# NOTICE TO READER

This Management's Discussion and Analysis for the thirteen week period ended March 27, 2020 has been revised (the "Revised MD&A") from the original version that was filed on SEDAR on May 11, 2020 and is being refiled concurrently with the Company's restated interim consolidated condensed financial statements for the thirteen week period ended March 27, 2020. This Revised MD&A reflects the effects of the restated financial statements (which are detailed in the section entitled "Restatement" and derive from an error recording the fair value of two interest rate swaps) and includes the disclosure of a material weakness in the Company's internal control over financial reporting that existed at the end of the interim period in light of the restatement.

First Quarter of Fiscal 2020

For the 13-week periods ended
March 27, 2020 and
March 29, 2019

June 11, 2020

# Revised Management's Discussion & Analysis

Pinnacle.
RENEWABLE ENERGY INC.

## GENERAL INFORMATION AND CAUTIONARY STATEMENTS

### Introduction

The following management's discussion and analysis ("MD&A") dated June 11, 2020 provides information concerning the financial condition and results of operations of Pinnacle Renewable Energy Inc. 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 period ended March 27, 2020. This MD&A should be read in conjunction with our unaudited interim condensed consolidated financial statements as at March 27, 2020 and for the three months then ended, our audited consolidated financial statements and accompanying notes for Fiscal 2019 (the "Consolidated Financial Statements") and our annual MD&A as at and for the year ended December 27, 2019, all 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 International Financial Reporting Standards ("IFRS"), as issued by International Accounting Standards Board ("IASB"), 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 2018" are to our 52-week period ended December 28, 2018, all references to "Fiscal 2019" are to our 52-week period ended 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 "Q1 2020" are to our 13-week period ended March 27, 2020, all references to "Q1 2019" are to our 13-week period ended March 29, 2019. 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.

Quarterly comparative information for fiscal 2019 has been restated in this MD&A to reflect the finalization of the purchase price allocation for our acquisition of a 70% interest in the Aliceville Facility (as defined herein). The Aliceville acquisition occurred in Q4 2018; however, the purchase price allocation was finalized in Q4 2019 in accordance with IFRS 3. See also Note 19 of the 2019 Annual Consolidated Financial Statements.

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 June 11, 2020, which is the date of filing in conjunction with our press release announcing our results for Q1 2020. Disclosure contained in this document is current to June 11, 2020, 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; COVID-19 and anticipated production from our facilities.

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 31, 2020, 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. 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 2020, 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 two in construction with a combined run-rate production capacity in excess of 2.83 million metric tonnes 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)”. On October 15, 2018, we acquired a 70% interest in an operating industrial wood pellet production facility located in Aliceville, Alabama (the “Aliceville Facility”) (300,000 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. We expect to commence commissioning of the expanded Williams Lake Facility in Q2 2020. We will look to complete the expansion of the Meadowbank Facility in the future. On July 4, 2019, we entered into a limited partnership agreement with Tolko Industries Ltd. (“Tolko”) to build and operate Northern Pellet Limited Partnership (“NPLP”), 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 200,000 MTPA. Initial wood pellet production at the High Level Facility is expected to commence in the fourth quarter of 2020. On December 19, 2019, we announced our planned construction of a new industrial wood pellet production facility in the southeast United States (the “Demopolis Facility”), in partnership with the Westervelt Company and Two Rivers Lumber Company. The Demopolis Facility is expected to have a production capacity of 360,000 MTPA. For additional information regarding these facilities, see “Recent Developments – New and Expanded Production Facilities”.

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 99% of our production capacity through 2026 on an aggregated basis, including new production capacity from the Demopolis, Aliceville, Entwistle and High Level Facilities, and increased capacity at the Williams Lake Facility. As at March 27, 2020, 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.

In February 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”.

## RESTATEMENT

In June 2020, the Company identified an error in recording the unrealized (non-cash) impacts of the change in fair value of two interest rate swap contracts for Q1 2020, whose market values declined as a result of a significant decline in interest rates. The interest rate swaps effectively convert the Company's floating interest rate interest payments into fixed interest rates and are marked-to-market for financial reporting purposes at each reporting period end reflecting fluctuations in fair values of the swap contracts caused by fluctuations in market interest rates. The effect of the error was that it required the restatement of the Company's Interim Condensed Consolidated Financial Statements for Q1 2020. For the 13-week period ended March 27, 2020, the effect of this error was an understatement of finance costs of $6,846 and an understatement of deferred tax recoveries of $1,848. As at 27 March 2020, Other long-term assets were overstated by $3,423, deferred tax assets were understated by $1,848, other long-term liabilities were understated by $3,423 and deficit was understated by $4,998.

The impact of the restatement on the interim condensed consolidated financial statements as at and for the 13-week period ended March 27, 2020 is as follows:

| | **As previously reported** | **Adjustment** | **Restated** |
|---|---|---|---|
| **STATEMENT OF FINANCIAL POSITION - MARCH 27, 2020** | | | |
| Other long-term assets | 3,769 | (3,423) | **346** |
| Deferred income taxes | 3,886 | 1,848 | **5,734** |
| Other long-term liabilities | 2,608 | 3,423 | **6,031** |
| Deficit | (126,032) | (4,998) | **(131,030)** |
| **STATEMENT OF LOSS AND COMPREHENSIVE INCOME(LOSS)** | | | |
| Finance costs | (1,500) | (6,846) | **(8,346)** |
| Deferred income tax recovery | 1,437 | 1,848 | **3,285** |
| Net loss | (4,134) | (4,998) | **(9,132)** |
| Net loss attributable to: | | | |
| Owners of the Company | (3,837) | (4,998) | **(8,835)** |
| Net loss per share attributable to owners (Basic and diluted): | (0.12) | (0.14) | **(0.26)** |
| Comprehensive income (loss) for the period | 1,671 | (4,998) | **(3,327)** |
| Comprehensive income (loss) attributable to: | | | |
| Owners of the Company | 226 | (4,998) | **(4,772)** |
| **STATEMENT OF CASH FLOWS** | | | |
| Net loss | (4,134) | (4,998) | **(9,132)** |
| Financing costs, net | 1,500 | 6,846 | **8,346** |
| Deferred income tax recovery | (1,437) | (1,848) | **(3,285)** |

## Strategy and Objectives

Through increasing capacity at our existing production facilities, the addition of other greenfield and brownfield projects, including the upgrades at our Williams Lake and Meadowbank Facilities, and the construction of the High Level and Demopolis Facilities, 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 2018 to 2026.

Our B.C. production facility diversity and purchasing power offers a unique proposition with wood fibre suppliers, as the entire residual basket can be acquired and optimally allocated amongst our multiple production facility locations for efficient processing. Sawmill industry production volumes vary with lumber prices, stumpage rates and economic cycles, resulting in sawmill closures and fluctuations in production of sawmill residuals during down cycles. To offset reduced sawmill residuals, we are able to source consistent supplies of harvest residuals to fill the gap of sawmill residuals, where necessary. We have wood fibre supply contracts through 2022 for approximately 69% of our raw material needs. Recent sawmill curtailments in B.C. have reduced the percentage of sawmill residual fibre under long term agreements. On average, harvest residuals and biologs have a higher cash conversion cost than sawmill residuals, resulting in higher drying and trucking costs for an equivalent amount of oven dried tons (ODT's) of fibre.

While the fibre team ensures fibre continuity for production at our B.C. facilities, increased harvest residuals result in higher fibre, fibre delivery, and repair and maintenance costs due to increased wear on production equipment. We will have reductions in production volumes in some of our B.C. facilities as a result of constraints on drying capacity and more downtime required for maintenance activities. As outlined below, we have undertaken and will continue to undertake strategies to mitigate the reduction in fibre from our historic suppliers through various strategic initiatives. The same cyclical dynamics are less pronounced in Alberta and Alabama as sawmills have not historically paid the same cost for logs and have been able to continue to operate during lower lumber price cycles.

Our partnerships and relationships with governments, local communities, and First Nations are a core component of our values. We collaborate with a long-term view to positively contribute to the communities we operate in within all states and provinces, grow sources of available fibre, contain operating costs, and enhance regional safety and forest stewardship. While the impact from forest fires in B.C. in 2019 was limited, the regions in B.C. where we operate have experienced a significant impact from the mountain pine beetles and forest fires over recent years. Our experienced fibre team continues to explore additional salvage opportunities as our facilities can consume a broad range of residual fibre. We continue 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 of the forest sector in B.C. We are working with First Nations to continue advancing opportunities for fibre procurement and processing, 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 remain focused on diversifying our fibre basket. Once our High Level and Demopolis Facilities come online in 2020 and 2021, we will have regionally diversified over 44% of our production capacity outside of B.C.

Our focus on operational excellence throughout our plant and logistics network is targeted on improvements in safety, production, and managing our fibre and cash conversion costs. Our facilities are able to process a broad range of residual biomass and we have increased our harvest residual fibre supplies and inventory for greater diversity of suppliers. The shift in fibre mix in B.C. from sawmill residuals to harvest residuals results in higher fibre processing and cash conversion costs. As such, we have increased our harvest residual breakdown capabilities by increasing the number of chippers from two units in 2018 to ten units in Q1 2020, to manage the fibre processing and cash conversion costs. Through the first quarter we have continued investing in chippers, destoners and other specialized biomass processing equipment. This investment, combined with our extensive operational knowledge, will help to drive cost effective production from harvest residual fibre sources.

We have access to a well-established rail infrastructure network in B.C. and Alberta, with all of our Canadian production facilities accessible along CN rail lines. We rely on rail transport to be operating effectively in order to transport our pellets to port. 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 Alabama facilities, wood pellets are cost-effectively shipped by barge downriver to the port of Mobile, Alabama where they are loaded directly onto cargo ships. The effectiveness of this mode of transport is subject to weather events and water levels.

In addition to organic growth opportunities, we continue to evaluate and pursue acquisition opportunities or other strategic initiatives in Western Canada, in the U.S. Southeast, and 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

### COVID-19

The Company's operations were not significantly impacted by the outbreak of a novel strain of coronavirus ("COVID-19") in Q1 2020, however employee absences did result in increased costs and this trend is expected to continue into Q2 2020. The governments of Alberta, B.C. as well as Alabama, consider our operations to be an essential service and as such, we have not lowered our production levels due to COVID-19 and have remained fully operational during the quarter. We have remained focused on work safety while adjusting to the recommended COVID-19 practices, including social distancing, thorough hand washing, limiting contractors and other visitors to our sites, and regular cleaning and disinfecting of objects and surfaces. Pinnacle does not expect demand for pellets to be impacted as the Company has long-term take or pay contracts with its customers in place, with fixed pricing and fixed volumes, that fully contract our production capacity with a weighted-average remaining term of approximately 9 years and a revenue backlog of $6.9 billion. We now have an annual average of 99% of our announced production capacity contracted through 2026, on an aggregated basis, including production capacity of the Entwistle Facility, incremental production capacity of the Williams Lake and Meadowbank facilities and new production capacity of the High Level and Demopolis Facilities. Most of the new volume demand commences in 2021 and beyond.

In the event power consumption declines, it is expected that use of other non-renewable fuels will be reduced ahead of any reduction in wood pellet use. COVID-19 has already had a material impact on our fibre suppliers. Announcements of sawmill curtailments began in March and continued into April. Although the new curtailments did not have a material impact on the Company's financial results in Q1 2020, we focused fibre procurement on increased harvest residuals and fibre inventories to improve production resilience in the changing supply environment.

### CN Rail disruptions

The January 2020 derailment of CN Rail ("CN") in B.C. resulted in the loss of Pinnacle leased railcars as well as loss of pellets. Costs were recovered from CN in March 2020 for lost pellets. The derailment however also resulted in service disruptions which further impacted production output for a period of clean up for which we were not compensated. Ten straight days of cold weather in January caused CN Rail disruptions resulting in some additional facility downtime.

In February 2020, several blockades were set up across Canada on rail lines belonging to CN Rail in solidarity with the Wet'suwet'en hereditary chiefs opposed to the Coastal GasLink pipeline project in northern B.C. These blockades resulted in curtailed production at our BC facilities when storage was already full, as well as disruption in scheduled shipping during the quarter at B.C. ports as ships were rescheduled to avoid demurrage costs during the period of high rail uncertainty. Additional production costs were incurred to manage the impact of the disruption from the blockades. The CN Rail disruptions resulted in approximately 20,000 MT of production lost with a $2.1M EBITDA impact.

### Charter vessel lease

In January 2020, Pinnacle entered into a long-term lease with NYK Bulk & Projects Carriers Ltd ("NYK"), to charter a vessel which will be used to carry our wood pellets from Canada to Japan. This vessel is scheduled to be available for use by Pinnacle commencing in Q1 2021, for a period of 15 years. The logistics model we are using will provide both ourselves and our customers the widest possible delivery flexibility at the lowest possible cost. This agreement is one of the important elements in our approach to logistics as we continue to participate in the trend of B.C. based businesses expanding in Asian markets.

### Appointment to Board of Directors

On April 21, 2020, the Company announced the appointment of Mr. Duncan Davies to its Board of Directors. From 2000 to 2019 Mr. Davies served as President and Chief Executive Officer of Interfor Corporation and holds a Bachelor of Arts (Economics) from the University of Victoria and a Master of Science (Forestry Economics) from the University of British Columbia. Mr. Davies currently serves as the Vice Chair of the Binational Softwood Lumber Council. He was previously Co-Chair of the B.C. Lumber Trade Council and the Canadian Lumber Trade Alliance and a Director of the Council of Forest Industries of B.C. He was also one of the founding members of the Softwood Lumber Board.

## New and Expanded Production Facilities

***Impact of COVID-19 on Capital Projects***

With the emergence of COVID-19 in Q1 2020 and the resulting supply chain disruptions and the announced international travel restrictions affecting the onsite presence of our external experts, Management decided to proactively delay smaller projects in order to preserve the Company's capital and enforce federal safety standards in light of the pandemic. We have however, with stringent safety precautions in place, including social distancing, thorough hand washing and regular cleaning and disinfecting of objects and surfaces, continued the planned construction of our new facilities at Demopolis and High Level in order to meet our future commitments to our customers and their long-term contracts.

***Demopolis***

In Q4 2019, we announced our plan to begin construction of a new industrial wood pellet production facility in the U.S southeast, in close proximity to the Aliceville Facility. The new facility (the "Demopolis Facility") will be located adjacent to an existing large sawmill in Demopolis, Alabama. The Demopolis Facility is expected to have annual production volume of 360,000 MTPA that will be sold through Pinnacle's contracted backlog of long-term, take-or-pay off-take contracts. As mentioned above, with added health and safety precautions in place, construction teams broke ground at this facility in Q1 2020 and construction has progressed as planned during the quarter and within budget. With the addition of the Demopolis facility, Pinnacle will have over 44% of its run-rate production capacity outside of the B.C. fibre basket. Commissioning the Demopolis Facility with initial industrial wood pellet production is expected in the second quarter of 2021.

***High Level***

Construction of the High Level Facility resumed with added health and safety precautions, as planned, in March 2020 along with the arrival of warmer weather conditions. The High Level Facility is expected to be completed as planned in Q4 2020. Review of budget and schedule and advancement of scope for the CN rail infrastructure has resulted in additional capital required of $2 million, bringing the total to $60.5 million before the project's share of capital required for rail infrastructure, with Pinnacle's 50% share being $30.25 million plus 50% of the project's share of capital for rail infrastructure. The budget overruns are the result of concerns with the design and fabrication of structural elements of the facility. Tolko will supply additional fibre for upcoming years due to forest fire log processing in the area, providing a strong supply of available fibre. We are confident that this will enable our High Level Facility to produce 200,000 MTPA.

***Williams Lake and Meadowbank***

In Q1 2020, Management decided to continue operating the Williams Lake Facility with the current dryer in place and to temporarily suspend the dryer upgrade project at this facility, as equipment vendors were not able to travel onsite for commissioning purposes due to travel restrictions resulting from the COVID-19 pandemic. As this project is near its completion, Management is investigating various options to engage remote support of experts and remote desktop access to proprietary equipment software in order to safely commission the remainder of the project in Q2 2020.

Upgrades at our Meadowbank Facility have been put on an extended schedule in order to preserve capital due to COVID-19 as previously stated. We will look to complete the expansion of the Meadowbank Facility in 2021.

These upgrades will provide further capabilities to manage increased harvest residuals in B.C. and will enhance the operating flexibility of the facilities, positioning Pinnacle to adapt to cyclical changes in wood fibre supply within the B.C. interior. Furthermore, the equipment, technology and infrastructure improvements will result in improved facility operating efficiencies, lower emissions, local employment opportunities and greater overall facility safety.

***Smithers***

In 2019, we finalized plans to install a chipper and additional pelleter at the Smithers Facility, in which we have a 70% interest, for a total capital cost of approximately $6.0 million (Pinnacle's portion amounting to $4.2 million). We plan to take advantage of the incremental available fibre in the region and anticipate that the upgrade will decrease costs and increase production run-rate output by approximately 15,000 MTPA. A substantial portion of this project was expected to begin in Q1 2020, but for the reasons stated above relating to COVID-19, Management has decided to extend the project schedule by approximately 6 months.

## MARKET UPDATE

Global demand for industrial wood pellets for electrical generation has been unaffected by the COVID-19 pandemic in Q1 2020 and Management expects this demand to remain unaffected for the foreseeable future. Despite a reduction in demand for total electrical energy due to COVID-19 related reductions in industrial output, demand for renewable electrical energy has been stable as incentives guaranteed by enabling countries for renewable energy are still in effect. Furthermore, a strong need exists for dispatchable thermal electricity to offset the intermittent supply of solar and wind power and also to provide an important grid stabilizer, particularly in light of the changed electrical demand pattern brought on by lower industrial demand.

The global demand outlook 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 (UK), the Renewable Energy Directive (EU), the Best Energy Mix (Japan) and the Renewable Portfolio Standard (South Korea).

In the United Kingdom ("UK"), Drax Group plc have recently demonstrated pilot scale carbon capture and storage using wood pellets as biomass fuel in a program called BioEnergy Carbon Capture & Storage ("BECCS"). BECCS will provide carbon negative generation capability, which could encourage further policy support from the UK government, as it would allow the UK to reach carbon goals more quickly. BECCS technology could in time be employed beyond the UK. If the Drax Group is successful with their BECCS proposal, this would significantly increase the future demand for pellets.

The COVID-19 pandemic has not affected the timeline for bringing on new biomass power plants in Japan and Korea.

Japanese demand remains strong as various feed-in tariff (FIT) new build projects slowly begin to come on-line. Pinnacle expects volumes in Japan to grow consistent with market demand as most FIT new build projects in Japan have now contracted their fuel. The next growth wave for wood pellets in Japan is expected to be the conversion of existing coal fired stations to some degree of co-firing with biomass. This could create additional biomass demand in that country. The regulatory framework for this initiative has been developed for implementation by 2030.

Pinnacle's Korean independent power producers (IPP) counterparties are in the midst of constructing their new build power stations. Shipments are expected to start in the second half of 2020.

The European Union (EU) commissioned consultants to develop guidance for EU sustainability which would come into effect by 2030. We expect that this will further underpin the need for sustainable biomass in the EU and will support the demand for wood pellets in Europe. Pinnacle shipments to the Netherlands will start to ramp up in 2020 as the co-firing effort there intensifies. Three of our European contract counterparties including Drax and RWE will benefit to various degrees by the recent approval of the EU Commission of the UK Capacity Market in respect of its compliance with State Aid regulations. This should improve the profitability of those companies. We expect this to reflect positively on their business in the longer term and therefore on their ability to consume biomass beyond the current subsidy horizon.

The coal phase-out proposed by the German Commission on Growth, Structural Change and Employment is expected to lead to legislation that should provide a phase-out of the use of coal for electrical generation in Germany by 2038. The German Government has announced plans to exit coal three years earlier than the 2038 deadline set by the Commission. German federal ministers and representatives of four coal mining states reached an agreement in January 2020, whereby, the German Government agreed to pay utility companies up to 4.35 billion euros collectively for the early exit, in addition to the 40 billion euros already promised to coal mining regions. Currently about one third of German power is derived from coal fired power stations, generating approximately 41 gigawatts of energy. If a portion of that generative capacity is converted to run on biomass fuels in order to ensure that stability can continue to be provided to the electrical grid from dispatchable generation units, the phase out of coal could provide further impetus for wood pellet demand as base load fuel in Germany.

## OPERATIONAL UPDATE

### Existing Production Facilities

A difficult Q4 2019 impacted Q1 2020 results as high cost and high volume finished pellet inventory from year end reduced margins in the quarter. In addition, third party purchased pellets, with no margin, were used to fulfill customer obligations due to production shortfall as a result of the Entwistle incident.

As discussed above, operational challenges continued in January and February due to disruptions resulting from the CN Rail strike in Q4 2019 as well as the January and February CN service disruptions. Progress was, however, realized in March with solid production volumes and cost performance as the facilities were able to operate continuously. Compared to Q1 2019, production in BC has been impacted due to the transition in fibre to greater harvest residuals. Investment in fibre inventory continues in 2020 in order to ensure consistent production levels at BC mills, with increased focus as we see sawmill curtailments resulting from falling lumber demand and prices due to COVID-19.

Entwistle production exceeded our expectations for production in the first complete quarter of full operations since recommissioning the dryer system. The destoner is commissioning well and working as intended. We achieved positive EBITDA contribution in March 2020 and exceeded run-rate production for two consecutive weeks in February. We expect positive EBITDA contribution for Q2 2020. Strong production results are providing support for continued discussions with our insurers for our business interruption insurance claim. In Q1 2020 we recorded amounts receivable in the statement of financial position of $2.5 million for property claim insurance proceeds receivable and $1.0 million for business interruption insurance proceeds receivable. Property claim proceeds were recorded in other income in the statement of profit (loss) while business interruption insurance proceeds were recorded against production costs.

February was a rain filled month at our Aliceville Facility, with the rain gauge at the facility registering 12.80 inches for the month. The Tombigbee River breached its banks, not only at our dock but also at surrounding homes and roads. Barges were unable to be placed at the dock for approximately 2 weeks, due to high river levels, which resulted in our silos being at or near top capacity at this Facility. Management made the decision to proactively bring the facility down for five days during the high-water. Adjusted gross margin was negatively impacted in Q1 2020 due to the prolonged pellet storage on barges during this high-water event.

### Fibre

The Company continued to invest in strategic fibre inventories in 2020. At the end of Q1 2020, the Company had built up enough fibre inventory to sustain 2.6 months of production activity at its B.C. facilities. This has increased by approximately 0.6 months since the end of Q4 and was done in order to mitigate the impact of fluctuations in fibre availability. In March, some of the large sawmill owners announced sawmill curtailments as a result of COVID-19. Pinnacle is sourcing alternative harvest residuals and will continue to invest in fibre inventories in Q2 2020. Anticipated stumpage rate declines in July 2020 should help sawmill profitability. However, the impact of COVID-19 on lumber demand and sawmill output into future quarters is uncertain. At the end of Q1 2020, the Company had accumulated a consistent fibre supply and held fibre inventory valued at $19.3 million, compared to $9.5 million in Q1 2019 and $14.2 million at the end of Q4, 2019.

The fibre supply was stable early in Q1 2020 after B.C. sawmills resumed operation after an uncharacteristically longer downtime over the early January holiday period. Our facilities utilized stock-pile fibre and harvest residuals during this period in order to supplement production.

Over the last two quarters we have been able to reduce the incremental procurement cost of harvest residuals. When the large curtailments were announced in Q3 2019, we had to purchase higher cost fibre to ensure consistency of supply and build inventories. In Q4 2019, and even more so in Q1 2020, we are able to be more selective about fibre quality and cost now that we have strong inventory levels. The benefit of the cost reduction activities is not yet reflected in Q1 2020 results as we are consuming older, higher cost fibre and shipping pellets made in prior months.

The Forest Enhancement Society of British Columbia (“FESBC”) was established to advance and advocate environmental and resource stewardship of B.C. forests. During the first quarter of 2020, our application was approved for an additional $1.3 million from the FESBC. This money provided an incremental hauling offset to approximately 45,000 ODT of logs and bushgrind volume that meet Pinnacle’s customer sustainability criteria and allows us to harvest uneconomical blocks that we would not harvest without this funding. Included in the above application, is a project that will benefit our Lavington Facility, whereby we received approval to spend $0.5 million on procuring fibre that would otherwise be uneconomical. We applied almost $0.1 million of this funding to move low grade logs from harvest blocks for processing by our contractors to be delivered to LPLP over the break-up season. We expect this project to be completed in Q2 2020. Also included in this successful application, was $0.9 million for a grinding project South of Francois Lake (Burns Lake), where there is an extensive area of predominantly dead or burnt pine. In Q1 2020, we have claimed approximately $0.2 million relating to this project. In aggregate, $1.1 million in funds were received during Q1 2020 and we will continue to apply for similar incentives during the remainder of 2020.

We continue to maintain an active dialogue and actively collaborate with our B.C. partners with whom we jointly own wood pellet production facilities, namely Canfor Corporation ("Canfor"), West Fraser, and Tolko Industries as well as other major suppliers, including Interfor Corporation and Weyerhaeuser Company to further refine and optimize the fibre procurement mitigation strategies. With the increased industry challenges resulting from COVID-19 we are working more closely than ever.

We continue to have good availability of wood fibre in Alberta. The Alberta government has increased annual logging volume from public lands by 30 per cent, while continuing to manage the province's forest resource in a healthy and sustainable fashion. This will result in additional fibre supply for our facilities in Alberta and will align with our plans to diversify additional fibre supply from outside of B.C. Although there are some sawmill curtailments in Alabama, we do not expect production volume or costs to be significantly impacted as a result.

## FINANCIAL HIGHLIGHTS

We refer the reader to the section entitled "Non-IFRS Measures" 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.

Selected financial highlights include the following:

| ***(In thousands $)*** | **Q1 2020 13 weeks** | **Q1 2019 13 weeks** |
|---|---|---|
| Revenue | **109, 675** | 89,627 |
| Production costs | **86,129** | 67,121 |
| Distribution costs | **14,561** | 12,766 |
| Selling, general and administration expenses | **4,657** | 3,793 |
| Amortization | **10,794** | 9,602 |
| Net profit (loss) | **(9,132)** | (7,006) |
| Adjusted Gross Margin* | **8,994** | 10,366 |
| Adjusted Gross Margin Percentage* | **8.2%** | 11.6% |
| Adjusted EBITDA* | **4,044** | 7,060 |
| Free Cash Flow* | **(1,137)** | 593 |
| **Net profit (loss) per share attributable to owners** | | |
| Basic and diluted | **(0.26)** | (0.20) |
| | **Mar 27, 2020** | **Dec 27, 2019** |
| Contracted Backlog ***(In billions $)*** | 6.9 | 7.0 |

* 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 March 27, 2020 is as follows ($ billions):

| | |
|---|---|
| Fiscal 2020 | 0.4 |
| Fiscal 2021 | 0.5 |
| Fiscal 2022 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 Restart

As previously disclosed, our Entwistle Facility sustained damage to its dryer and surrounding equipment on February 11, 2019 and caused the Facility to stop production. We restarted the dryer at Entwistle as planned in early November 2019 and we have finished the rebuild, restarted the furnace, and commissioned the new equipment. Production in Q1 2020 has exceeded expectations and performance resulted in positive EBITDA contribution in March 2020.

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 approximately $22.5 million. A total of $25.0 million (net of $1.0 million deductible) of insurance proceeds have been recognized from Q1 2019 through Q1 2020. Outstanding insurance recoveries available are expected to be finalized with our insurance providers in Q2 2020, and include 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. Capital asset repair costs are expected to total $13.4 million. $12.0 million has been capitalized to construction in progress, all incurred in fiscal 2019. $1.2 million of demolition expenses are recorded in other expenses on the statement of profit (loss). The impact has been partially offset by property insurance proceeds of $11.5 million (net of $1.0 million deductible) received since Q1 2019 which have been recognised in net profit (loss), of which $2.5 million was recognised in Q1 2020. Remaining property insurance proceeds of $0.9 million are expected to be recognised in Q2 2020. At the end of Q1 2020, a total of $13.5 million for business interruption insurance has been recognised in net profit (loss) as a reduction of production costs, of which $1.0 million was recognised in Q1 2020. As at March 27, 2020, $19.0 million has been received in cash for property and business interruption insurance and $6.0 million has been included in other receivables. $3.0 million of the amount receivable at March 27, 2020 was received in cash in April 2020. The remaining balance of $3.5 million is expected to be received in Q2 2020.

Approximately $10.3 million of remaining costs relate to fixed overhead, other expenses, and incident response costs. $9.2 million has been incurred since the event; $0.5 million was reflected in production costs in Q1 2020, $7.3 million fiscal 2019. $0.6 million was incurred in other expenses in Q1 2020 and $1.8 million in fiscal 2019.

As of March 27, 2020, the Entwistle Facility has been performing at a higher rate than our recommissioning plan and is drawing closer to full run rate capacity. The costs of the event, including capital, incident response, investigation, and asset impairment are substantially complete. The remaining range in costs of $0.2 million for capital and $0.1 million for fixed overhead, other expenses, and incident response costs are intended to cover final paving onsite at the Entwistle Facility and any additional professional fees and overhead costs required to finalize the property insurance and business interruption insurance claims in Q2 2020. The timing of remaining costs, recognition of final insurance recoveries, and receipt of cash 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 in the first and second quarters of 2020, as well as our non-IFRS financial measures, may not be comparable to those for previously reported periods in 2019.

## RESULTS OF OPERATIONS

### Analysis of Results for Q1 2020 to Q1 2019:

| *(In thousands $)* | Q1 2020 | Q1 2019 | Change |
|---|---|---|---|
| **MT('000) of industrial wood pellets sold** | **510** | 402 | 26.9% |
| **Revenue** | **109,675** | 89,627 | 22.4% |
| **Costs and expenses** | | | |
| Production | **86,129** | 67,121 | 28.3% |
| Distribution | **14,561** | 12,766 | 14.1% |
| Selling, general and administration | **4,657** | 3,793 | 22.8% |
| Amortization | **10,794** | 9,602 | 12.4% |
| | **116,141** | 93,282 | 24.5% |
| **Loss before finance costs and other income (expense)** | **(6,466)** | (3,655) | 76.8% |
| Finance (cost)/ income | **(8,346)** | (6,773) | 23.2% |
| Other income (expense) | **2,395** | 880 | 172,2% |
| | **(5,951)** | (5,893) | 1.0% |
| **Net loss before income taxes** | **(12,417)** | (9,548) | 30.0% |
| **Income tax recovery** | | | |
| Deferred income taxes | 3,285 | 2,542 | 29.2% |
| **Net loss** | **(9,132)** | (7,006) | (30.3%) |
| Impact of: | | | |
| Entwistle Incident* | 1,782 | (1,566) | n.a |
| **Net loss (excluding above impact)** | **(10,914)** | (5,440) | 100.6% |

* Tax effected at 27%.

***Revenue***

Revenue for Q1 2020 totaled $109.7 million, an increase of $20.0 million, or 22.4%, compared to $89.6 million for Q1 2019. The increase is primarily attributable to higher sales volumes. Q1 2020 CIF sales were 1.2% lower than Q1 2019 and accounted for 48% of total sales in Q1 2020 which also contributed to a shift of revenue in Q1 2020 compared to Q1 2019. We also experienced shipping delays due to the CN Rail strike in Q4 2019 that resulted in a shift of revenue into Q1 2020 as over 30% of the pellets shipped during Q1 2020 were produced in 2019.

***Production***

Production costs were $86.1 million for Q1 2020, an increase of $19.0 million, or 28.3% compared to $67.1 million for Q1 2019. The increase in production costs can be attributed to an increase in sales volume (108k MTs), higher fibre costs ($2.2 million) and higher rail costs ($0.9 million). Production costs were also affected by the high cost of Q4 inventory sold in Q1 2019. This inventory included high fibre costs consumed in Q4 as well as the costs associated with the CN Rail disruptions in Q4 2019. The higher costs were partially offset by lower cash conversion costs ($2.2 million). During Q1 2020, we also sold third-party pellets for a net loss of $0.4 million. Additional production costs were also incurred to manage the impact of the disruption from the CN Rail blockades.

Business interruption insurance recoveries of $1.0 million for lost net profit from the Entwistle Incident were recorded in production costs in Q1 2020. This amount offsets fixed overhead, and incident response costs incurred from the Entwistle Incident of $0.03 million in Q1 2020 that are recorded in production costs.

***Distribution***

Distribution costs were $14.6 million for Q1 2020 an increase of $1.8 million, or 14.1% compared to $12.8 million for Q1 2019. The increase in distribution costs is the result of increased revenues as well as higher port charges and demurrage costs in Q1 2020 resulting from scheduled shipping delays due to the CN Rail disruptions.

***Selling, general and administration***

SG&A expenses were $4.7 million for Q1 2020, an increase of $0.9 million, or 22.7% compared to $3.8 million for Q1 2019. The increase was driven by an increase of $0.6 million for professional fees and an increase of $0.1 million in business development both due to the capitalization of engineering and professional costs in Q1 2019 with no such credit in Q1 2020. IT costs were also $0.1 million higher in Q1 2020 compared to Q1 2019 due to additional spending on IT security.

***Amortization***

Amortization expense was $10.8 million for Q1 2020, an increase of $1.2 million, or 12.4% compared to $9.6 million for Q1 2019. The increase was primarily attributable to the amortization of additions to property, plant and equipment related to the Aliceville Facility and amortization on new leases for equipment and rail cars in Q1 2020 compared to Q1 2019.

***Finance costs***

Finance costs were $8.3 million for Q1 2020, an increase of $1.6 million compared to finance costs of $6.8 million for Q1 2019. Q1 2020 includes a $3.0 million fair value loss on derivative contracts compared to a loss of $1.9 million in Q1 2019. Q1 2020 also includes a $0.5 million unrealized gain on foreign exchange compared to a loss of $0.5 million in Q1 2019. The remaining increase in costs can be attributed to an increase of $0.6 million in interest paid on debt facilities and an increase of $0.3 million in realized losses on foreign exchange and $0.6 million increase in costs due to other items

***Other income (expense)***

Other income was $2.4 million for Q1 2020 compared to other income of $0.9 million in Q1 2019. Q1 2019 includes an impairment of $9.4 million relating to the Entwistle incident with no such cost incurred in Q1 2020. This variance is partially offset by a decreased of $7.1 million in other income in Q1 2020 as the 2019 period includes a $6.5 million gain on the settlement of a legal claim against a former equipment supplier. Equity earnings from associates decreased by $0.6 million compared to Q1 2019 as well as a decrease of $0.5 million in insurance recoveries for property loss at Entwistle.

## 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.

***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.

***Adjusted Gross Margin Percentage***

| ***(In thousands $ except per MT amounts)*** | **Q1 2020 13 weeks** | **Q1 2019 13 weeks** | **Change** |
|---|---|---|---|
| **Operating loss** | **(6,466)** | (3,655) | 76.8% |
| Selling, general and administration | **4,657** | 3,793 | 22.7% |
| Amortization | **10,794** | 9,602 | 12.4% |
| Equity earnings in HPLP | **(288)** | 312 | n.a |
| Non-controlling interests | **297** | 314 | (5.4%) |
| **Adjusted Gross Margin** | **8,994** | 10,366 | (13.2%) |
| **Adjusted Gross Margin per MT** | **17.64** | 25.79 | (31.6%) |
| **Adjusted Gross Margin Percentage** | **8.2%** | 11.6% | **-** |
| Impact of: | | | |
| Entwistle Incident | **494** | (2,100) | n.a |
| **Adjusted Gross Margin (excluding above impact)** | **8,500** | 12,466 | (35.6%) |

Adjusted Gross Margin Percentage was 8.2% for Q1 2020 ($17.64/MT), a decrease from 11.6% in Q1 2019 ($25.79/MT). The decrease was primarily due to an increase in operating loss as discussed above, partially offset by increases in SG&A and amortization expenses in Q1 2020. Production costs in Q1 2020 include $0.5 million of costs associated with fixed overhead and incident response costs for the Entwistle Incident (Q1 2019 - $nil). These costs are offset by $1.0 million of business interruption insurance receivable recorded in Q1 2020.

Excluding the impact of the Entwistle Incident, Adjusted Gross Margin in Q1 2020 was $8.5 million (Q1 2019 - $12.5 million).

*Adjusted EBITDA*

| *(In thousands $ except per MT amounts)* | Q1 2020 13 weeks | Q1 2019 13 weeks | Change |
|---|---|---|---|
| **MT of industrial wood pellets sold** | **510** | 402 | 26.9% |
| **Net loss** | **(9,132)** | (7,006) | 30.3% |
| Income tax expense (recovery) | **(3,285)** | (2,542) | 29.2% |
| Finance costs (1) | **8,339** | 6,622 | 25.9% |
| Amortization of equipment and intangible assets (2) | **10,108** | 9,104 | 11.0% |
| **EBITDA** | **6,030** | 6,178 | (2.4%) |
| *EBITDA Adjustments* | | | |
| Stock-based compensation expense (recovery) | **205** | 168 | 22.2% |
| (Gain) loss on disposal of PP&E and impairment (3) | **12** | 9,725 | (99.9%) |
| Insurance recovery on Entwistle Incident | **(2,500)** | (3,000) | (16.7%) |
| Gain on settlement of legal claim | **-** | (6,463) | n.a |
| Other items (4) | **297** | 451 | (34.1%) |
| Total Adjustments | **(1,986)** | 881 | n.a |
| **Adjusted EBITDA** | **4,044** | 7,060 | (42.7%) |
| **Adjusted EBITDA per MT** | **7.93** | 17.56 | (54.8%) |
| Impact of: | | | |
| Entwistle Incident | **(59)** | (2,145) | n.a |
| **Adjusted EBITDA (excluding above impact)** | **4,103** | 9,205 | (55.4%) |

**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 interests' 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 interests' share of LPLP, SPLP and PWRHLLC.

(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 interests' share of LPLP, SPLP and PWRHLLC.

Adjusted EBITDA for Q1 2020 was $4.0 million, $3.1 million lower compared to $7.1 million in Q1 2019. Increased revenue was offset by higher production costs as noted above due to increased sales volumes, the sale of external finished pellet inventory and costs incurred to manage the impact of the CN Rail disruptions and higher port charges due to blockades. This was partially offset by the impact of business interruption amounts recoverable.

In Q1 2020, $1.1 million (Q1 2019 - $2.1 million) of expenses were incurred related to the Entwistle Incident for fixed overhead, other expense, and incident response. In Q1 2020, we also recognized $2.5 million (Q1 2019 - $3.0 million) of insurance proceeds receivable in connection with the Entwistle Incident for property loss insurance as well as $1.0 million of insurance proceeds for business interruption property loss that offset production costs for lost net profit.

Excluding the impact of the Entwistle Incident, Adjusted EBITDA for Q1 2020 was $4.1 million (Q1 2019 - $ 9.2 million.).

*Free Cash Flow*

| *(In thousands $ except per MT amounts)* | Q1 2020 | Q1 2019 | Change |
|---|---|---|---|
| **Adjusted EBITDA** | **4,044** | 7,060 | (43.2%) |
| Maintenance capital expenditures [(1)] | **(538)** | (430) | 25.1% |
| Interest and finance costs, net | **(4,643)** | (4,037) | 15.0% |
| Mandatory amortization [(2)] | **-** | (2,000) | n.a |
| **Free Cash Flow** | **(1,137)** | 593 | n.a |
| Impact of: | | | |
| Entwistle Incident | **(59)** | (2,145) | n.a |
| **Free Cash Flow (excluding above impact)** | **(1,078)** | 2,738 | n.a |

**Notes:**

(1) "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 High Level Facility and Demopolis Facility to require $5.2 million in annual maintenance capital expenditures.

(2) Mandatory amortization was incurred in Q1 2019. Debt refinancing was completed in June 2019 and mandatory amortization has been deferred. There were no mandatory amortization payments made in Q4 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 Q1 2020 was -$1.1 million, a decrease of $1.7 million from $0.6 million in Q1 2019. The decrease is primarily due to a decrease of $3.1 million in Adjusted EBITDA, an increase of $0.6 million in interest and a $2.0 million mandatory amortization charge in Q1 2019 with no such corresponding charge in Q1 2020.

Excluding the impact of the Entwistle Incident, Free Cash Flow in Q1 2020 was -$1.1 million (Q1 2019 - $2.7 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)

| | 2020 | | | 2019 | | | | 2018 |
|---|---|---|---|---|---|---|---|---|
| | Q1* | Q4* | Q3* | Q2* | Q1* | Q4 | Q3 | Q2 |
| *(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** | **510** | **419** | **423** | **478** | **402** | **473** | **421** | **385** |
| **Revenue** | **109,675** | **91,465** | **92,552** | **104,164** | **89,627** | **103,728** | **87,606** | **85,084** |
| **Costs and expenses** | | | | | | | | |
| Production (2) | 86,129 | 60,334 | 60,189 | 70,903 | 67,121 | 73,472 | 57,222 | 53,893 |
| Distribution | 14,561 | 13,793 | 14,457 | 13,005 | 12,766 | 13,371 | 12,360 | 13,138 |
| Selling, general and administration | 4,653 | 4,747 | 4,808 | 5,147 | 3,793 | 3,933 | 5,374 | 4,265 |
| Amortization | 10,794 | 10,300 | 10,067 | 10,028 | 9,602 | 7,324 | 6,719 | 5,381 |
| | **116,141** | **89,174** | **89,521** | **99,083** | **93,282** | **98,100** | **81,675** | **76,677** |
| **Profit (loss) before finance costs and other (income) expenses** | (6,466) | 2,291 | 3,031 | 5,081 | (3,655) | 5,628 | 5,931 | 8,407 |
| Finance income (cost) | (8,346) | (5,203) | (4,813) | (7,389) | (6,773) | 1,828 | (4,360) | (41) |
| Other income (expense ) (3) | 2,395 | (575) | (71) | 4,917 | 880 | 1,626 | 399 | 320 |
| | (5,951) | (5,778) | (4,884) | (2,472) | (5,893) | 3,454 | (3,961) | 279 |
| **Net profit (loss) before income taxes** | **(12,417)** | **(3,487)** | **(1,853)** | **2,609** | **(9,548)** | **9,082** | **1,970** | **8,686** |
| **Income tax recovery (expense)** | | | | | | | | |
| Deferred income taxes | 3,285 | 246 | 394 | (877) | 2,542 | (1,643) | (454) | (2,182) |
| | 3,285 | 246 | 394 | (877) | 2,542 | (1,643) | (454) | (2,182) |
| **Net profit (loss) attributable to:** | **(9,132)** | **(3,241)** | **(1,459)** | **1,732** | **(7,006)** | **7,439** | **1,516** | **6,504** |
| Owners of the Company | (8,835) | (3,847) | (1,695) | 1,427 | (6,692) | 7,095 | 1,184 | 6,218 |
| Non-controlling interests | (297) | 606 | 236 | 305 | (314) | 344 | 332 | 286 |
| **Net profit (loss)** | **(9,132)** | **(3,241)** | **(1,459)** | **1,732** | **(7,006)** | **7,439** | **1,516** | **6,504** |
| Net profit (loss) attributable to owners | (8,835) | (3,847) | (1,695) | 1,427 | (6,692) | 7,095 | 1,184 | 6,218 |
| **Net profit (loss) per share attributable to owners** | | | | | | | | |
| **Basic and diluted** | **(0.26)** | **(0.12)** | **(0.05)** | **0.04** | **(0.20)** | **0.22** | **0.04** | **0.19** |

** 2019 and 2020 results include the adoption of IFRS 16 *Leases*, from December 30, 2018, on a prospective basis. Comparative periods for 2018 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 Q1 2020, $1.1 million of costs related to fixed overhead and incident response costs were reflected in production costs, $1.1 million, $1.4 million, $2.7 million and $2.1 million were reflected in Q4, Q3, Q2 and Q1 2019, respectively. Business interruption insurance were also reflected in production costs, $1.0 million in Q1 2020, $4.5 million in Q4 2019, $4.0 million in Q3 2019, and $4.5 million in Q2 2019.

(3) In Q1 2019, $9.4 million of asset impairment costs and $3.0 million of insurance recoveries were recognized in relation to the Entwistle Incident. An additional $9.5 million of insurance recoveries were recognized in Q2 2019; $4.0 million was recognized in Q3 2019, $5.5 million was recognized in Q4 2019 and $2.5 million in Q1 2020.

(4) At the end of Fiscal 2019, quarterly results for Q4 2018 and for each of the quarters in 2019 were adjusted to reflect the impact of the finalization of the purchase price allocation for our Aliceville Facility as required by IFRS which increased amortization expense each quarter by less than $0.1 million. In addition, quarterly results for each of the quarters in 2019 were adjusted to correct for an error identified in our inventory flow model in Q4 2019. Although the error identified is not considered material by the Company to each of the quarters, the Company corrected the prior quarters in the annual MD&A as the overall adjustment would have been significant to Q4 2019. The adjustment to net income/(loss) for each of the quarters was $-0.7 million respectively in each of Q1, Q2 and Q3 2019.

## 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 "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 Demopolis Facility, High Level Facility and our anticipated capital expenditures associated therewith. Increased challenges with B.C. sawmill residual supply as a result of COVID-19 will reduce our cash flows from operating activities.

In light of the recent uncertainty in the global economic climate, a review of the Company's dividend policy was conducted by the Board. It was determined that in order to ensure the Company is well-positioned to withstand the ongoing economic impacts from the COVID-19 health threat and preserve liquidity for growth projects, the Company dividend will be revised during this period of uncertainty related to COVID-19 to an annual level of $0.15 per common share, beginning with the dividend payable for the first quarter of 2020.

Pinnacle currently has sufficient liquidity and is within its financial covenants with its lending syndicate, and this revision will help to ensure the business is prepared in the event of an extended global economic crisis. This cautious approach and re-prioritization of capital will contribute to maintaining a healthy balance sheet and provide greater flexibility for the Company to continue to pursue its strategy.

### 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 $10.0 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 March 27, 2020, the $280,000 term loan was in a CAD BA loan at 5.70% (December 27, 2019 - CAD BA loan at 5.45%) and the $11,000 revolver loan was a CAD Prime loan at 5.95% (December 27, 2019 - CAD Prime loan at 6.95%). At March 27, 2020 the $54,100 delayed draw was in a CAD Prime loan at 5.95% (December 27, 2019 - CAD Prime loan at 6.95%).

During Q1 2020, we completed a drawdown of $34.1 million our delayed draw term loan. Including drawdowns made during the most recent fiscal quarter, Pinnacle has drawn a total of $54.1 million under the delayed draw term loan through the end of Q1 2020. At March 27, 2020, the Company had issued letters of credit totaling $562 (December 27, 2019 - $970).

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 construction and commissioning phase including Entwistle, High Level and Smithers Facilities, among other adjustments. The primary debt covenants are the Senior Debt to Adjusted EBITDA and Fixed Charge Coverage Ratio. Our credit agreement provides for calculation of the debt covenants prior to the application of IFRS 16. As at March 27, 2020 and December 27, 2019, the Company was in compliance with all debt covenants.

We have sufficient covenant room and liquidity as Entwistle contributes to EBITDA and we improve the profitability of our existing mills. While there is risk of unanticipated impacts to our operational cashflows as a result of COVID-19, we are deferring some growth and maintenance capital expenditures, unless deemed critical for safety or effective operations, in order to preserve capital. The planned delays on site work at Williams Lake, Meadowbank, and Smithers will delay cash outflows related to those projects without material impact on operations cashflow in 2020.

The Senior Credit Facilities are 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**

| *(In thousands $)* | **Q1 2020** | **Q1 2019** | **Change** |
|---|---|---|---|
| Cash flow from operations before net change in non-cash working capital | 9,873 | 16,620 | (6,747) |
| Net change in non-cash operating working capital | 1,926 | (6,366) | 8,292 |
| Financing activities | 15,372 | (13,604) | 28,976 |
| Investing activities | (35,473) | (6,261) | (29,212) |
| Other | 83 | 93 | (10) |
| Change in cash | **(8,219)** | **(9,518)** | 1,299 |
| Cash and cash equivalents, beginning of year | 11,267 | 18,028 | (6,761) |
| Cash and cash equivalents, end of year | **3,048** | **8,510** | (5,462) |

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

Cash flow from operations before net change in non-cash working capital decreased by $6.7 million to $9.9 million for Q1 2020, compared to $16.6 million for Q1 2019. This is mainly due to a decrease in operating profit of $2.8 million as higher production costs, distribution costs and higher SG&A costs exceeded the increased revenue from higher sales volumes when compare to Q1 2019. Q1 2019 also included a $2.4 million distribution from Houston Pellet Limited Partnership with no corresponding cash flow in Q1 2020.

***Net change in non-cash working capital***

The $8.3 million increase in cash generated from non-cash working capital was primarily due to change in cashflows from accounts receivable offset by changes in cashflows from accounts payable and accrued liabilities, other current assets and inventory compared to Q1 2019.

***Financing activities***

The $29.0 million increase in financing activities in Q1 2020 was primarily due to drawings made on the delayed draw loan with no corresponding cash flows in Q1 2019.

***Investing activities***

The increase in cash used for investing activities is due to cash outflows relating to the purchase of property, plant and equipment in Q1 2020 compared to Q1 2019.

## OUTLOOK

We expect 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. In addition, 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 and new greenfield and brownfield growth projects. Moreover, 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:

- realize production and operating efficiencies in our existing production facilities to optimize EBITDA per MT;
- grow our business through the commissioning and operational execution of the High Level and Demopolis Facilities and other greenfield and brownfield project opportunities throughout North America;
- expand production capacity at existing production facilities, including that at the Aliceville Facility with our planned second phase capital program as well as facility upgrades at the Williams Lake Facility;
- make potential accretive acquisitions of industrial wood pellet producers in Canada or the U.S;
- increase our supply to European customers from our U.S. Southeast production facilities; and
- continue to capture our share of opportunities in the growing Asian marketplace as a result of our proximity to this market, which results in shipping cost advantages and our longstanding relationships with customers in the region. We will manage our contracting activity as we stabilize our fibre sourcing in B.C. and realize improvement in our EBITDA per MT and grow high return opportunities outside of B.C.

The Entwistle Facility has achieved increasing production levels during Q1 2020, exceeding our commissioning curve for the facility and will continue to improve and add production volume throughout 2020. The Entwistle Facility is expected to make a positive contribution to Adjusted EBITDA in Fiscal 2020. As our insurer monitors production ramp post restart, we will continue to seek further business interruption insurance in Fiscal 2020. Final insurance recoveries of capital costs incurred for the rebuild are expected in Fiscal 2020 as well.

As Aliceville and Smithers facilities are both operating at full production run-rate, incremental production volume and Adjusted EBITDA contribution is expected for 2020.

CN Rail blockades and port delays that impacted profitability in Q1 2020 were resolved by the end of February. As a result, the Company experienced solid production volume and cost performance at facilities in March.

COVID-19 has the potential to impact several areas of our business, including our employees, contractors required for maintenance, critical part suppliers and logistics partners. Future disruptions to capital projects may also result.

Sawmills, key fibre suppliers, have already started to curtail output as they see sharp reductions in demand and prices for lumber. We enter Q2 2020 with substantial fibre inventory to mitigate the impact of sawmill curtailments (103% more than at this period last year), however, the length and depth of the COVID-19 impact on our key suppliers will most likely result in us depending on a larger percentage of harvest residuals. As Q2 2020 continues we see B.C. sawmill residual supplies stabilizing as lumber demand is relatively constant, government incentives are enacted, and the industry looks toward reduction in stumpage rates in Q3 2020.

As the proportion of wet, coarse fibre increases we will experience drying capacity constraints. Depending on the length of the sawmill curtailments, we expect to have resulting reductions in production volumes in some of our B.C. facilities and adjusted gross margin will be impacted. We do not anticipate a material impact from COVID-19 on our fibre supply in Alberta and Alabama due to our inventory levels and the abundance of overall fibre supply in these regions. Although there are some sawmill curtailments in Alabama, we do not expect production volume or costs to be significantly impacted.

## CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

| | Carrying amount | Contractual cash flows | Current | Between 2 and 5 years | More than 5 years |
|---|---|---|---|---|---|
| Non derivative financial liabilities | | | | | |
| Accounts payable and accrued liabilities | 50,966 | 50,966 | 50,966 | | |
| Revolver loan | 11,000 | 11,000 | 11,000 | - | - |
| Term loan | 280,000 | 280,000 | 5,600 | 274,400 | - |
| Delayed draw loan | 54,100 | 54,100 | - | 54,100 | - |
| Lease liabilities | 36,443 | 47,125 | 9,595 | 21,602 | 15,928 |

The obligations under the senior credit facilities are discussed in the "Liquidity and Capital Resources" section of this 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 March 27, 2020 was $3.0 million (December 27, 2019 - $11.3 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 March 27, 2019 was $12.9 million (December 27, 2019 - $10.9 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 March 27, 2020 we had available liquidity of $57.1 million (December 27, 2019 - $57.1 million) from our debt facilities (excluding delayed draw) and cash balances and we forecast sufficient liquidity throughout Fiscal 2020. 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 March 27, 2020, our ratio of net debt to last twelve month Adjusted EBITDA was 7.7 times. This ratio was impacted because our growth capex has been slower than expected due to COVID-19 offset by lower EBITDA in Q1 2020, investment in new capacity from the Entwistle Facility, and the expansion projects at Williams Lake, Meadowbank, High Level and Demopolis have not yet generated their run-rate EBITDA. 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 17 to the Interim Condensed 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. On June 28, 2019, we entered into two $50.0 million interest rate swaps totaling $100.0 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 during the year.

We are subject to certain financial covenants in our debt obligations. Refer to Note 8 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.

## 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 described in note 2 (d) to the Consolidated Financial Statements. These include measuring and valuing inventories, determining useful lives for property, plant and equipment, assumptions used in testing goodwill for impairment, determining fair values of assets acquired in acquisitions, assumptions used in valuing deferred tax assets and assumption used in determining provisions, consistent with that as described in the Consolidated Financial Statements.

### Recently Adopted Significant Accounting Standards

No new significant accounting standards were adopted in Q1 2020.

## TRANSACTIONS WITH LESS THAN WHOLLY OWNED ENTITIES AND AFFILIATES

The Company consolidates 4 entities whereby it owns less than 100% and equity accounts for one affiliate. In each of these arrangements, the Company purchases all the pellets from these entities and often transacts with the other owners for fibre and other costs. These transactions are negotiated on an arm's length basis with the non-related third-party owners.

Any amounts receivable or payable to us under these arrangements are settled under normal trade terms and are unsecured and non-interest bearing. See Note 16 to the Interim Condensed 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 June 11, 2020, we had 33,359,570 Common Shares issued and outstanding and no preferred shares issued and outstanding. As of June 11, 2020, an aggregate of 2,107,679 options to acquire Common Shares and 21,483 restricted share units representing the right to Common Shares are outstanding.

### Additional Information

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

## INTERNAL CONTROLS OVER FINANCIAL REPORTING ("ICFR") – Material Weakness

Pinnacle's management, including the CEO and CFO, is responsible for establishing and maintaining adequate internal control over financial reporting ("ICFR"). ICFR is a process designed by, or under the supervision of, the CEO and CFO and effected by management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The Company is required to disclose the existence of any material weakness that exists in the design or operation of its ICFR in its MD&A for each reporting period. A material weakness is a deficiency, or combination of deficiencies, in ICFR, such that there is a reasonable possibility that a material misstatement of the Company's financial statements will not be prevented or detected on a timely basis.

When the Company originally filed its interim condensed consolidated financial statements and related MD&A for the thirteen weeks ended March 27, 2020 (in May 2020), it was unaware that an error had been made for the period recording two interest rate swaps in the preparation of the statements and, accordingly, of the existence of a material weakness in its ICFR. The impact of the interest rate swap accounting error on the Company's interim consolidated condensed financial statements for Q1 2020 was quantitatively material and the statements have been restated accordingly. The "Restatement" section of this MD&A illustrates the impact of the error on the financial statements for the interim period ended March 27, 2020.

In June 2020, management determined that the foregoing restatement reflects the existence of a material weakness in the Company's ICFR involving derivatives and complex accounting transactions for the period ended March 27, 2020. Internal controls over accounting for interest rate swaps did not sufficiently assess the accuracy and reasonability of interest rate swap fair value journal entries or include adequate review by management personnel with the necessary expertise required to detect the foregoing error.

Pinnacle is committed to improving its control environment. The Company will develop procedures aimed at remediating this weakness by redesigning internal controls over derivatives and complex accounting matters and ensuring management review is performed by personnel with the necessary technical expertise. These procedures will be implemented prior to filing of its financial statements for the next reporting period in 2020.

### Limitations of Controls and Procedures

Pinnacle's management, including the CEO and CFO, believe that disclosure controls and procedures and internal control over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgements in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the controls. The design of any control system also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed.

### Changes in ICFR

Other than the material weakness identified and discussed above relating to controls over complex accounting including derivatives, there have been no changes to ICFR in the 13-week period ended March 27, 2020.