, respectively, legal fees related to pursuing a damage claim, deduction for the non-controlling interest’s share of LPLP, SPLP, and PWRHLLC, and realized foreign exchange gains and losses on accounts payable and accrued liabilities.

Adjusted EBITDA was $24.4 million in YTD 2019, a decrease of $2.4 million from $26.8 million in YTD 2018. Increased revenue was offset by higher production costs, including higher conversion costs principally to due to fibre mix constraints resulting in higher repair and maintenance expenses, higher fibre costs because of extended curtailments in the B.C. region, and costs associated with the Entwistle Incident, as discussed above, partially offset by the impact of IFRS 16 and business interruption amounts recoverable.

$1.4 million of costs (net of insurance) associated with the Entwistle Incident, primarily consisting of fixed overhead and incident response costs without generating revenue. We expect to recover additional costs through our business interruption insurance policies in future months. Excluding the costs associated with the Entwistle Incident, Adjusted EBITDA was $25.9 million or $29.39/MT YTD 2019.

As a result of applying IFRS 16, Adjusted EBITDA for YTD 2019 has increased by $3.6 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Excluding the impact of IFRS 16, Adjusted EBITDA YTD 2019 was $20.8 million.

Excluding the impact of the Entwistle Incident and applying IFRS 16, Adjusted EBITDA YTD 2019 was $22.3 million.

*Free Cash Flow**

(In thousands)	YTD 2019 26 weeks	YTD 2018 26 weeks	YTD 2019 vs. YTD 2018
Net loss	**$ (3,884)**	**$ (6,270)**	**$ 2,386**
Income tax (recovery) (1)	(1,241)	(3,512)	2,271
Finance costs (2)	15,073	524	14,549
Amortization of equipment and intangible assets (3)	18,485	10,523	7,962
EBITDA	**$ 28,433**	**$ 1,265**	**$ 27,168**
Stock-based compensation expense	629	4,379	(3,750)
Loss on disposal and impairment of PP&E (4)	9,792	232	9,560
Insurance recovery on Entwistle Incident	(8,000)	-	(8,000)
Gain on settlement of legal claim	(6,461)	-	(6,461)
Plant curtailment costs	-	108	(108)
Loss on conversion of shareholder debentures	-	21,881	(21,881)
Revaluation of Class B and Class D common shares	-	(3,563)	3,563
Other items (5)	50	2,516	(2,466)
Adjusted EBITDA (6)	**$ 24,443**	**$ 26,818**	**$ (2,375)**
Maintenance capital expenditures (7)	(5,260)	(2,317)	(2,943)
Interest and finance costs, net (8)	(8,169)	(3,480)	(4,689)
Mandatory amortization (9)	(2,000)	(2,000)	-
Free Cash Flow	**$ 9,014**	**$ 19,021**	**$ (10,007)**
Impact of:			
IFRS 16	2,446	N/A	2,446
Entwistle Incident	(4,417)	N/A	(4,417)
Free Cash Flow (excluding above impact)	**$ 10,985**	**$ 19,021**	**$ (8,036)**

* See "Non-IFRS Measures".

Notes:

(1) In recent years, we have accumulated significant net operating losses that will shield future earnings from taxes. As at December 28, 2018, we had unused non-capital loss carry forwards of $92.1 million. We do not anticipate a requirement to pay income tax before 2020.
(2) Finance cost excluding shareholder debentures excludes realized (gain) loss on derivatives and foreign exchange.
(3) Amortization of PP&E includes our share of HPLP and excludes the non-controlling interest's share of LPLP, SPLP, and PWRHLLC.
(4) Loss on disposal of PP&E includes our share of HPLP and excludes the non-controlling interest's share of LPLP and SPLP.
(5) Other items include professional fees incurred in connection with the IPO and Secondary Offering in YTD 2018 of $1.2 million and $0.3 million, respectively, legal fees related to pursuing a damage claim, deduction for the non-controlling interest's share of LPLP and SPLP and realized foreign exchange gains and losses on accounts payable and accrued liabilities.
(6) See definition of Adjusted EBITDA in the section entitled "Key Performance Indicators" and reconciliation of Adjusted EBITDA to net income in "Selected Consolidated Financial Information".
(7) "Maintenance capital expenditures" refers to cash expenditures to maintain long-term operating capacity or net income. Annual maintenance capital expenditure allows for the maintenance of long-term operating capacity or net income. Upon commissioning of the Entwistle Facility and the Smithers Facility, we anticipate these facilities to require $3.6 million in annual maintenance capital expenditures.
(8) Reflects post-IPO capital structure, and therefore excludes interest and financing costs on historical credit facilities that were repaid in connection with the IPO.
(9) Mandatory amortization was incurred in Q1 2019. Debt refinancing was completed in June 2019 and mandatory amortization has been deferred. Refer to the section entitled "Material Contracts – Credit Agreement" in the AIF for details of our credit facilities.

Free cash flow was $9.0 million in YTD 2019 a decrease of $10.0 million from $19.0 million in YTD 2018. The decrease is primarily due to a decrease in Adjusted EBITDA of $2.4 million, an increase of $2.9 million in maintenance capital expenditures, and an increase of $4.7 million in interest and finance costs.

As a result of applying IFRS 16, Free Cash Flow for YTD 2019 has increased by $2.4 million related to lease payment expenses that were previously classified as operating leases under IAS 17. Excluding the impact of the Entwistle Incident and of applying IFRS 16, Free Cash Flow in YTD 2019 was $11.0 million.

SUMMARY OF CONSOLIDATED RESULTS AND CERTAIN PERFORMANCE MEASURES

The following table summarizes the results of our operations for the last eight quarters. This unaudited quarterly information has been prepared in accordance with IFRS. [1]

	2019		2018				2017	
	Q2*	Q1*	Q4	Q3	Q2	Q1	Q4	Q3
(In thousands except per share amounts)	13 Weeks	13 Weeks	13 Weeks	13 Weeks	13 Weeks	13 Weeks	13 Weeks	13 Weeks
MT of industrial wood pellets sold	**478**	**402**	**473**	**421**	**385**	**328**	**334**	**387**
Revenue	**$ 104,164**	**$ 89,627**	**$ 103,728**	**$ 87,606**	**$ 85,084**	**$ 71,022**	**$ 72,958**	**$ 82,366**
Costs and expenses								
Production [2]	69,921	66,535	73,472	57,222	53,893	48,520	47,377	51,628
Distribution	13,005	12,766	13,371	12,360	13,138	8,030	9,925	11,568
Selling, general and administration	5,147	3,793	3,933	5,374	4,265	9,217	4,347	4,222
Amortization	9,801	9,583	7,220	6,719	5,381	5,358	5,280	5,365
	97,874	**92,677**	**97,996**	**81,675**	**76,677**	**71,125**	**66,929**	**72,783**
Profit (loss) before finance costs and other (income) expenses	6,290	(3,050)	5,732	5,931	8,407	(103)	6,029	9,583
Finance income (cost)	(7,753)	(6,409)	1,741	(4,360)	(41)	(382)	(6,120)	(6,469)
Other income (expense) [3][4]	4,991	806	1,626	399	320	(17,983)	358	(9,146)
	(2,762)	(5,603)	3,367	(3,961)	279	(18,365)	(5,762)	(15,615)
Net profit (loss) before income taxes	3,528	(8,653)	9,099	1,970	8,686	(18,468)	267	(6,032)
Income tax recovery (expense)								
Deferred income taxes	(1,143)	2,384	(1,643)	(454)	(2,182)	5,694	(163)	2
Net profit (loss)	**$ 2,385**	**$ (6,269)**	**$ 7,456**	**$ 1,516**	**$ 6,504**	**$ (12,774)**	**$ 104**	**$ (6,030)**
Net profit (loss) attributable to:								
Owners of the Company	1,980	(5,992)	7,081	1,184	6,218	(12,633)	124	(6,371)
Non-controlling interests	405	(277)	375	332	286	(141)	(20)	341
Net profit (loss)	**$ 2,385**	**$ (6,269)**	**$ 7,456**	**$ 1,516**	**$ 6,504**	**$ (12,774)**	**$ 104**	**$ (6,030)**
Net profit (loss) attributable to owners								
Net profit (loss) attributable to owners	1,980	(5,992)	7,081	1,184	6,218	(12,633)	124	(6,371)
Cumulative preferred dividends	-	-	-	-	-	(104)	(409)	(309)
	$ 1,980	$ (5,992)	$ 7,081	$ 1,184	$ 6,218	$ (12,737)	$ (285)	$ (6,680)
Net profit (loss) per share attributable to owners								
Basic and diluted	**$ 0.06**	**$ (0.18)**	**$ 0.22**	**$ 0.04**	**$ 0.19**	**$ (0.58)**	**$ (0.04)**	**$ (0.97)**

** Q1 and Q2 2019 results include the adoption of IFRS 16 *Leases*, from December 30, 2018, on a prospective basis. Comparative periods have not been restated.

Notes:

(1) Factors that impact the comparability of the quarters include the following: (a) the cost of producing industrial wood pellets during the winter is typically greater than that during the summer due to the higher moisture content of raw materials which results in higher drying costs and the increased costs of maintaining operating equipment due to lower ambient temperatures; and (b) net profit (loss) is also impacted by fluctuations in Canadian dollar exchange rates from the revaluation of the Company's outstanding US dollar forward exchange contracts and the translation of our US operations.

(2) In Q2 2019, $1.9 million of costs related to fixed overhead and incident response costs were reflected in production costs, $2.1 million was reflected in Q1 2019.

(3) In the third quarter of Fiscal 2017, a revaluation loss of $6.0 million (before-tax) was recognised. Upon closing of the IPO in Q1 2018, a gain of $3.6 million (before-tax) was recognised on conversion of Class B and Class D common shares. In Q1 2019, $9.4 million of asset impairment costs and $3.0 million of insurance recoveries were recognised in relation to the Entwistle Incident.

(4) In Q1 2018, a $21.9 million (before-tax) loss and an associated $5.8 million deferred income tax recovery were recognised on conversion of shareholders' debentures upon closing of the IPO.

LIQUIDITY AND CAPITAL RESOURCES

Overview

Our principal uses of funds are for operating expenses, capital expenditures, debt service requirements and dividends. We believe that cash generated from operations, together with amounts available under our credit agreement, will be sufficient to meet our operating expenses, capital expenditures, debt service and dividend requirements. In addition, we believe that our capital structure provides us with financial flexibility to pursue our future growth strategies.

However, our ability to fund operating expenses, capital expenditures, and future debt service and dividend requirements will depend on, among other things, our future operating performance, which will be affected by general economic, financial and other factors, including factors beyond our control. See “Summary of Factors Affecting Performance” and “Financial Risk Factors” in this MD&A for additional information. We review investment opportunities in the normal course of our business and may make select investments to implement our business strategy when suitable opportunities arise.

Historically, the funding for our investments has come from cash flow from operating activities and/or our credit facilities. We believe our delayed draw facility under the Amended Facility, together with the proceeds from the IPO, will be sufficient to finance the Entwistle Facility, Smithers Facility, Aliceville Facility and our anticipated capital expenditures associated therewith. At this time, we do not reasonably expect any presently known trend or uncertainty to affect our ability to access our potential sources of liquidity.

Non-cash Working Capital

“Non-cash working capital” is defined as the sum of accounts receivable, inventories, and other current assets, less accounts payable and accrued liabilities, and other current liabilities. Non-cash working capital excludes cash, the current portion of our long-term debt including the revolving credit facility and therefore provides our management and investors with a clear understanding of the efficiency of our operational working capital needs. Our need for non-cash working capital is highly dependent on the timing of shipments, particularly at the end of a period as a total shipment can be valued at over $10 million. Shipment timing impacts accounts receivable and finished industrial wood pellet inventories. Payment terms differ for each contract, but we typically receive an initial payment equal to 90% of the total value of a shipment 12 to 15 days after the shipment leaves the port, with the balance received after the vessel fully discharges its cargo to the customer. Less significantly, non-cash working capital is impacted by wood fibre inventory changes due to the accumulation of wood fibre in winter months and increases in whole log volumes and values as we diversify our wood fibre sources and create supply stockpiles.

Senior Credit Facilities

On June 14, 2019 the Company amended and expanded its credit facility to $530.0 million, comprised of a $65.0 million revolving line, a $280.0 million term loan, and a $185.0 million delayed draw term loan. The Amended Facility also extended the maturity date from December 13, 2022 to June 14, 2024.

Advances under the Amended Facility are available as Canadian dollar Prime-Based Loans, Banker’s Acceptances (“BA”) from the BA Lenders in Canadian dollars, BA Equivalent Loans from the Non-BA Lenders in Canadian dollars, US dollar Base Rate Loans, and LIBOR Loans in US dollars. Interest accrues daily at the applicable Bank Prime, BA, US Base or LIBOR rate plus a margin. The margin varies based on the ratio of Senior Debt to Adjusted EBITDA with a minimum margin of 1.50% and 2.50% for Prime/US Base and BA/LIBOR loans respectively, and maximum margin of 3.00% and 4.00%, respectively. At June 28, 2019, the $280,000 term loan was in a Canadian dollar Prime-Based loan at 6.45% to facilitate the Amended Facility funds flow. (At June 28, 2019, the $198 million term loan was in a Canadian dollar BA loan at 5.20%.) Subsequent to quarter end, the full amount was moved from the Prime-based loan and into a Canadian dollar BA that carries a rate of 5.50%.

During the 26-week period ended June 28, 2019 we made scheduled repayments of $2.0 million on our term loan (26-week period ended June 29, 2018 – $2.0 million). These scheduled repayments were made prior to the senior secured debt being amended on June 14, 2019. At June 28, 2019, we had issued letters of credit totaling $1.3 million (June 29, 2019 - $0.5 million).

EBITDA and Adjusted EBITDA are defined in our credit agreement and used in the calculation of debt covenants and interest rate margins. Adjusted EBITDA as defined in our credit agreement is different than Adjusted EBITDA as presented in our MD&A as it includes adjustments to reflect run-rate EBITDA at facilities in the commissioning phase including Entwistle and Smithers Facilities, among other adjustments. The primary debt covenants are the Senior Debt to Adjusted EBITDA and Fixed Charge Coverage Ratio. The U.S. federal New Markets Tax Credit (“NMTC”) Debt is not included in the calculation of Senior Debt (as defined in the credit agreement) as it is indemnified by Westervelt and the we carry a NMTC Receivable from Westervelt of an equal amount. Our credit agreement provides for calculation of the debt covenants prior to the application of IFRS 16. As at June 28, 2019 and December 28, 2018, the Company was in compliance with all debt covenants.

The debt is secured by a first-ranking security interest on all present and after-acquired assets of the Company.

All the credit facilities require mandatory loan prepayments by us of principal and interest if certain events occur.

Refer to the "Credit Agreement" sub-section under the "Material Contracts" section in the AIF for details of our credit facilities.

CASH FLOWS

Analysis of cash flows for Q2 2019 compared to Q2 2018

(In thousands)		Q2 2019 13 weeks		Q2 2018 13 weeks		Q2 2019 vs. Q2 2018
Cash flow from operations before net change in non-cash working capital	$	15,490	$	14,091	$	1,399
Net change in non-cash operating working capital		(7,414)		(4,557)		(2,857)
Financing activities		7,138		(9,476)		16,614
Investing activities		(13,889)		(10,459)		(3,430)
Other		(8)		221		(229)
Change in cash		**1,317**		**(10,180)**		**11,497**
Cash and cash equivalents, beginning of period		8,510		32,525		(24,015)
Cash and cash equivalents, end of period	**$**	**9,827**	**$**	**22,345**	**$**	**(12,518)**

Cash flows from operations before net change in non-cash working capital

Cash flow from operations before net change in non-cash working capital increased by $1.4 million to $15.5 million for Q2 2019 from $14.1 million for Q2 2018, primarily driven by higher revenue in Q2 2019 compared to Q2 2018 and receipt of a $3.0 million payment for property insurance proceeds from the Entwistle Incident recognised in Q1 2019.

Net change in non-cash working capital

The $7.4 million decrease in cash flows from non-cash working capital was primarily comprised of a $10.9 million increase in accounts receivable and a $0.4 million increase in other current assets, partially offset by a $2.2 million increase in accounts payable and accrued liabilities, a $1.3 million decrease in inventory and a $0.3 million increase in other current liabilities. The $4.5 million decrease in cash flows from non-cash working capital in Q2 2018 was primarily comprised of a $2.2 million decrease in accounts receivable, a $1.7 million decrease in accounts payable and accrued liabilities, and a $1.5 million decrease in other current liabilities, partially offset by a decrease of $0.3 million in inventory and $0.7 million of other current assets.

Financing activities

In Q2 2019, we expanded our credit facility by $150.0 million to $530 million; financing activities provided net $7.1 million of cash primarily from drawings on term debt of $278.0 million, partially offset by $258.3 million repayment of delayed draw loan, term debt and revolver loans, $5.0 million of dividends paid, $5.0 million of finance costs paid, $2.4 million of finance leases, and $0.2 million in distributions to non-controlling interest. In Q2 2018, financing activities used $9.5 million of cash primarily from $3.1 million in finance costs paid, $3.0 million in dividends paid, $2.0 million in term debt paid, and $1.6 million in share issuance costs accrued in the prior period and paid in the current period.

Investing activities

Cash used for investing activities relates primarily to the acquisition and construction of property, plant and equipment. $13.9 million of cash used for property, plant and equipment during Q2 2019 includes approximately $3.6 million associated with the rebuilding of the dryer at our Entwistle Facility and $1.6 million for the construction related to other growth projects. The costs related to asset repairs at the Entwistle Facility have been capitalised to construction-in-progress for Q2 2019. As of June 28, 2019, we have recognised $9.5 million of insurance proceeds (net of deductible) in accounts receivable. In Q2 2018, cash used for property, plant and equipment was $10.5 million, primarily related to the construction of the Entwistle Facility.

Analysis of cash flows for YTD 2019 compared to YTD 2018

(In thousands)	YTD 2019 26 weeks	YTD 2018 26 weeks	YTD 2019 vs. YTD 2018
Cash flow from operations before net change in non-cash working capital	$ 32,622	$ 23,581	$ 9,041
Net change in non-cash operating working capital	(14,292)	13,342	(27,634)
Financing activities	(6,466)	4,088	(10,554)
Investing activities	(20,150)	(37,896)	17,746
Other	85	322	(237)
Change in cash	**(8,201)**	**3,437**	**(11,638)**
Cash and cash equivalents, beginning of period	18,028	18,908	(880)
Cash and cash equivalents, end of period	**$ 9,827**	**$ 22,345**	**$ (12,518)**

Cash flow from operations before net change in non-cash working capital

Cash flow from operations before net change in non-cash working capital increased by $9.0 million to $32.6 million for YTD 2019, versus $23.6 million for YTD 2018, primarily due to higher revenues YTD 2019 compared to YTD 2018 and because non-cash increases to working capital were higher YTD 2019 than YTD 2018.

Net change in non-cash working capital

The $14.3 million decrease in cash flows from non-cash working capital was primarily comprised of a $5.0 million increase in inventory, a $4.5 million increase in other current assets, and a $5.1 million decrease in accounts payable and accrued liabilities, offset by a decrease in accounts receivable of $0.2 million and a decrease in other current assets of $0.2 million. The increase in non-cash working capital of $13.3 million in YTD 2018 reflected a decrease in accounts receivable of $15.8 million, decrease in inventory of $2.0 million, a decrease in other current assets of $1.3 million, and an increase in accounts payable and accrued liabilities of $5.6 million, offset by a decrease in other current liabilities of $11.4 million.

Financing activities

In YTD 2019, we expanded our credit facility by $150 million to $530 million and financing activities in YTD 2019 used $6.5 million of cash primarily from a $262.2 million repayment of delayed draw loan, term debt and revolver loans, $9.9 million of dividends paid, $8.6 million of finance costs paid, and $4.7 million of finance leases paid, and $0.6 million in distributions to non-controlling interest, partially offset by drawings on term debt of $278 million, and $1.3 million in investment from non-controlling interest.

In YTD 2018, financing activities provided $4.1 million of cash, primarily from net proceeds of the IPO of $64.6 million, offset by repayment of shareholders' debentures of $28.6 million, net repayment of credit facilities of $24.0 million, finance costs paid of $5.8 million, and dividend paid of $3.0 million.

Investing activities

Cash used for investing activities relates primarily to the acquisition and construction of property, plant and equipment. In YTD 2019, net cash used for property, plant and equipment was $20.2 million, a $17.8 million decrease from YTD 2018. YTD 2019 includes approximately $5.8 million associated with the rebuilding of the dryer at our Entwistle Facility and $3.8 million for the construction related to other growth projects. YTD 2018 cash used for investing was primarily related to the construction of the Entwistle Facility.

OUTLOOK

We believe that we have the opportunity to continue growing our revenue and profitability over the next several years as a result of contracted price increases in most of our off-take agreements. As the potential demand for industrial wood pellets continues to grow globally, we are well positioned to meet this demand growth through a combination of expansion projects at existing production facilities, as well as new greenfield and brownfield growth projects. Additionally, we will continue to evaluate potential acquisitions and joint ventures to grow our production platform.

Our strategies to realize on these opportunities are summarized as follows:

- continue to realize production and operating efficiencies in our existing production facilities to increase EBITDA per MT;
- grow our business through the commissioning and operational execution of the Entwistle Facility, Smithers Facility, High Level Facility, and other greenfield and brownfield project opportunities throughout North America;
- expand production capacity at existing production facilities, including that of the recently acquired Aliceville Facility as well as facility upgrades at the Williams Lake and Meadowbank Facilities;
- make accretive acquisitions of industrial wood pellet producers in Canada and the U.S.; and
- continue to capture our share of opportunities in the growing Asian marketplace as a result of our longstanding relationships with customers in the region, and our proximity to this market, which results in shipping cost advantages.

We continue to expect strong execution of our strategic growth plan in 2019 as reflected by the completion of three new customer contracts in Asia since the beginning of the year, commencement of the Williams Lake and Meadowbank expansions, and development of the High Level Facility. The Aliceville and Smithers Facilities are expected to continue to achieve production levels above the commissioning curve established by the Company.

The Entwistle Facility is expected to continue to produce pellets from dry fibre at 25-30% of full run-rate production capacity while the dryer is being rebuilt. The project remains on schedule and is expected to be completed in Q4 2019 at which time we expect to return the facility to its pre-incident commissioning curve. We continue to make progress working with insurers in obtaining business interruption insurance.

Production and revenue growth are expected to continue through 2019, as will the margin compression experienced in Q2 2019 as we adapt our operations to manage the impact of fibre transition in our B.C. facilities. Our fibre procurement team has successfully replaced sawmill residual reductions and we now have sufficient fibre for all of our facilities. We are very focused on improving our fibre processing, haulage and cash conversion costs. At this time, we expect to achieve our previously communicated guidance.

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Effective June 14, 2019 we amended and expanded our credit facility from $380.0 million to $530.0 million and extended the maturity date to June 14, 2024. The expanded credit facility is supported by a syndicate of Canadian and United States banks. Details are as follows:

	June 14, 2019	December 13, 2017
Credit Facility component	**Fourth Amended Credit Agreement**	Third Amended Credit Agreement
Revolver	**$ 65,000,000**	$ 50,000,000
Term Facility	**280,000,000**	200,000,000
Delayed Draw Facility	**185,000,000**	130,000,000
Total	**$ 530,000,000**	$ 380,000,000

Other than as noted above, there were no material changes in Q2 2019 in the contractual obligations, off-balance sheet arrangements or commitments specified in our Q1 2019 interim condensed consolidated financial statements and related MD&A.

FINANCIAL RISK FACTORS

We are exposed to a number of risks as a result of holding financial instruments including credit risk, liquidity risk and market risk. Our Risk Management Committee manages risk related to counterparty credit risk and market risk such as foreign exchange.

Credit risk

Credit risk is the risk of financial loss to us if a counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments that are subject to credit risk include cash and accounts receivable. We manage our credit risk on cash by using major Canadian chartered banks for all cash deposits. The cash balance at June 28, 2019 was $9.8 million (December 28, 2018 - $18.0 million).

We manage our credit risk on accounts receivable by reviewing individual sales contracts considering the length of the contract and assessing the credit quality of the counterparty. Board approval is required for contracts over $5.0 million. The significant majority of our sales are contracted with large utility customers. The trade accounts receivable balance at June 28, 2019 was $39.0 million (December 28, 2018 - $34.4 million).

Liquidity risk

Liquidity risk is the risk that we will not be able to meet our respective obligations as they come due. We manage liquidity requirements through frequent monitoring of cash inflows and outflows, preparation of regular cash flow forecasting and our available credit facilities.

At June 28, 2019 we had available liquidity of $65.0 million (December 28, 2018 - $49.1 million) from our debt facilities (excluding delayed draw) and cash balances and forecast sufficient liquidity throughout Fiscal 2019. We expect to finance our operations and cash flows from our current available resources without further support from our shareholders and lenders. However, to the extent that additional cash resources are required due to unforeseen circumstances, we anticipate support from our shareholders and lenders, although there can be no guarantees. At June 28, 2019, our ratio of net debt to last twelve month Adjusted EBITDA was 5.11 times. This ratio was impacted because of the investment in the Aliceville Facility in Q4 2018, in significant new capacity at the Entwistle and Smithers Facilities in advance of achieving run-rate Adjusted EBITDA, and in expansion projects at Williams Lake, Meadowbank, and High Level. As these facilities reach their run-rate capacity, we expect these ratios to decline.

Market risk

Market risk is that the change in market prices such as foreign exchange rates will affect our net profit (loss) and that the future cash flows of a financial instrument will fluctuate due to changes in market prices.

With respect to costs of distribution, we mitigate the market risk of fluctuations in shipping costs by entering into long-term, fixed-price shipping contracts with reputable shippers matching the terms and volumes of our CIF off-take contracts for which we are responsible for managing shipping. We enter into these long-term shipping contracts at the same time as we enter long-term sales contracts, ensuring matching the terms and tenure between both contracts. Certain of our off-take contracts include pricing adjustments for volatility in fuel prices, which allows us to pass the majority of the fuel price risk associated with shipping through to our customers.

Foreign currency

For our Canadian entities, the functional and reporting currency is the Canadian dollar. Our sales, operating and capital expenditures are primarily denominated and settled in Canadian dollars. We have exposure to the US dollar on our shipping costs, rail car leases and some capital purchases. We mitigate our exposure to the US dollar on our shipping costs by invoicing the shipping portion in US dollars and with a contract with our major shipping provider with a fixed US dollar to Canadian dollar exchange rate. We mitigate the remaining exposure by entering into a series of US dollar forward contracts matching the amount and timing of the estimated US dollar expenditures.

These contracts are simultaneously settled on a gross tax basis as the Company exchanges US dollars into Canadian dollars at predetermined rates. We do not apply hedge accounting to our US dollar forward contracts. Refer to Note 18 to the Consolidated Financial Statements for outstanding notional amounts of the US dollar forward contracts and their contractual maturities.

For our U.S. entities, the functional currency is the US dollar. Our sales, operating and capital expenditures are primarily denominated and settled in US dollars.

Interest rate

We are exposed to interest rate risk through our credit facility including our revolver, term loan and delayed draw term loan which are subject to variable lending rates. As at June 28, 2019, we entered into two $50 million interest rate swaps totaling $100 million as hedges of the variability in cash flows attributable to movement in interest rates. The swaps expire on March 31, 2024 and require interest payments.

Our objective when managing our capital structure is to maintain a strong financial position and to provide returns with sufficient liquidity to undertake further growth for the benefit of our shareholders.

There were no changes to our approach to capital management from Fiscal 2018.

We are subject to certain financial covenants in our debt obligations. Refer to Note 7 to the Interim Condensed Consolidated Financial Statements for details. Our strategy is to ensure we remain in compliance with all of our existing covenants so as to ensure continuous access to required debt to fund growth. We review results and forecasts to monitor our compliance.

DISCLOSURE CONTROLS & PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reports for external purposes in accordance with IFRS. In designing such controls, it should be recognised that due to inherent limitations, any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements. Additionally, management is required to use judgment in evaluating controls and procedures.

Changes in Internal Control Over Financial Reporting

There were no changes to our disclosure controls and procedures and internal control over financial reporting (“ICFR”) during Q2 2019 that have materially affected, or are reasonably likely to materially affect, ICFR or disclosure controls.

CRITICAL ACCOUNTING ESTIMATES AND ACCOUNTING STANDARDS

Critical Accounting Estimates and Judgments

The preparation of consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and assumptions are continuously evaluated and are based on management’s best judgments and experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected. Actual results may differ from these estimates.

The most significant accounting judgments and estimates that we have made in the preparation of the Consolidated Financial Statements are consistent with that as described in our Fiscal 2018 consolidated financial statements and MD&A.

Recently Adopted Significant Accounting Standards

IFRS 16

IFRS 16 was issued in January 2016 by the IASB as a replacement for IAS 17 and is effective for annual periods beginning on or after January 2019. IFRS 16 introduces a single, on-balance sheet accounting model for lessees. A lessee recognises a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Right-of-use assets will be initially measured at cost, which includes the initial measurement of the lease liabilities and other costs, less lease incentives. Lease liabilities will initially be measured at the present value of future lease payments and will subsequently be measured at amortized cost using the effective interest rate method.

IFRS 16 may be applied retrospectively to each prior period presented (full retrospective approach), or with the cumulative effect of adoption recognised at initial application (modified retrospective approach). The modified retrospective method offers the option, on a lease by lease basis, to either measure the right-of-use asset retrospectively using the discount rate as at the date of initial application, or to measure the right of use asset at an amount equal to the lease liability. We have elected to apply the modified retrospective approach upon adoption at December 29, 2018 measuring the right of use asset at an amount equal to the lease liability. The short-term and low-value recognition exemptions available under the standard will be utilized, along with certain practical expedients.

On transition to IFRS 16, we recognised additional right-of-use assets and additional lease liabilities of equal amounts. Accordingly, there are no differences to be recognised in retained earnings. The impact on transition is summarised below.

(in thousands)	**Q2 2019 Actual**	**Q2 2018 Actual**
IFRS 16 - Adjusted EBITDA impact		
Adjusted EBITDA	**$ 16,136**	**$ 14,861**
Deduct: Lease Payment Expense*	(1,798)	-
Adjusted EBITDA (excl. IFRS 16)	**14,338**	**14,861**
IFRS 16 - Net profit (loss) impact		
Net profit (loss)	**2,385**	**6,504**
Deduct: Lease Payment Expense*	(1,798)	-
Add: ROU Asset Depreciation*	2,004	-
Add: Interest on Lease Liabilities*	587	-
Net profit (loss) impact	793	-
Net profit (loss) impact (tax-effected at 27%)	579	-
Net profit (loss) (excl. IFRS 16)	**$ 2,964**	**$ 6,504**

* Adjusted for non-controlling interests.

As a result of initially applying IFRS 16, in relation to the leases that were previously classified as operating leases, we recognised $36.8 million of right-of-use assets and $36.8 million of lease liabilities as at December 29, 2018.

Also, in relation to those leases under IFRS 16, we have recognised depreciation and interest costs, instead of operating lease expense. During Q2 2019, we recognised $2.1 million of depreciation charges and $0.6 million of interest costs from these leases.

Non-IFRS Measures

The measures below are used by management as key performance indicators for our business. Certain measures used by management are not recognised under IFRS. See “Non-IFRS Measures”.

Adjusted Gross Margin Percentage

“Adjusted Gross Margin” is defined as gross margin excluding gains and losses on asset disposals and amortization of equipment and intangible assets included in cost of goods sold.

“Adjusted Gross Margin Percentage” is defined as Adjusted Gross Margin as a percentage of revenue.

We use Adjusted Gross Margin Percentage to measure our financial performance. We believe Adjusted Gross Margin Percentage is a meaningful measure because it compares our revenue generating activities to our operating costs for a view of profitability and performance. By calculating Adjusted Gross Margin Percentage, we can show the performance trends over time as our sales mix changes. Adjusted Gross Margin Percentage will primarily be affected by our ability to meet targeted production volumes and to control direct and indirect costs associated with procurement and delivery of wood fibre to our production facilities and the production and distribution of industrial wood pellets. Adjusted Gross Margin Percentage as we calculate it may not be comparable to metrics provided by other businesses.

Adjusted EBITDA

“EBITDA” is defined as consolidated net income (loss) before depreciation and amortization, finance expense and provision for income taxes.

"Adjusted EBITDA" is defined as EBITDA excluding non-cash stock compensation expense, asset impairments and disposals, and certain items of income or loss that we characterize as unrepresentative of our ongoing operations. Adjusted EBITDA includes an amount representing our 30% share of HPLP and excludes the non-controlling interests share of LPLP, SPLP, and PWRHLLC.

We use Adjusted EBITDA to measure our financial performance. Adjusted EBITDA is a supplemental measure used by management and other users of our financial statements including shareholders and lenders, to assess the financial performance of our business without regard to financing methods or capital structure.

We believe Adjusted EBITDA is a useful measure of operating performance as it provides a more relevant picture of operating results by excluding the effects of financing and investing activities which removes the effects of interest, depreciation and amortization costs, expenses that are not reflective of our underlying business performance, and other one-time or non-recurring expenses. We use Adjusted EBITDA to facilitate a comparison of our operating performance on a consistent basis and to provide for a more complete understanding of factors and trends affecting our business.

Free Cash Flow

"Free Cash Flow" is defined as Adjusted EBITDA less maintenance capital expenditures, finance costs, principal repayments, and cash taxes paid.

We use Free Cash Flow as a performance metric to compare the cash generating performance of the business from period to period and to compare the cash generating performance for specific periods to the cash distributions, if any, that are expected to be paid to our shareholders. We do not rely on Free Cash Flow as a liquidity measure.

As we intend to distribute dividends on an ongoing basis, and since Adjusted EBITDA is a metric used by many investors and financial analysts to compare issuers on the basis of the ability to generate cash from operations, we believe that, in addition to net cash provided by operations, Adjusted EBITDA is a useful non-IFRS supplemental measure from which to make adjustments to determine Free Cash Flow. We believe Adjusted EBITDA provides a more relevant picture of operating results in that it excludes the effects of financing and investing activities by removing the effects of interest, depreciation and amortization costs, expenses that are not reflective of underlying business performance, and other one-time or non-recurring income or expenses. However, there are no standard definitions of Adjusted EBITDA or Free Cash Flow prescribed by IFRS and other issuers may calculate similarly described measures differently.

RELATED PARTY TRANSACTIONS

HPLP transactions

HPLP is owned 30% by us and 70% by non-related third parties. We purchase industrial wood products from HPLP and earn revenue from sales of fibre and distribution fees. We manage and administer the business affairs of HPLP and charge a management fee. These transactions are at negotiated amounts with the non-related third parties.

The amounts receivable and payable to us are unsecured and non-interest bearing.

LPLP transactions

LPLP is owned 75% by us and 25% by a non-related third party. We purchase industrial wood products from LPLP and earn revenue from sales of fibre at negotiated prices with the non-related third party. We manage and administer the business affairs of LPLP.

The amounts receivable and payable to us are unsecured and non-interest bearing.

SPLP transactions

SPLP is owned 70% by us and 30% by a non-related third party. We and the non-related third party make contributions proportionate to our ownership interest to fund the construction of the Smithers Facility. We manage and administer the business affairs of SPLP.

The amounts receivable and payable to us are unsecured and non-interest bearing.

PWRHLLC transactions

PWRHLLC is owned 70% by us and 30% by a non-related third party. We and the non-related third party make contributions proportionate to our ownership interest to fund the capital spending program at the Aliceville Facility through WPILLC. We manage and administer the business affairs of PWRHLLC.

The amounts receivable and payable to us are unsecured and non-interest bearing.

Significant shareholder

Based on information provided by ONCAP, as at June 28, 2019 ONCAP beneficially owned, or controlled or directed, directly or indirectly, approximately 31.3% of the issued and outstanding common shares of the Company. ONCAP is ultimately controlled by Onex Corporation.

See Note 17 to the Consolidated Financial Statements for additional details on related party transactions.

SHARE CAPITAL

Our authorized share capital consisted of unlimited common participating, voting shares, without par value, and unlimited preferred participating, non-voting shares, without par value.

Current Share Information

As of August 12, 2019 we had 33,307,313 Common Shares issued and outstanding and no preferred shares issued and outstanding. As of August 12, 2019 an aggregate of 2,125,233 options to acquire Common Shares and 14,793 restricted share units representing the right to Common Shares are outstanding.

SUBSEQUENT EVENT

On August 5 and 6 2019, USD $53.7 million of NMTC debt was repaid by WPI LLC. This represents all of the federal portion of the NMTC debt and reduces each of the amounts payable and receivable against the NMTC debt. The remaining balance of the NMTC debt of USD $9.3 million is anticipated to be repaid in the first quarter of 2020.

Additional Information

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