

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2011 and 2010

Management's Statement of Responsibility for Financial Information

The consolidated financial statements contained in this Annual Report are the responsibility of management, and have been prepared in accordance with International Financial Reporting Standards. Where necessary, management has made judgements and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in the Annual Report and for ensuring that this information is consistent, where appropriate, with the information and data included in the consolidated financial statements.

The Company maintains a system of internal controls to provide reasonable assurance as to the reliability of the financial records and safeguarding of its assets. The consolidated financial statements have been examined by the Company's independent auditors, PricewaterhouseCoopers LLP, and they have issued their report thereon.

The Board of Directors is responsible for overseeing management in the performance of its responsibilities for financial reporting. The Board exercises its responsibilities through the Audit Committee which is comprised of four independent directors. The Audit Committee meets from time to time with management and the Company's independent auditors to review the financial statements and matters relating to the audit. The Company's independent auditors have full and free access to the Audit Committee. The consolidated financial statements have been reviewed by the Audit Committee, who recommended their approval by the Board of Directors.



Brian McManus
President and
Chief Executive Officer



George T. Labelle, CA
Senior Vice-President and
Chief Financial Officer

Saint-Laurent, Quebec
March 15, 2012

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Stella-Jones Inc.

We have audited the accompanying consolidated financial statements of Stella-Jones Inc. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2011 and 2010 and January 1, 2010 and the consolidated statements of change in shareholders' equity, income, comprehensive income and cash flows for the years ended December 31, 2011 and 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Stella-Jones Inc. and its subsidiaries as at December 31, 2011 and 2010 and January 1, 2010 and their financial performance and their cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards.



Montréal, Quebec
March 15, 2012

¹ Chartered accountant auditor permit No. 19983

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member of which is a separate legal entity.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(expressed in thousands of Canadian dollars)

	Note	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Assets				
Current assets				
Accounts receivable	6	76,511	56,315	30,160
Derivative financial instruments	21	349	—	2,196
Inventories	7	243,590	205,335	212,590
Prepaid expenses		8,348	4,517	3,223
Income taxes receivable		1,721	2,875	4,726
		330,519	269,042	252,895
Non-current assets				
Property, plant and equipment	8	119,441	104,763	87,684
Intangible assets	9	71,062	64,179	16,781
Goodwill	9	91,720	73,973	5,494
Other assets	10	4,314	5,331	5,185
		617,056	517,288	368,039
Liabilities and Shareholders' Equity				
Current liabilities				
Bank indebtedness	11	2,585	31,923	56,119
Accounts payable and accrued liabilities	12	43,693	32,426	21,481
Derivative financial instruments	21	171	44	31
Current portion of long-term debt	13	1,465	10,459	4,746
Current portion of provisions and other long-term liabilities	14	9,418	4,705	1,235
		57,332	79,557	83,612
Non-current liabilities				
Long-term debt	13	178,629	115,369	82,334
Deferred income taxes	17	43,417	34,685	14,284
Provisions and other long-term liabilities	14	2,117	3,668	4,629
Employee future benefits	18	2,271	2,572	2,257
Derivative financial instruments	21	1,378	1,335	1,400
		285,144	237,186	188,516
Shareholders' equity				
Capital stock	15	131,272	130,229	52,019
Contributed surplus		1,342	1,376	1,112
Retained earnings		201,268	155,636	128,015
Accumulated other comprehensive loss		(1,970)	(7,139)	(1,623)
		331,912	280,102	179,523
		617,056	517,288	368,039

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

Approved by the Board of Directors



Tom A. Bruce Jones, CBE
Director



George J. Bunze, CMA
Director

CONSOLIDATED STATEMENTS OF CHANGE IN SHAREHOLDERS' EQUITY

For the years ended December 31, 2011 and 2010
(expressed in thousands of Canadian dollars)

	Capital stock \$	Contributed surplus \$	Retained earnings \$	Accumulated other comprehensive loss			Total \$	Total share- holders' equity \$
				Foreign currency translation adjustment \$	Translation of long-term debts designated as net investment hedges \$	Unrecognized losses on cash flow hedges \$		
Balance – January 1, 2011	130,229	1,376	155,636	(8,471)	2,243	(911)	(7,139)	280,102
Comprehensive income								
Net income for the year	—	—	55,709	—	—	—	—	55,709
Other comprehensive income (loss)	—	—	(2,105)	6,232	(1,197)	134	5,169	3,064
Comprehensive income for the year	—	—	53,604	6,232	(1,197)	134	5,169	58,773
Transactions with shareholders								
Dividends on common shares	—	—	(7,972)	—	—	—	—	(7,972)
Stock option plan	655	—	—	—	—	—	—	655
Exercise of stock options	—	(255)	—	—	—	—	—	(255)
Employee share purchase plans	388	—	—	—	—	—	—	388
Stock-based compensation	—	221	—	—	—	—	—	221
	1,043	(34)	(7,972)	—	—	—	—	(6,963)
Balance – December 31, 2011	131,272	1,342	201,268	(2,239)	1,046	(777)	(1,970)	331,912

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

CONSOLIDATED STATEMENTS OF CHANGE IN SHAREHOLDERS' EQUITY (continued)

For the years ended December 31, 2011 and 2010
(expressed in thousands of Canadian dollars)

	Capital stock \$	Contributed surplus \$	Retained earnings \$	Foreign currency translation adjustment \$	Accumulated other comprehensive loss			Total \$	Total share- holders' equity \$
					Translation of long-term debts designated as net investment hedges \$	Unrecog- nized losses on cash flow hedges \$	Reclassi- fication to net income of losses on cash flow hedges \$		
Balance – January 1, 2010	52,019	1,112	128,015	—	(637)	(986)	—	(1,623)	179,523
Comprehensive income									
Net income for the year	—	—	34,441	—	—	—	—	—	34,441
Other comprehensive income (loss)	—	—	(779)	(8,471)	2,880	(85)	160	(5,516)	(6,295)
Comprehensive income for the year	—	—	33,662	(8,471)	2,880	(85)	160	(5,516)	28,146
Transactions with shareholders									
Dividends on common shares	—	—	(6,041)	—	—	—	—	—	(6,041)
Exchange of subscription receipts for common shares (note 5(b))	77,748	—	—	—	—	—	—	—	77,748
Stock option plan	159	—	—	—	—	—	—	—	159
Exercise of stock options	—	(41)	—	—	—	—	—	—	(41)
Employee share purchase plans	303	—	—	—	—	—	—	—	303
Stock-based compensation	—	305	—	—	—	—	—	—	305
	78,210	264	(6,041)	—	—	—	—	—	72,433
Balance – December 31, 2010	130,229	1,376	155,636	(8,471)	2,243	(1,071)	160	(7,139)	280,102

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

CONSOLIDATED STATEMENTS OF INCOMEFor the years ended December 31, 2011 and 2010
(expressed in thousands of Canadian dollars, except earnings per common share)

	Note	2011 \$	2010 \$
Sales		640,148	561,046
Expenses			
Cost of sales		515,286	467,783
Selling and administrative		35,835	32,548
Other losses, net		1,059	25
	16	552,180	500,356
Operating income		87,968	60,690
Financial expenses			
Interest on long-term debt		6,777	8,914
Other interest		1,262	1,651
		8,039	10,565
Income before income taxes		79,929	50,125
Provision for (recovery of) income taxes			
Current	17	23,147	16,996
Deferred	17	1,073	(1,312)
		24,220	15,684
Net income for the year		55,709	34,441
Basic earnings per common share	15	3.49	2.27
Diluted earnings per common share	15	3.48	2.26

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended December 31, 2011 and 2010
(expressed in thousands of Canadian dollars)

	2011 \$	2010 \$
Net income for the year	55,709	34,441
Other comprehensive income (loss)		
Net change in gains (losses) on translation of financial statements of foreign operations	6,232	(8,471)
Change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations	(1,211)	3,228
Income tax on change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations	14	(348)
Change in gains (losses) on fair value of derivatives designated as cash flow hedges	178	(108)
Income tax on change in gains (losses) on fair value of derivatives designated as cash flow hedges	(44)	23
Change in actuarial losses on post-retirement benefit obligations	(2,784)	(1,039)
Income tax on change in actuarial losses on post-retirement benefit obligations	679	260
Reclassification to net income of losses on cash flow hedges	—	160
	3,064	(6,295)
Comprehensive income for the year	58,773	28,146

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

 For the years ended December 31, 2011 and 2010
 (expressed in thousands of Canadian dollars)

	Note	2011 \$	2010 \$
Cash flows provided by (used in)			
Operating activities			
Net income for the year		55,709	34,441
Adjustments for			
Depreciation of property, plant and equipment		4,523	4,851
Amortization of intangible assets		4,192	5,502
Interest accretion		1,239	1,405
Loss on disposal of property, plant and equipment		505	36
Employee future benefits		(1,965)	(120)
Stock-based compensation		221	305
Loss on derivative financial instruments		—	2,196
Asset impairment		2,206	2,950
Financial expenses		8,039	10,565
Income taxes		23,147	16,996
Deferred income taxes		1,073	(1,312)
Restricted stock units obligation		747	408
Other		(9)	(160)
		99,627	78,063
Changes in non-cash working capital components			
Accounts receivable		(11,968)	(11,560)
Inventories		(30,204)	31,282
Prepaid expenses		(3,408)	(304)
Income taxes receivable		(79)	177
Accounts payable and accrued liabilities		6,153	5,729
Asset retirement obligations		(270)	(347)
Provisions and other long-term liabilities		3,359	2,271
		(36,417)	27,248
Interest paid		(8,594)	(10,011)
Income tax paid		(21,822)	(13,692)
		32,794	81,608
Financing activities			
Decrease in bank indebtedness		(4,792)	(23,148)
Increase in deferred financing costs		(122)	(1,144)
Increase in long-term debt		98,286	66,027
Repayment of long-term debt		(80,108)	(103,932)
Non-competes payable		(1,218)	(1,311)
Dividend on common shares		(7,972)	(6,041)
Proceeds from issuance of common shares		788	421
Proceeds from issuance of subscription receipts		—	76,903
		4,862	7,775
Investing activities			
Decrease (increase) in other assets		(459)	31
Business acquisition	5	(29,015)	(83,565)
Increase in intangible assets		(658)	(922)
Purchase of property, plant and equipment		(7,834)	(5,157)
Decrease in assets held for sale		205	—
Proceeds from disposal of property, plant and equipment		105	230
		(37,656)	(89,383)
Net change in cash and cash equivalents during the year		—	—
Cash and cash equivalents – Beginning of year		—	—
Cash and cash equivalents – End of year		—	—

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

1 DESCRIPTION OF THE BUSINESS

Stella-Jones Inc. (the "Company") is a North American producer and marketer of industrial treated wood products, specializing in the production of railway ties and timbers as well as wood poles supplied to electrical utilities and telecommunication companies. The Company manufactures the wood preservative creosote and other coal tar-based products and provides the railroad industry with used tie pickup and disposal services. Switching, locomotive and railcar maintenance services are also offered, as is tie-derived boiler fuel. The Company also provides treated residential lumber products and customized services to lumber retailers and wholesalers for outdoor applications. Other treated wood products include marine and foundation pilings, construction timbers, highway guardrail posts and treated wood for bridges. The Company has treating and pole peeling facilities across Canada and the United States and sells its products mainly in these two countries. The Company's headquarters are located in Saint-Laurent, Quebec, Canada. The Company is incorporated under the *Canada Business Corporations Act*, and its common shares are listed on the Toronto Stock Exchange ("TSX") under the stock symbol SJ.

2 SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION AND ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Company prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA"). In 2010, the CICA Handbook was revised to incorporate IFRS as issued by the International Accounting Standards Board ("IASB") and to require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company commenced reporting on this basis in the March 2011 and 2010 interim consolidated financial statements. In the present consolidated financial statements, the term "Canadian GAAP" or "CA GAAP" refers to Canadian GAAP before the adoption of IFRS.

These consolidated financial statements represent the first annual financial statements of the Company and its subsidiaries prepared in accordance with IFRS. Subject to certain transition elections disclosed in note 4, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position as at January 1, 2010 and throughout all periods presented as if these policies had always been in effect. Note 4 discloses the impact of the transition to IFRS on the Company's reported consolidated statements of financial position, income, comprehensive income and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP. These consolidated financial statements were approved by the Board of Directors on March 15, 2012.

BASIS OF MEASUREMENT

The consolidated financial statements have been prepared under the historical cost convention, except for derivative financial instruments and certain long-term debts which are measured at fair value.

PRINCIPLES OF CONSOLIDATION

a) Subsidiaries

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The significant subsidiaries are as follows: Guelph Utility Pole Company Ltd., I.P.B.-W.P.I. International Inc., 4552822 Canada Inc., 4552831 Canada Inc., Stella-Jones Canada Inc., Stella-Jones U.S. Holding Corporation ("SJ Holding"), Stella-Jones Corporation ("SJ Corp"), Stella-Jones U.S. Finance Corporation, Canadalux S.à.r.l. and Tangent Rail Corporation ("Tangent"). SJ Holding, SJ Corp, Stella-Jones U.S. Finance Corporation, Canadalux S.à.r.l. and Tangent are foreign operations that have a different functional currency from that of the Company.

Following the close of business on December 31, 2010, Tangent was merged with SJ Corp. The surviving corporation was Tangent, which changed its name to Stella-Jones Corporation concurrently with the merger.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PRINCIPLES OF CONSOLIDATION (CONTINUED)

a) Subsidiaries (Continued)

The subsidiaries are all entities over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are de-consolidated from the date that control ceases.

The acquisition method of accounting is used to account for the acquisition of subsidiaries by the Company. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the group. The consideration transferred also includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

The excess of the aggregate of the consideration transferred, the fair value of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the group's share of the net identifiable assets acquired and liabilities assumed is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statement of income. Intercompany transactions, balances and unrealized gains on transactions between companies are eliminated. Unrealized losses are also eliminated. Accounting policies of the subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

b) Joint venture

The consolidated accounts of the Company include the accounts of a 50% interest in Kanaka Creek Pole Company Limited ("Kanaka"), a joint venture which is accounted for under the proportionate consolidation method of accounting.

A joint venture entity is an entity in which the Company holds a long-term interest and shares joint control over the strategic, financial and operating decisions with one or more other venturers under a contractual arrangement.

FOREIGN CURRENCY TRANSLATION

a) Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

b) Foreign currency transactions

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Revenue and expenses denominated in a foreign currency are translated by applying the monthly average exchange rates. Monetary assets and liabilities denominated in foreign currencies are translated at the rate in effect at the statement of financial position date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities not denominated in the functional currency are recognized in the consolidated statement of income within other losses, net, except for qualifying cash flow hedges which are recognized in other comprehensive income and deferred in accumulated other comprehensive loss in shareholders' equity.

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PRINCIPLES OF CONSOLIDATION (CONTINUED)

b) Foreign currency transactions (continued)

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in the consolidated statement of income, except for differences arising on the translation of available-for-sale (equity) investments and foreign currency differences arising on the translation of a financial liability designated as a hedge of a net investment, which are recognized in other comprehensive income.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at cost remain translated into the functional currency at historical exchange rates.

c) Foreign operations

The financial statements of entities that have a functional currency different from that of the Company are translated using the rate in effect at the statement of financial position date for assets and liabilities, and the average exchange rates during the year for revenues and expenses. Adjustments arising from this translation are recorded in accumulated other comprehensive loss in shareholders' equity.

d) Hedges of net investments in foreign operations

Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of net investment in foreign operations are recognized in other comprehensive income to the extent that the hedge is effective, and are presented within equity. To the extent that the hedge is ineffective, such differences are recognized in the consolidated statement of income. When the hedged part of a net investment (the subsidiary) is disposed of, the relevant amount in equity is transferred to the consolidated statement of income as part of the gain or loss on disposal.

REVENUE RECOGNITION

Revenue from the sale of products and services is recognized when the entity has transferred to the buyer the significant risks and rewards of ownership of the goods, the entity does not retain either continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the entity, and the costs incurred or to be incurred in respect of the sale can be measured reliably. Revenue is net of trade or volume discounts, returns and allowances and claims for damaged goods.

The Company enters into service agreements where green tie procurement and tie treating services are offered separately. These services consist mainly of procuring, trimming, grading and treating railway ties for which revenue is recognized when the services are provided, based on contractual terms. Revenues for green tie procurement, trimming and grading services can be recognized either at the time of the green tie sale or when treating services are rendered, depending on the contractual agreement. Treating revenues are recognized at the time of treating or when the railway ties are shipped. Under certain agreements, the customer will supply the green ties and the Company will offer all of the other services. The Company capitalizes costs incurred to provide the service and reverses them to cost of sales when the revenue is recognized.

The Company offers used tie pickup and disposal services. Revenue is recognized upon reaching certain points in the process of removal of the used ties from the customer's right of way, along side the railway.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUE RECOGNITION (CONTINUED)

The Company also operates timber licences to harvest logs as part of a process to procure raw material for the processing and treatment of utility poles. Logs not meeting pole-quality standards are regularly harvested and sold to third parties. Proceeds from the sale of non-pole-quality logs are included in the cost of poles sold since the production of non-pole-quality logs is a by-product of the Company's pole raw material procurement operations. Sales of non-pole-quality logs totalled \$11,493 for the year ended December 31, 2011 (2010 – \$9,433).

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, bank balances and short-term liquid investments with initial maturities of three months or less.

ACCOUNTS RECEIVABLE

Accounts receivable are amounts due from customers from the sale of products or services rendered in the ordinary course of business. Accounts receivable are classified as current assets if payment is due within one year or less. Accounts receivable are recognized initially at fair value and subsequently measured at amortized cost, less provision for doubtful accounts.

INVENTORIES

Inventories of raw materials are valued at the lower of weighted average cost and net realizable value. Finished goods are valued at the lower of weighted average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead expenses. Net realizable value is the estimated selling price less cost necessary to make the sales.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost, including borrowing costs incurred during the construction period, less accumulated depreciation. The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts, and depreciates separately each such part. Depreciation is calculated on a straight-line basis using rates based on the estimated useful lives of the assets.

	Useful life
Buildings	7 to 60 years
Production equipment	5 to 60 years
Anti-pollution equipment	10 to 60 years
Rolling stock	3 to 15 years
Office equipment	2 to 10 years

Roads are recorded at cost less accumulated depreciation, which is provided on the basis of timber volumes harvested. Depreciation amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested in the licensed area served by the road, and are applied against the historical cost.

The assets' residual values and useful lives are reviewed and adjusted, if appropriate, at the end of each reporting period.

BORROWING COSTS

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the consolidated statement of income in the period in which they are incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INTANGIBLE ASSETS

Intangible assets with finite useful lives are recorded at cost and are amortized over their useful lives. Intangible assets with indefinite useful lives are recorded at cost and are not amortized. The amortization method and estimate of the useful life of an intangible asset are reviewed on an annual basis:

	Method	Useful life
Customer relationships	Straight-line and declining balance	3 to 25 years
Non-compete agreements	Straight-line	6 years
Creosote registration	—	Indefinite

Standing timber costs are recorded at cost less accumulated amortization, which is provided on the basis of timber volumes harvested. In Canada, the Company has perpetual cutting rights where planning and site preparation costs for specific geographical areas are capitalized until the harvest process can begin. Amortization amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested in the specific area.

Cutting rights are recorded at cost less accumulated amortization, which is provided on the basis of timber volumes harvested. Amortization amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested during a 40-year period, and are applied against the historical cost.

The creosote registration is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it might be impaired.

GOODWILL

Goodwill represents the excess of the consideration transferred over the fair value of the Company's share of the net identifiable assets, liabilities and contingent liabilities of the acquiree and the fair value of the non-controlling interest in the acquiree at the date of acquisition. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Goodwill is allocated to cash-generating units ("CGUs") for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose.

IMPAIRMENT

Impairments are recorded when the recoverable amounts of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost to sell and its value in use. Impairment losses are evaluated for potential reversals when events or changes in circumstances warrant such consideration, except goodwill.

Non-financial assets

The carrying values of non-financial assets with finite lives, such as property, plant and equipment and intangible assets with finite useful lives, are assessed for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Non-financial assets other than goodwill that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IMPAIRMENT (CONTINUED)

Goodwill

The carrying value of goodwill is tested annually for impairment. Goodwill is allocated to CGUs for the purpose of impairment testing based on the level at which management monitors it, which is not higher than that of an operating segment. The allocation is made to those CGUs that are expected to benefit from the synergies of the combination.

LEASES

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the consolidated statement of income on a straight-line basis over the term of the lease.

The Company leases certain property, plant and equipment. Leases of property, plant and equipment where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each finance lease payment is allocated between the liability and finance consolidated charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in long-term debt. The interest element of the finance cost is charged to the consolidated statement of income over the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the Company adopts for depreciable assets that are owned. If there is reasonable certainty that the Company will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise, the asset is depreciated over the shorter of the lease term and its useful life.

NON-CURRENT ASSETS HELD FOR SALE

Non-current assets are classified as assets held for sale when their carrying amount is to be recovered principally through a sales transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less cost to sell if their carrying amount is to be recovered principally through a sales transaction rather than through continuing use.

PROVISIONS

Provisions for reforestation, site remediation and other provisions are recognized when the Company has a legal or constructive obligation as a result of past events, when it is probable that an outflow of resources will be required to settle the obligation and when a reliable estimate can be made of the amount of the obligation. If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recorded in the consolidated statement of financial position as a separate asset, but only if it is virtually certain that reimbursement will be received.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as other interest expense.

The Company considers the current portion of provision to be an obligation whose settlement is expected to occur within the next 12 months.

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(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

PROVISIONS (CONTINUED)

Reforestation obligations

The *Forest Act* (British Columbia) and the *Forests Act* (Alberta) require the industry to assume the costs of reforestation on certain harvest licences. Accordingly, the Company records its best estimate, which is the fair value of the cost of reforestation in the period in which the timber is harvested, with the fair value of the liability determined with reference to the present value of the estimated future cash flows. Reforestation costs are included in the costs of current production.

Site remediation obligations

Site remediation obligations relate to the discounted present value of estimated future expenditures associated with the obligations of restoring the environmental integrity of certain properties. The Company reviews estimates of future site remediation expenditures on an ongoing basis and records any revisions, along with the accretion expense on existing obligations, in selling and administrative expenses in the consolidated statement of income.

At each reporting date, the liability is remeasured for changes in discount rates and in the estimate of the amount, timing and cost of the work to be carried out.

INCOME TAXES

The tax expense comprises current and deferred tax. Tax is recognized in the consolidated statement of income, except to the extent that it relates to items recognized in other comprehensive income or directly to shareholders' equity.

Current tax

The current income tax charge is based on the results for the period as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were enacted or substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax

Deferred tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the statement of financial position date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income tax assets and liabilities are presented as non-current.

Deferred tax assets and liabilities are not recognized in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination.

EMPLOYEE FUTURE BENEFITS

Other post-retirement benefit programs

The cost of future benefits earned by employees is established by actuarial calculations using the projected benefit method pro-rated on years of service based on management's best estimate of economic and demographic assumptions.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EMPLOYEE FUTURE BENEFITS (CONTINUED)

The Company provides other post-retirement health care benefits to certain retirees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are attributed from the date when service by the employee first leads to benefits under the plan, until the date when further service by the employee will lead to no material amount of further benefits. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise.

Defined benefit pension plan

The Company accrues obligations and related costs under defined benefit pension plans, net of plan assets. The cost of pensions earned by employees is actuarially determined using the projected unit credit method and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and discount rates on obligations. For the purpose of calculating the expected return on plan assets, those assets are valued at fair market value. Past service costs from plan amendments are recognized in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortized on a straight-line basis over the vesting period.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise. The amounts recognized in other comprehensive income are recognized immediately in retained earnings without recycling to the statements of income in subsequent periods.

STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

The Company operates a number of equity-settled and cash-settled share-based compensation plans under which it receives services from employees as consideration for equity instruments of the Company or cash payments.

Equity-settled plan

The Company accounts for stock options granted to employees using the fair value method. Under this method, compensation expense for stock options granted is measured at fair value at the grant date using the Black-Scholes valuation model and is charged to operations over the vesting period of the options granted, with a corresponding credit to contributed surplus. For grants of share-based awards with graded vesting, each tranche is considered a separate grant with a different vesting date and fair value. Any consideration paid on the exercise of stock options is credited to capital stock together with any related stock-based compensation expense included in contributed surplus.

Cash-settled plan

The Company has restricted stock units. The Company measures the liability incurred and the compensation expenses at fair value by applying the Black-Scholes valuation model. The compensation expenses are recognized in the statements of income over the vesting periods. Until the liability is settled, the fair value of that liability is remeasured at each reporting date, with changes in fair value recognized in the statements of income.

FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINANCIAL INSTRUMENTS (CONTINUED)

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- a) Financial assets and financial liabilities at fair value through profit or loss: A financial asset or financial liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. Interest rate swaps and foreign exchange forward contracts are the only derivative financial instruments held by the Company and are designated as cash flow hedges (see (e) below).

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of income. Gains and losses arising from changes in fair value are presented in the consolidated statement of income as part of other gains and losses in the period in which they arise. Financial assets and financial liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond 12 months of the statement of financial position date, which is classified as non-current.

- b) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. Available-for-sale investments are classified as non-current unless they mature within 12 months, or management expects to dispose of them within 12 months.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the consolidated statement of income as part of interest income. Dividends on available-for-sale equity instruments are recognized in the consolidated statement of income as part of other gains and losses when the Company's right to receive payment is established. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the consolidated statement of income and are included in other gains and losses.

- c) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise accounts receivable and cash and cash equivalents, and are included in current assets due to their short-term nature.

Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FINANCIAL INSTRUMENTS (CONTINUED)

- d) Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, bank indebtedness and long-term debt. Accounts payable and accrued liabilities are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payable and accrued liabilities are measured at amortized cost using the effective interest method. Bank indebtedness and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

- e) Derivative financial instruments: The Company uses derivatives in the form of interest rate swaps to manage risks related to its variable rate debt and foreign exchange forward contracts to limit its exposure to the fluctuations of the U.S. dollar. All derivatives classified as held-for-trading are included in the consolidated statement of financial position, are classified as current or non-current based on the contractual terms specific to the instrument, with gains and losses on remeasurement recorded in income. All derivatives qualifying for hedge accounting are included in the consolidated statement of financial position and are classified as current or non-current based on the contractual terms specific to the instruments, with gains and losses on remeasurement included in other comprehensive income.

HEDGING TRANSACTIONS

The Company enters into foreign exchange forward contracts to limit its exposure under contracted cash inflows of sales denominated in U.S. dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These contracts are treated as cash flow hedges for accounting purposes and are not fair-valued through profit and loss.

Effective derivative financial instruments held for cash flow hedging purposes are recognized at fair value, and the changes in fair value related to the effective portion of the hedge are recognized in other comprehensive income. The changes in fair value related to the ineffective portion of the hedge are immediately recorded in the consolidated statement of income. The changes in fair value of foreign exchange forward contracts and interest rate swaps recognized in other comprehensive income are reclassified in the consolidated statement of income under sales and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect income.

When the derivative financial instrument no longer qualifies as an effective hedge, or when the hedging instrument is sold or terminated prior to maturity, hedge accounting, if applicable, is discontinued prospectively. Accumulated other comprehensive income related to a foreign exchange forward contract and interest swap hedges that cease to be effective are reclassified in the consolidated statement of income under foreign exchange gain or loss and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect income. Furthermore, if the hedged item is sold or terminated prior to maturity, hedge accounting is discontinued, and the related accumulated other comprehensive income is then reclassified in the consolidated statement of income at the original maturity date of the hedged item.

The Company designated a portion of its U.S. dollar-denominated long-term debt as a hedge of its net investment in foreign operations. For such debt designated as a hedge of the net investment in foreign operations, exchange gains and losses are recognized in accumulated other comprehensive loss.

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net income (loss) for the period attributable to equity owners of the Company by the weighted average number of common shares outstanding during the year.

Diluted earnings per share is calculated using the treasury stock method. Under this method, earnings per share data are computed as if the options were exercised at the beginning of the year (or at the time of issuance, if later) and as if the funds obtained from exercise were used to purchase common shares of the Company at the average market price during the year.

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

IFRS 9, *Financial Instruments*, was issued in November 2009. It addresses the classification and measurement of financial assets and replaces the multiple classification and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are recognized either at fair value through profit and loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent they do not clearly represent a return on investment, are recognized through profit and loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive loss indefinitely. In December 2011, the effective date of implementation of IFRS 9, which was originally for accounting periods beginning on or after January 1, 2013, was deferred to annual periods beginning on or after January 1, 2015. The Company has not yet assessed the impact of this standard on its financial statements.

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements*; IFRS 11, *Joint Arrangements*; IFRS 12, *Disclosure of Interests in Other Entities*; IAS 27, *Separate Financial Statements*; IFRS 13, *Fair Value Measurement*; and amended IAS 28, *Investments in Associates and Joint Ventures*. Each of the new standards is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

In June 2011, the IASB amended IAS 19, *Employee Benefits*, and IAS 1, *Presentation of Financial Statements*, which has not yet been adopted by the Company. The Company has not yet begun the process of assessing the impact that the amended standards will have on its financial statements.

In December 2011, the IASB amended IAS 32, *Financial Instruments: Presentation*, which has not yet been adopted by the Company. The Company has not yet begun the process of assessing the impact that the amended standard will have on its financial statements.

The following is a brief summary of the new standards:

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities*, and parts of IAS 27, *Consolidated and Separate Financial Statements*.

2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED (CONTINUED)

IFRS 11 – Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special-purpose vehicles and off-balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with an entity's interests in other entities.

IFRS 13 – Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

AMENDMENTS TO OTHER STANDARDS

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements*, and IAS 28, *Investments in Associates and Joint Ventures*. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10, 11, 12 and 13.

IAS 19 – Employee Benefits

IAS 19 has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits.

The amended standard removes the option to use the “corridor approach” whereby actuarial gains and losses are deferred, and it also removes the option to recognize actuarial gains and losses immediately through income. Instead, it requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. Past service cost (which will now include curtailment gains and losses) will no longer be recognized over a service period. Instead, past service costs will be recognized immediately in the period of a plan amendment.

Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past service cost, settlements and curtailments); and (ii) finance expense or income. The finance expense or income component will be calculated based on the net defined benefit asset or liability. The amendments clarify that benefits requiring future services (e.g. stay bonuses) are not termination benefits in the scope of IAS 19, and this may result in a different pattern of recognition of such costs.

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2 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

AMENDMENTS TO OTHER STANDARDS (CONTINUED)

A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures.

The new requirements are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IAS 1 – Presentation of Financial Statements

Presentation of items of other comprehensive income (“OCI”):

IAS 1 has been amended to change the disclosure of items presented in OCI, including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to the statement of income in the future.

The new requirements are effective for annual periods beginning on or after July 1, 2012.

IAS 32 – Financial Instruments: Presentation

The IAS 32 amendments clarify some of the requirements for offsetting financial assets and financial liabilities in the statement of financial position.

The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The amendments clarify that the right of set-off must be available immediately and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy.

Gross settlement mechanisms with features that both (i) eliminate credit and liquidity risk and (ii) process receivables and payables in a single settlement process, are effectively equivalent to net settlement; they would, therefore, satisfy the IAS 32 criterion in these instances.

The IAS 32 changes are retrospectively applied, with an effective date of annual periods beginning on or after January 1, 2014.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to estimates and assumptions include the estimated useful life of assets, impairment of goodwill and impairment of long-lived assets. It is possible that actual results could differ from those estimates, and such differences could be material. Estimates are reviewed periodically and, as adjustments become necessary, they are reported in the consolidated statement of income in the period in which they become known.

3 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS (CONTINUED)

ESTIMATED IMPAIRMENT OF GOODWILL AND INTANGIBLE ASSETS WITH INDEFINITE USEFUL LIVES

The Company performs annual goodwill and intangible asset with indefinite useful lives impairment tests. The recoverable amounts of the CGUs have been determined based on value-in-use calculations. These calculations require the use of estimates. See note 9 for further details.

ESTIMATED IMPAIRMENT OF LONG-LIVED ASSETS

Property, plant and equipment and intangible assets with finite useful lives (referred to as “long-lived assets”) are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable through future operations. This is accomplished by determining whether the carrying amount exceeds its recoverable amount at the assessment date. The recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use (being the present value of the expected future cash flows of the relevant asset). Estimates of future cash flows are based on judgment and could change. There is measurement uncertainty since adverse changes in one or a combination of the Company’s key assumptions or change in use of such operations could require a significant change in the carrying amount of the assets tested for impairment.

4 ADOPTION OF IFRS

The Company’s annual consolidated financial statements for the year ended December 31, 2011 are the first annual consolidated financial statements that comply with IFRS. For all accounting periods prior to this, the Company prepared its financial statements under Canadian GAAP. In accordance with IFRS 1, *First-time Adoption of IFRS*, certain disclosures relating to the transition to IFRS are provided in this note. These disclosures are prepared under IFRS as set out in the basis of presentation in note 2.

IFRS 1 requires that comparative financial information be provided. The date at which the Company began applying IFRS, January 1, 2010, is recognized as the “Transition Date”. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company is December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time adopters.

INITIAL ELECTIONS UPON ADOPTION

IFRS 1 optional exemptions

- a) *Business combinations* – Under IFRS 1, a first-time adopter may elect not to apply IFRS 3, *Business Combinations*, retrospectively to business combinations that occurred before the Transition Date. The Company has taken advantage of this election.
- b) *Employee future benefits* – Under IFRS 1, a first-time adopter may elect to recognize all cumulative actuarial gains or losses deferred under Canadian GAAP in opening retained earnings at the Transition Date. The Company has taken advantage of this election.
- c) *Cumulative translation adjustment* – Under IFRS 1, a first-time adopter may elect to be exempt from the requirements of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, for cumulative translation differences that existed at the Transition Date. It permits cumulative translation differences to be reset to zero at the Transition Date. The Company has chosen to apply this election, and has eliminated the cumulative translation difference and adjusted retained earnings by the same amount at the Transition Date.
- d) *Borrowing costs* – Under IFRS 1, an entity may adopt IAS 23, *Borrowing Costs*, prospectively and capitalize borrowing costs to projects for which the capitalization commencement date is after the Transition Date. The Company has taken advantage of this election.

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4 ADOPTION OF IFRS (CONTINUED)

INITIAL ELECTIONS UPON ADOPTION (CONTINUED)

- e) *Leases* – The Company has elected, under IFRS 1, to apply the exemption from the full retrospective application of International Financial Reporting Interpretations Committee Interpretation 4 (“IFRIC 4”), *Determining Whether an Arrangement Contains a Lease*, to determine whether an arrangement existing as of January 1, 2010 contains a lease based on the facts and circumstances existing at that date.
- f) *Share-based payments* – Under IFRS 1, a first-time adopter may choose not to apply IFRS 2, *Share-based Payment*, to all equity instruments of share-based payments that have vested at the Transition Date and not to apply IFRS 2 for all cash-settled share-based payments that have been settled before the Transition Date. The Company has elected not to take advantage of this exemption and to apply IFRS 2 to all stock options.
- g) *Asset retirement obligation* – The Company applied the requirements of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, which retrospectively requires specified changes in decommissioning, restoration or similar liabilities to be added to or deducted from the cost of the asset to which it relates and the adjusted depreciable amount of the asset to then be depreciated prospectively over its remaining useful life. The Company elected not to comply with the requirements of IFRIC 1 for changes that occurred in such liabilities before the Transition Date.

IFRS 1 mandatory exceptions

- a) *Hedge accounting* – Hedge accounting can only be applied prospectively from the Transition Date to transactions that satisfy the hedge accounting criteria in IAS 39 at that date. Hedging relationships cannot be designated retrospectively, and the supporting documentation cannot be created retrospectively. As a result, only hedging relationships that satisfied the hedge accounting criteria as at the Transition Date are reflected as hedges in the Company’s results under IFRS.
- b) *Estimates* – In accordance with IFRS 1, an entity’s estimates under IFRS at the Transition Date must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company’s estimates as at January 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

IMPACT OF TRANSITION TO IFRS

IFRS 1 requires an entity to reconcile equity and comprehensive income for periods prior to January 1, 2011. The following represents the reconciliations from Canadian GAAP to IFRS for the consolidated statements of financial position as at January 1, 2010 and December 31, 2010, and the consolidated statement of income and comprehensive income for the year ended December 31, 2010.

Reconciliations of total operating, investing and financing cash flows are not provided, as the changes to these cash flows are not material.

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4 ADOPTION OF IFRS (CONTINUED)

RECONCILIATION OF CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

	Note	As at December 31, 2010			As at January 1, 2010		
		CA	Adj.	IFRS	CA	Adj.	IFRS
		GAAP			GAAP		
		\$	\$	\$	\$	\$	\$
Assets							
Current assets							
Accounts receivable		56,315	—	56,315	30,160	—	30,160
Derivative financial instruments		—	—	—	2,196	—	2,196
Inventories		205,335	—	205,335	212,590	—	212,590
Prepaid expenses		4,517	—	4,517	3,223	—	3,223
Income taxes receivable		2,875	—	2,875	4,726	—	4,726
Deferred income taxes	a, m	3,206	(3,206)	—	1,683	(1,683)	—
		272,248	(3,206)	269,042	254,578	(1,683)	252,895
Non-current assets							
Property, plant and equipment	b, c	113,956	(9,193)	104,763	96,885	(9,201)	87,684
Intangible assets	b, c	54,986	9,193	64,179	7,580	9,201	16,781
Goodwill		73,973	—	73,973	5,494	—	5,494
Other assets	d, e, f	6,152	(821)	5,331	4,878	307	5,185
Deferred income taxes	a, m	318	(318)	—	1,380	(1,380)	—
		521,633	(4,345)	517,288	370,795	(2,756)	368,039
Liabilities and Shareholders' Equity							
Current liabilities							
Bank indebtedness		31,923	—	31,923	56,119	—	56,119
Accounts payable and accrued liabilities	n	34,697	(2,271)	32,426	21,481	—	21,481
Derivative financial instruments		44	—	44	31	—	31
Deferred income taxes	a, m	292	(292)	—	869	(869)	—
Current portion of long-term debt		10,459	—	10,459	4,746	—	4,746
Current portion of provisions and other long-term liabilities	n	2,434	2,271	4,705	1,235	—	1,235
		79,849	(292)	79,557	84,481	(869)	83,612
Non-current liabilities							
Long-term debt		115,369	—	115,369	82,334	—	82,334
Deferred income taxes	a, m	37,956	(3,271)	34,685	16,257	(1,973)	14,284
Provisions and other long-term liabilities	k	3,676	(8)	3,668	4,629	—	4,629
Employee future benefits	g, h, i	2,063	509	2,572	1,716	541	2,257
Derivative financial instruments		1,335	—	1,335	1,400	—	1,400
		240,248	(3,062)	237,186	190,817	(2,301)	188,516
Shareholders' equity							
Capital stock		130,229	—	130,229	52,019	—	52,019
Contributed surplus	j	1,136	240	1,376	777	335	1,112
Retained earnings	p	158,934	(3,298)	155,636	130,580	(2,565)	128,015
Accumulated other comprehensive loss	l, q	(8,914)	1,775	(7,139)	(3,398)	1,775	(1,623)
		281,385	(1,283)	280,102	179,978	(455)	179,523
		521,633	(4,345)	517,288	370,795	(2,756)	368,039

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

4 ADOPTION OF IFRS (CONTINUED)

RECONCILIATION OF CONSOLIDATED STATEMENT OF INCOME

For the year ended December 31, 2010

	Note	CA GAAP \$	Adj. \$	IFRS \$
Sales		561,046	—	561,046
Expenses				
Cost of sales	o	457,428	10,355	467,783
Selling and administrative	f, i, j, k	32,594	(46)	32,548
Other losses, net		25	—	25
Depreciation of property, plant and equipment and amortization of intangible assets	o	10,355	(10,355)	—
		500,402	(46)	500,356
Operating income		60,644	46	60,690
Financial expenses				
Interest on long-term debt		8,914	—	8,914
Other interest		1,651	—	1,651
		10,565	—	10,565
Income before income taxes		50,079	46	50,125
Provision for (recovery of) income taxes				
Current		16,996	—	16,996
Deferred		(1,312)	—	(1,312)
		15,684	—	15,684
Net income for the year		34,395	46	34,441
Basic earnings per common share		2.27		2.27
Diluted earnings per common share		2.26		2.26

4 ADOPTION OF IFRS (CONTINUED)

RECONCILIATION OF CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	For the year ended December 31, 2010			
	Note	CA GAAP \$	Adj. \$	IFRS \$
Net income for the year	f, i, j, k	34,395	46	34,441
Other comprehensive income (loss)				
Net change in gains (losses) on translation of financial statements of foreign operations		(8,471)	—	(8,471)
Change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations		3,228	—	3,228
Income tax on change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations		(348)	—	(348)
Change in gains (losses) on fair value of derivatives designated as cash flow hedges		(108)	—	(108)
Income tax on change in gains (losses) on fair value of derivatives designated as cash flow hedges		23	—	23
Change in actuarial losses on post-retirement benefit obligations	e, h	—	(1,039)	(1,039)
Income tax on change in actuarial losses on post-retirement benefit obligations		—	260	260
Reclassification to net income of losses on cash flow hedges		160	—	160
		(5,516)	(779)	(6,295)
Comprehensive income		28,879	(733)	28,146

a) Under IFRS, it is not appropriate to classify deferred income tax balances as current, irrespective of the classification of the assets or liabilities to which the deferred income tax relates or the expected timing of reversal. The deferred income tax balances also have to be presented net, as an asset or a liability. Under Canadian GAAP, deferred income tax relating to current assets or current liabilities must be classified as current and are not presented net. Accordingly, a current deferred income tax asset of \$1,683 and a non-current income tax asset of \$1,380 reported under Canadian GAAP as at January 1, 2010 (\$3,206 and \$318 respectively as at December 31, 2010) has been reclassified as a non-current deferred income tax liability under IFRS. As at January 1, 2010, a current deferred income tax liability of \$869 reported under Canadian GAAP (\$292 as at December 31, 2010) has been reclassified as a non-current deferred income tax liability under IFRS.

b) The Company currently holds cutting rights. Under Canadian GAAP, the Company classified them as property, plant and equipment.

Under IFRS, cutting rights can be accounted for as operating leases, intangible assets or agricultural assets, depending on the nature of the contracts. The Company has concluded that under IFRS the cutting rights should be classified as intangible assets and treated as such under IAS 38, *Intangible Assets*. Accordingly, as at January 1, 2010, \$6,150 (\$6,314 as at December 31, 2010) has been reclassified from property, plant and equipment to intangible assets.

c) The Company currently holds standing timber. Under Canadian GAAP, the Company classified them as property, plant and equipment. The Company has analyzed the nature of the standing timber and concluded that under IFRS those assets should be classified as intangible assets and are subject to IAS 38. Accordingly, as at January 1, 2010, \$3,051 (\$2,879 as at December 31, 2010) has been reclassified from property, plant and equipment to intangible assets.

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

4 ADOPTION OF IFRS (CONTINUED)

- d) As mentioned earlier in IFRS 1 optional exemptions, the Company has elected to take advantage of the exemption related to employee future benefits and recognize all its pension plan cumulative actuarial gains or losses through consolidated retained earnings at the Transition Date. As a result, the carrying value of the accrued benefit asset has been increased by \$307 as at January 1, 2010.
- e) As described under significant accounting policies in note 2, actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise.

Under Canadian GAAP, the Company applied the corridor method of accounting for such gains and losses. Under this method, gains and losses are recognized only if they exceed specified thresholds. The impact of the change of method is a decrease of \$699 in the carrying value of the accrued benefit asset as at December 31, 2010 in order to recognize the loss of \$1,006 for the year. No actuarial gains or losses were recognized under Canadian GAAP using the corridor method.

- f) The expense recognized for the pension plans under IFRS differs from the expense recognized under Canadian GAAP. As at December 31, 2010, the impact of that change related to past service costs has resulted in a decrease of the carrying value of the accrued benefit asset of \$122.
- g) As mentioned earlier in IFRS 1 optional exemptions, the Company has elected to take advantage of the exemption related to employee future benefits and recognize all its post-retirement benefits cumulative actuarial losses through consolidated retained earnings at the Transition Date. As a result, the carrying value of the net liability for employee future benefits has been increased by \$990 as at January 1, 2010.
- h) As described under significant accounting policies in note 2, actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to other comprehensive income in the period in which they arise.

The impact of the change of method is an increase in the net liability for employee future benefits obligation of \$1,023 as at December 31, 2010 in order to recognize the actuarial loss of \$33 in other comprehensive income for the year. No actuarial gains or losses were recognized under Canadian GAAP using the corridor method.

- i) IAS 19 indicates that employee future benefits should be attributed from the date that first leads to benefits under the plan to the date that future service leads to no material amount of further benefits. In the Company's case, the attribution period for non-unionized employees would be the last 10 years of service for full eligibility for the benefits.

Under Canadian GAAP, the benefits are attributed from the date of hiring. The impact of the change as at January 1, 2010 is a reduction of \$449 in the carrying value of the net liability for employee future benefits obligation (\$514 as at December 31, 2010).

- j) Under IFRS, for grants of share-based awards with graded vesting, each tranche is considered a separate grant with a different vesting date and fair value.

Under Canadian GAAP, the fair value of stock-based awards with graded vesting are calculated as one grant, and the resulting fair value is recognized on a straight-line basis over the vesting period. As a result of that change, contributed surplus has been increased and retained earnings reduced by \$335 as at January 1, 2010. In 2010, that change reduced contributed surplus and increased income by \$95 as at December 31, 2010.

4 ADOPTION OF IFRS (CONTINUED)

- k) The Company has restricted stock units ("RSUs") granted on December 18, 2009. Under Canadian GAAP, a liability is accrued based on the intrinsic value of the award with changes recognized in the consolidated statement of income each period.

Under IFRS, an entity must measure the liability incurred at fair value by applying an option pricing model. Until the liability is settled, the fair value of that liability is remeasured at each reporting date, with changes in fair value recognized as the awards vest. Starting January 1, 2010, the Company used the Black-Scholes valuation model to measure the liability related to its RSUs. No adjustment was recorded as at January 1, 2010. As at December 31, 2010, the non-current liability was reduced and income was increased by \$8.

- l) As mentioned earlier in IFRS 1 optional exemptions, the Company has elected to reset the cumulative translation adjustment account, which includes gains and losses arising from the translation of foreign operations, to zero at the Transition Date. Accumulated other comprehensive loss has been increased and retained earnings reduced by \$1,775.

- m) Deferred income tax liabilities have been adjusted as follows:

	Note	As at December 31, 2010 \$	As at January 1, 2010 \$
Deferred income tax liabilities			
Employee future benefits – attribution period	i	(146)	(146)
Reclassification from non-current deferred income tax assets	a	(318)	(1,380)
Employee future benefits – actuarial losses	d, e, g, h	107	367
Reclassification from current deferred income tax liabilities	a	292	869
Reclassification from current deferred income tax assets	a	(3,206)	(1,683)
		(3,271)	(1,973)

- n) An amount of \$2,271 has been reclassified as at December 31, 2010 from accounts payable and accrued liabilities to current portion of provisions. This reclassification has been made based on the nature of the liability.
- o) Depreciation and amortization have been reclassified into cost of sales to comply with the presentation under IFRS.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

4 ADOPTION OF IFRS (CONTINUED)

p) The following is a summary of transition adjustments to retained earnings from Canadian GAAP to IFRS:

	Note	As at December 31, 2010 \$	As at January 1, 2010 \$
Retained earnings as reported under Canadian GAAP		158,934	130,580
IFRS adjustments increase (decrease)			
Employee future benefits – actuarial gains – pension plan	d	307	307
Employee future benefits – actuarial loss – pension plan	e	(1,006)	—
Employee future benefits – actuarial loss – post-retirement plan	g	(990)	(990)
Employee future benefits – actuarial loss – post-retirement plan	h	(33)	—
Employee future benefits – attribution period – post-retirement plan	i	514	449
Employee future benefits – year expense – pension plan	f	(122)	—
Amortization of employee stock options	j	(240)	(335)
Amortization of restricted stock units	k	8	—
Deferred income tax – actuarial loss – pension plan	m	252	—
Deferred income tax – actuarial loss – post-retirement plan	m	8	—
Cumulative translation adjustment	l	(1,775)	(1,775)
Deferred income tax	m	(221)	(221)
		(3,298)	(2,565)
Retained earnings as reported under IFRS		155,636	128,015

q) The following is a summary of transition adjustments to accumulated other comprehensive loss from Canadian GAAP to IFRS:

	Note	As at December 31, 2010 \$	As at January 1, 2010 \$
Accumulated other comprehensive loss as reported under Canadian GAAP		(8,914)	(3,398)
IFRS adjustments increase			
Cumulative translation adjustment	l	1,775	1,775
Accumulated other comprehensive loss as reported under IFRS		(7,139)	(1,623)

5 BUSINESS ACQUISITION

a) On December 7, 2011, the Company completed the acquisition of 100% of the shares of Thompson Industries, Inc. (“Thompson”), a provider of treated wood products to the railroad industry. Thompson produced treated wood products, mainly railway ties and timbers, at a facility located in Russellville, Arkansas. Total cash outlay associated with the acquisition was approximately \$29,015 (US\$28,719), excluding acquisition costs of approximately \$423 (US\$414).

5 BUSINESS ACQUISITION (CONTINUED)

The following fair value determination of the net assets acquired and liabilities assumed is preliminary and is based on management's best estimates and information known at the time of preparing these consolidated financial statements. This fair value determination is expected to be completed within 12 months of the acquisition date and consequently, changes could occur mainly with respect to intangible assets, goodwill and deferred income taxes. Immediately following the acquisition, Thompson was merged with SJ Corp and the surviving corporation was SJ Corp. The results of operations of the acquiree have been included in the Company's consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

	\$
Assets acquired	
Non-cash working capital	11,018
Property, plant and equipment	9,452
Cash surrender value of life insurance	150
Customer relationships	12,225
Customer backlog	273
Non-deductible goodwill	15,975
	49,093
Liabilities assumed	
Accounts payable and accrued liabilities	2,835
Long-term debt	3,460
Deferred income tax liabilities	7,587
Total net assets acquired and liabilities assumed	35,211
Consideration transferred	
Cash	29,015
Unsecured note payable to vendor	5,322
Consideration payable	874
Consideration transferred for shares	35,211

The Company's valuation of intangible assets has identified customer relationships and customer backlog. The assigned useful lives for customer relationships are 25 years and 10 months for customer backlog. Goodwill is not amortized nor deductible for tax purposes, and represents the future economic value associated with the increased railroad network access, acquired workforce and synergies with the Company's operations. Note 9 provides a roll-forward of the net book value balances of intangible assets and goodwill.

The Company financed the acquisition through existing credit facilities and an unsecured vendor note of \$6,574 (US\$6,507), bearing interest at 2.67% and repayable in equal instalments over a 10-year period. The vendor note was fair-valued at \$5,322 (US\$5,268) using an interest rate of 7.0%.

In the period from December 7 to December 31, 2011, the acquiree's sales and loss before income taxes amounted to \$1,690 and \$102, respectively. On a pro forma basis, management's estimate of sales and income before income taxes of the combined operations of the Company and Thompson for the 12-month period ended December 31, 2011 would have been approximately \$687,526 and \$84,260 respectively, had the Thompson acquisition occurred as of January 1, 2011. To arrive at the pro forma estimates, management considered the financing structure resulting from the acquisition as well as other adjustments related to the acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

5 BUSINESS ACQUISITION (CONTINUED)

- b) On April 1, 2010, the Company completed the acquisition of 100% of the shares of Tangent, a provider of wood crosstie supply chain services to the railroad industry. Tangent served the railroad industry with treated wood products, mainly railway ties, through facilities located in Warrior, Alabama; Terre Haute and Winslow, Indiana; Alexandria, Louisiana; and McAlisterville, Pennsylvania. The wood preservative, creosote, was produced at its distilleries in Terre Haute, Indiana and Memphis, Tennessee. Life cycle solutions consisting of used tie pickup and disposal were carried out at three facilities, in Alabama, Minnesota and North Carolina. This acquisition expands the Company's capabilities in the U.S. railway tie industry and provides it with creosote manufacturing operations.

Total cash outlay associated with the acquisition was approximately \$172,700 (US\$170,000), including cash on hand of \$6,800 (US\$6,700) and excluding acquisition costs of approximately \$2,000 (US\$2,000). This amount includes \$90,400 (US\$89,000) paid to Tangent's shareholders, \$81,300 (US\$80,100) used to reimburse Tangent's debts with financial institutions and \$1,000 (US\$ 900) to pay accrued interest on these debts.

The results of operations of Tangent have been included in the Company's consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

	\$
Assets acquired	
Non-cash working capital	48,603
Property, plant and equipment	22,734
Customer relationships	20,905
Customer backlog	670
Creosote registration	31,723
Non-deductible goodwill	70,239
Deferred income tax assets	615
	<hr/> 195,489
Liabilities assumed	
Accounts payable and accrued liabilities	5,290
Long-term debt	81,340
Site remediation obligation	1,311
Deferred income tax liabilities	23,983
	<hr/> 83,565
Total net assets acquired and liabilities assumed	
<hr/>	
Consideration transferred	
Cash	172,694
Payment of accrued interest	(956)
Payment of long-term debt	(81,340)
Cash on hand	(6,833)
	<hr/> 83,565
Consideration transferred for shares	
	<hr/> 83,565

5 BUSINESS ACQUISITION (CONTINUED)

The Company's valuation of intangible assets has identified customer relationships, a creosote registration and customer backlog. The assigned useful lives for customer relationships are between 6 and 10 years, and 3 months for customer backlog. The creosote registration is not subject to amortization as the Company considers it to have an indefinite useful life. Goodwill is not amortized nor deductible for tax purposes, and represents the future economic value associated with the increased railroad network access, acquired workforce and synergies with the Company's operations. Note 9 provides a roll-forward of the net book value balances of intangible assets and goodwill.

Financing for the transaction was secured through an \$80,050 private placement of subscription receipts which successfully closed on March 15, 2010, as well as through the issuance to the Solidarity Fund QFL of a \$25,395 (US\$25,000) unsecured, subordinated and non-convertible debenture, the addition of a \$40,632 (US\$40,000) syndicated bank term facility which successfully closed on March 24, 2010, and the increase of existing operating debt facilities. More details on financing facilities can be found in notes 11 and 13. Underwriting and legal fees related to the private placement of subscription receipts amounted to \$3,147, generating net proceeds of \$76,903. The subscription receipts were exchanged as at the close of business, April 1, 2010, for common shares in the capital stock of the Company on the basis of one common share per subscription receipt. The Company recorded the capital stock issuance at a value of \$77,748, as the net proceeds were subject to a deferred income tax adjustment of \$845. Holders of subscription receipts were not required to take any action in order to receive the common shares to which they were entitled. As the subscription receipts were sold on a private placement basis, these common shares were subject to regulatory restrictions on resale until July 16, 2010.

During the nine-month period ended December 31, 2010, Tangent's sales and income before taxes amounted to \$120,456 and \$8,923, respectively. On a pro forma basis, management's estimate of sales and income before taxes of the combined operations of the Company and Tangent for the 12-month period ended December 31, 2010 would have been approximately \$601,360 and \$54,924, respectively, had the Tangent acquisition occurred as of January 1, 2010. To arrive at the pro forma estimates, management considered the financing structure resulting from the acquisition as well as other adjustments related to the acquisition.

6 ACCOUNTS RECEIVABLE

	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Trade receivables	72,673	53,912	29,026
Less: Provision for doubtful accounts	(414)	(279)	(496)
Trade receivables – net	72,259	53,633	28,530
Other receivables	4,252	2,682	1,630
	76,511	56,315	30,160

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

6 ACCOUNTS RECEIVABLE (CONTINUED)

As at December 31, 2011, trade receivables of \$25,900 (December 31, 2010 – \$22,389) were past due but not impaired. These past due balances are related to various independent customers for whom there is no recent history of default.

The aging of gross trade receivables at each reporting date was as follows:

	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Current	46,359	31,244	17,073
Past due 1-30 days	18,066	14,910	8,903
Past due 31-60 days	5,918	4,671	2,392
Past due more than 60 days	2,330	3,087	658
	72,673	53,912	29,026

As at December 31, 2011, trade receivables of \$414 (December 31, 2010 – \$279) were impaired and provided for. Details of the provision for doubtful accounts are as follows:

	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Balance – Beginning of year	279	496	244
Provision (recovery)	210	(180)	396
Bad debt write-off	(81)	(13)	(88)
Foreign exchange adjustments	6	(24)	(56)
Balance – End of year	414	279	496

The variation of the provision for doubtful accounts has been included in selling and administrative expenses in the consolidated statement of income.

7 INVENTORIES

	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Raw materials	187,660	149,102	160,351
Finished goods	55,930	56,233	52,239
	243,590	205,335	212,590

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

8 PROPERTY, PLANT AND EQUIPMENT

	Land \$	Roads \$	Buildings \$	Production and anti- pollution equipment \$	Rolling stock \$	Office equipment \$	Total \$
As at January 1, 2010							
Cost	6,498	2,617	22,497	83,167	6,467	1,984	123,230
Accumulated depreciation	—	(853)	(4,712)	(26,863)	(2,178)	(940)	(35,546)
Net book amount	6,498	1,764	17,785	56,304	4,289	1,044	87,684
Year ended December 31, 2010							
Opening net book amount	6,498	1,764	17,785	56,304	4,289	1,044	87,684
Acquisition of subsidiary	1,582	—	4,013	13,439	3,612	88	22,734
Additions	—	340	879	3,594	40	681	5,534
Disposals	—	—	—	—	(264)	—	(264)
Depreciation	—	(318)	(654)	(2,489)	(980)	(410)	(4,851)
Transfer to assets held for sale	(314)	—	(1,412)	—	—	—	(1,726)
Impairment	—	—	—	(1,394)	(339)	—	(1,733)
Exchange differences	(152)	—	(565)	(1,653)	(234)	(11)	(2,615)
Closing net book amount	7,614	1,786	20,046	67,801	6,124	1,392	104,763
As at December 31, 2010							
Cost	7,614	2,957	25,284	96,691	8,856	2,722	144,124
Accumulated depreciation	—	(1,171)	(5,238)	(28,890)	(2,732)	(1,330)	(39,361)
Net book amount	7,614	1,786	20,046	67,801	6,124	1,392	104,763
Year ended December 31, 2011							
Opening net book amount	7,614	1,786	20,046	67,801	6,124	1,392	104,763
Acquisition of subsidiary	3,031	—	3,446	2,108	765	102	9,452
Additions	—	349	1,289	6,872	5	660	9,175
Disposals	—	—	—	(292)	(300)	(18)	(610)
Depreciation	—	—	(660)	(2,695)	(924)	(244)	(4,523)
Depreciation included in inventory	—	(475)	(20)	(7)	(3)	(35)	(540)
Reversal of impairment	—	—	—	280	—	—	280
Exchange differences	101	—	318	779	97	149	1,444
Closing net book amount	10,746	1,660	24,419	74,846	5,764	2,006	119,441
As at December 31, 2011							
Cost	10,746	3,306	30,379	106,733	9,397	3,474	164,035
Accumulated depreciation	—	(1,646)	(5,960)	(31,887)	(3,633)	(1,468)	(44,594)
Net book amount	10,746	1,660	24,419	74,846	5,764	2,006	119,441

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

8 PROPERTY, PLANT AND EQUIPMENT (CONTINUED)

Additions to production and anti-pollution equipment costs include \$58 (2010 – nil) of interest capitalized at an average borrowing rate of 3.23%.

Pursuant to the Tangent acquisition made in 2010, the Company has increased its production capacity and has consolidated the production of its railway tie requirements. As a result, the Spencer plant in West Virginia will be producing lower annual volumes going forward. This decision by management triggered a requirement to test the Spencer plant's long-lived assets for recoverability, which resulted in a \$1,733 impairment expense recorded in the 2010 second quarter income.

A piece of production equipment impaired in 2010 due to its non-utilization is now being used by the Company. Consequently, the impairment charge of \$280 has been reversed in 2011.

9 INTANGIBLE ASSETS AND GOODWILL

The intangible assets, which include customer relationships, non-compete agreements, cutting rights, standing timber and a creosote registration, were initially evaluated at fair value, which subsequently became the cost. The presentation in the consolidated statements of financial position is at cost less accumulated amortization and the related amortization expense is included in cost of sales in the consolidated statements of income.

Customer relationships comprise long-term agreements with certain customers and ongoing business relationships. The acquisition cost was established based on future benefits associated with these relationships. Intangible assets associated with long-term customer agreements are amortized over the terms of the agreements, which range between 3 and 10 years. Intangible assets associated with ongoing business relationships are amortized over a period ranging from 10 to 25 years.

The acquisition cost of the non-compete agreements was established based on the discounted value of future payments using a discount rate of 10.2%. For cash flow purposes, this has been treated as a non-cash transaction. The intangible asset associated with the non-compete agreements is amortized on a straight-line basis over the terms of the agreements, which are 6 years.

As part of the Tangent acquisition, the Company allocated value to a creosote registration. This intangible asset has an indefinite useful life and is therefore not amortized. The creosote registration was initially evaluated at fair value, which subsequently became the cost.

9 INTANGIBLE ASSETS AND GOODWILL (CONTINUED)

IMPAIRMENT TESTS FOR GOODWILL

Goodwill is allocated for impairment testing purposes to CGUs which reflect how it is monitored for internal management purposes.

The recoverable amount of a CGU is determined based on value-in-use calculations. Value-in-use calculations use cash flow projections based on financial budgets covering a five-year period that are based on the latest budgets for revenue and cost as approved by senior management. Cash flow projections beyond five years are based on internal management forecasts and assume a growth rate not exceeding gross domestic product for the respective countries. Pre-tax cash flow projections are discounted using a real pre-tax discount rate of 10.7%. One percent real growth rates are assumed in perpetuity for most of the businesses given the commodity nature of the majority of the products (i.e. volume growth is assumed to be offset by real price declines). Perpetuity capital expenditures have been assumed at 60% of depreciation. The assumptions used in calculating value in use have considered the current economic environment, resulting in a more conservative estimate regarding future value.

Expected future cash flows are inherently uncertain and could materially change over time. They are significantly affected by a number of factors, including market and production estimates, together with economic factors such as prices, discount rates, estimates of production costs and future capital expenditure. A 1% increase in the discount rate or a 1% decrease in cash flows would not give rise to an impairment.

IMPAIRMENT TESTS FOR INTANGIBLE ASSETS WITH INDEFINITE USEFUL LIFE

The creosote registration is allocated for impairment testing purposes to CGUs which reflect how it is monitored for internal management purposes. The recoverable amount of a CGU is determined based on value-in-use calculations. Value-in-use calculations use cash flow projections based on financial budgets covering a five-year period that are based on the latest forecasts for revenue and cost as approved by senior management. Cash flow projections beyond five years are based on internal management forecasts and assume a growth rate not exceeding domestic product for the respective countries. Pre-tax cash flow projections are discounted using a real pre-tax discount rate of 10.7%. One percent real growth rates are assumed in perpetuity for most of the business given the commodity nature of the majority of the products (i.e. volume growth is assumed to be offset by real price declines).

Expected future cash flows are inherently uncertain and could materially change over time. They are significantly affected by a number of factors, including market and production estimates, together with economic factors such as prices, discount rates, estimates of production costs and future capital expenditure. A 1% increase in the discount rate or a 1% decrease in cash flows would not give rise to an impairment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

9 INTANGIBLE ASSETS AND GOODWILL (CONTINUED)

IMPAIRMENT TESTS FOR INTANGIBLE ASSETS WITH INDEFINITE USEFUL LIFE (CONTINUED)

The net book amount of these intangible assets was as follows:

	Intangible assets					Total	Goodwill
	Cutting rights	Standing timber	Customer relationships	Non-compete agreements	Creosote registration		
	\$	\$	\$	\$	\$		
As at January 1, 2010							
Cost	6,505	4,717	4,603	5,980	—	21,805	5,494
Accumulated amortization	(355)	(1,666)	(1,259)	(1,744)	—	(5,024)	—
Net book amount	6,150	3,051	3,344	4,236	—	16,781	5,494
Year ended December 31, 2010							
Opening net book balance	6,150	3,051	3,344	4,236	—	16,781	5,494
Additions	287	635	—	—	—	922	—
Addition of Tangent - customer relationships	—	—	20,905	—	—	20,905	—
Addition of Tangent - customer backlog	—	—	670	—	—	670	—
Addition of Tangent - creosote registration	—	—	—	—	31,723	31,723	—
Addition of Tangent - goodwill	—	—	—	—	—	—	70,239
Amortization	(123)	(807)	(3,586)	(986)	—	(5,502)	—
Exchange differences	—	—	(473)	(185)	(662)	(1,320)	(1,760)
Closing net book amount	6,314	2,879	20,860	3,065	31,061	64,179	73,973
As at December 31, 2010							
Cost	6,792	5,352	25,482	5,659	31,061	74,346	73,973
Accumulated amortization	(478)	(2,473)	(4,622)	(2,594)	—	(10,167)	—
Net book amount	6,314	2,879	20,860	3,065	31,061	64,179	73,973
Year ended December 31, 2011							
Opening net book balance	6,314	2,879	20,860	3,065	31,061	64,179	73,973
Additions	—	658	—	—	—	658	—
Addition of Thompson - customer relationships	—	—	12,497	—	—	12,497	—
Addition of Thompson - goodwill	—	—	—	—	—	—	15,975
Amortization	—	—	(3,258)	(934)	—	(4,192)	—
Impairment	—	—	(2,486)	—	—	(2,486)	—
Amortization included in inventory	(114)	(673)	—	—	—	(787)	—
Exchange differences	—	—	454	39	700	1,193	1,772
Closing net book amount	6,200	2,864	28,067	2,170	31,761	71,062	91,720
As at December 31, 2011							
Cost	6,792	6,010	37,965	5,787	31,761	88,315	91,720
Accumulated amortization	(592)	(3,146)	(9,898)	(3,617)	—	(17,253)	—
Net book amount	6,200	2,864	28,067	2,170	31,761	71,062	91,720

In December 2011, the Company took an impairment charge of \$2,486 following the non-renewal of a service contract included in customer relationships for which a value was assigned in a previous acquisition.

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

10 OTHER ASSETS

	Note	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Advances and notes receivable		541	536	567
Accrued benefit asset	18 (b)	—	1,119	1,723
Assets held for sale*		3,164	3,318	2,895
Other		609	358	—
		4,314	5,331	5,185

* Assets held for sale mainly represent a building that the Company owns in Ripley, West Virginia, and a plant in Stanton, Kentucky.

11 BANK INDEBTEDNESS

	Note	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Demand revolving facility	11(a)	—	30,293	—
Demand operating loan with a Canadian bank	11(b)	—	—	28,786
Demand operating loan with a U.S. bank	11(c)	—	—	24,969
Proportionate share of Kanaka's demand operating loan	11(d)	2,585	1,630	2,364
		2,585	31,923	56,119

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

11 BANK INDEBTEDNESS (CONTINUED)

- a) On July 28, 2011, the Company and SJ Holding, as borrowers, entered into an agreement to amend and restate in its entirety their existing revolving credit agreement dated March 24, 2010 (see note 11(b) and (c)). The existing demand revolving facility was replaced by a five-year term committed revolving facility and is presented under long-term debt (note 13(a)). Previously, a demand revolving facility was made available to the Company by a syndicate of bank lenders and consisted of Tranche A, a maximum demand operating loan of \$50,000 made available to the Company, and Tranche B, a maximum demand operating loan of US\$75,000 made available to SJ Holding. Borrowings were obtained by the Company under Tranche A in the form of Canadian prime rate loans, Canadian bankers' acceptances ("BAs"), U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit up to a maximum of \$5,000. Borrowings were obtained by SJ Holding under Tranche B in the form of U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit. The interest rate margin with respect to Canadian prime rate loans and U.S. base rate loans was 0.75% and with respect to BAs, LIBOR loans and fees for letters of credit, the interest rate margin was 2.0%. The borrowing base consisted of 75% in value of acceptable receivables and 50% in value of acceptable inventories, up to a maximum of \$80,000.
- b) Previously, the Company had a credit facility with a Canadian bank which was amended and restated as part of the credit agreement entered into on March 24, 2010 (note 11(a)).
- c) Previously, SJ Holding and SJ Corp (collectively "the U.S. subsidiaries") had a credit facility with a U.S. bank which was amended and restated as part of the credit agreement entered into on March 24, 2010 (note 11(a)).
- d) The Company includes in its consolidated financial statements its 50% proportionate share of Kanaka, which has a credit facility with a Canadian bank comprising a \$7,000 demand operating loan. This loan bears interest at the bank's prime rate plus 0.5%, the bank's U.S. base rate plus 0.5%, LIBOR plus 2.0% or BA rate plus 2.0%. One half of the indebtedness, up to a maximum of \$5,000, has been guaranteed by Stella-Jones Canada Inc. and the Company.

12 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	Note	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Trade payables		22,367	13,053	8,478
Amounts due to related parties	23	85	36	93
Accrued expenses		14,888	11,261	8,993
Other payables		6,353	8,076	3,917
		43,693	32,426	21,481

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

13 LONG-TERM DEBT

	Note	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Committed revolving facility	13(a)	124,989	—	—
Revolving term loan with a Canadian bank	13(b)	—	—	22,098
Term loans with a Canadian bank	13(c)	—	—	2,539
Term facilities	13(d)	—	55,573	—
Term loans with a U.S. bank	13(e)	—	7,381	8,693
Unsecured and non-convertible debenture	13(f)	—	—	10,000
Unsecured, subordinated and non-convertible debenture	13(g)	25,425	24,865	—
Unsecured and non-convertible debenture	13(h)	10,170	24,865	26,275
Subordinated note	13(i)	5,899	6,112	6,822
Bond – County of Fulton, Kentucky	13(j)	4,363	4,399	4,788
Bond – Arkansas Development Finance Authority	13(k)	2,649	—	—
Unsecured promissory note	13(l)	5,374	—	—
Subordinated promissory note	13(m)	—	746	788
Unsecured promissory note	13(n)	394	557	755
Promissory note	13(o)	226	289	373
Promissory note	13(p)	266	296	356
Mortgage loans	13(q)	652	1,717	3,805
Obligation under finance leases		—	—	275
		180,407	126,800	87,567
Deferred financing costs		(313)	(972)	(487)
		180,094	125,828	87,080
Less: Current portion of long-term debt		1,524	10,780	4,811
Less: Current portion of deferred financing costs		(59)	(321)	(65)
		178,629	115,369	82,334

- a) On July 28, 2011, the Company and SJ Holding, as borrowers, entered into an agreement to amend and restate in its entirety their existing revolving credit agreement. The existing demand revolving facility made available by a syndicate of bank lenders under the March 24, 2010 amendment (note 11(a)) was replaced by a committed revolving facility in the amount of \$170,000, to be used to repay and refinance existing indebtedness and for working capital and general corporate purposes. The \$170,000 committed revolving facility has been made available for a five-year term by a syndicate of lenders to the Company and SJ Holding (previously Tranche A, a maximum demand operating loan of \$50,000 made available to the Company, and Tranche B, a maximum demand operating loan of US\$75,000 made available to SJ Holding). Borrowings may be obtained in the form of prime rate loans, BAs, U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit. The interest rate margin with respect to Canadian prime rate loans and U.S. base rate loans will range from 0.25% to 1.50% based on a pricing grid (previously 0.75%). The interest rate margin with respect to BAs, LIBOR loans and fees for letters of credit will range from 1.25% to 2.50% based on a pricing grid (previously 2.0%). As at December 31, 2011, borrowings from Canadian entities denominated in U.S. dollars represented \$82,404 (US\$81,027), of which \$79,529 (US\$78,200) was designated as a hedge of net investment in foreign operations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

13 LONG-TERM DEBT (CONTINUED)

During the year, the Company entered into interest rate swap agreements fixing certain rates as described in note 21, Financial instruments.

As collateral for the committed revolving facility, the bank lenders hold a first ranking charge over all of the assets, tangible and intangible, present and future, of the Company, SJ Holding and their material subsidiaries, with the exception of certain assets as outlined in the agreement.

- b) The Company had a two-year revolving term loan which was amended and restated on March 24, 2010 (see note 13(d)).
- c) The Company had available three term loans of \$2,300, \$2,700 and \$1,900 with a Canadian bank which were amended and restated on March 24, 2010 (see note 13(d)).
- d) On March 24, 2010, the Company entered into an agreement with a syndicate of lenders amending and restating, without novation, existing term credit agreements and made available a new five-year term facility. Under this new agreement, four facilities (A, B, C and D) were made available. Credit facility A was a US\$40,000 syndicated bank term loan used for the purpose of acquiring Tangent. The term loan bore interest at the bank's U.S. base rate plus 1.5% or LIBOR plus 3.0%, at the Company's option. Repayment was in 19 consecutive quarterly principal instalments of US\$1,425 starting July 1, 2010, and a balloon repayment of US\$12,925 constituting the twentieth and final payment of the residual capital balance on April 1, 2015. This term loan was designated as a hedge of net investment in foreign operations.

Credit facility B was a two-year revolving term facility in the aggregate principal amount \$27,500 maturing February 14, 2012, under which borrowings could be made in either Canadian or U.S. dollars. Upon the Company's request to the lender, this credit facility could have been extended for additional one-year terms or converted into a five-year term loan. For loans in Canadian dollars, the credit facility bore interest at the bank's prime rate plus 1.5% or BA rate plus 3.0%, and for loans in U.S. dollars, the credit facility bore interest at the bank's U.S. base rate plus 1.5% or LIBOR plus 3.0%. A US\$10,000 loan under this facility was designated as a hedge of net investment in foreign operations. The Company entered into an interest rate swap fixing the interest rate on this US\$10,000 term loan at a base rate of 1.53%, which matured in April 2011.

Credit facility C was a non-revolving term facility in the aggregate principal amount of \$2,143 comprising Tranche 1 in the amount of \$1,157 maturing February 1, 2011 and Tranche 2 in the amount of \$986 maturing December 28, 2010. Tranches 1 and 2 were repaid in their entirety with the proceeds of the committed revolving facilities and without penalties upon maturity.

Credit facility D was a non-revolving term facility in the aggregate principal amount of \$300 which matured and was repaid in its entirety with the proceeds of the committed revolving facilities and without penalties upon maturity on September 30, 2010.

On August 11, 2011, the remaining balances on credit facilities A and B were repaid in their entirety.

- e) The U.S. subsidiaries entered into a US\$10,000 term loan agreement with a U.S. bank. The term loan was repayable in 84 consecutive average monthly instalments of US\$119 and maturing July 1, 2015. The loan was subject to two interest rate swaps of US\$5,000 each, fixing the rates at 5.80% and 5.54% over the term of the loan. On August 11, 2011, the U.S. subsidiaries repaid the term loan in its entirety.
- f) The Company had available an unsecured and non-convertible debenture bearing interest at 7.72%, repayable in five consecutive annual principal instalments of \$1,000 beginning July 1, 2011 and a final payment of \$5,000 on July 1, 2016. The Company repaid the debenture in its entirety on October 4, 2010.

13 LONG-TERM DEBT (CONTINUED)

- g) On April 1, 2011, the Company entered into an agreement to amend and restate a US\$25,000 unsecured, subordinated and non-convertible debenture. The amended debenture bears interest at 7.27% (previously 9.75%) and is repayable in a single instalment of US\$25,000 on April 1, 2016 (previously, a single instalment of US\$25,000 on April 1, 2015). No advance repayment will be permitted under the amended agreement. The amended debenture was designated as a hedge of net investment in foreign operations. The amendment was accounted for as a modification of the terms of the debt and without penalties.
- h) On April 1, 2011, the Company entered into an agreement to amend and restate a US\$25,000 unsecured and non-convertible debenture and repaid US\$15,000 of the capital amount. The amended debenture bears interest at 7.27% (previously 7.89%) and is repayable in a single instalment of US\$10,000 on April 1, 2016 (previously, five annual principal repayments of US\$2,500 starting on April 1, 2013 and a final payment of US\$12,500 on April 1, 2018). No advance repayment will be permitted under the amended debenture. The amended debenture was designated as a hedge of net investment in foreign operations. The amendment was accounted for as a modification of the terms of the debt and without penalties.
- i) Pursuant to a business acquisition on February 28, 2007, SJ Corp issued a note payable to J.H. Baxter and Co. The note is subordinated to existing lenders and bears interest at 5.0%. The note is repayable in five annual principal repayments of US\$500, with a final payment of US\$5,500 on the sixth anniversary date. The note was initially recorded at a fair value of \$6,981 using an interest rate of 8.0%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.
- j) Bond issued in favour of the County of Fulton, Kentucky (the Burke-Parsons-Bowlby Project), Series 2006, repayable in annual principal repayments of US\$200 starting July 2008 through July 2011, US\$300 starting August 2011 through July 2019 and US\$400 starting August 2019 through July 2026. The bond bears interest at a variable rate based on the SIFMA Municipal Swap Index. On June 15, 2009, the Company entered into an interest rate swap agreement fixing the rate at 2.99% up to December 1, 2015. The bond is secured by substantially all assets of the Fulton facility, which have a net book value of US\$7,683 as at December 31, 2011. The bond was initially recorded in the consolidated financial statements at a fair value of US\$4,835 using an interest rate of 6.50%. The difference between the face value and the fair value of the bond is being accreted on an effective yield basis over its term.
- In order to provide security for the timely payment of the principal and interest due on the bond, the U.S. subsidiaries entered into a US\$5,200 irrevocable letter of credit with the bank that is also the trustee for the Series 2006 Bond Indenture, at an annual fee of 1.0% of the outstanding loan balance. The letter of credit expires on January 17, 2026.
- k) As part of the Thompson acquisition, SJ Corp assumed a bond issued in favour of the Arkansas Development Finance Authority, repayable in annual principal repayments ranging from US\$145 to US\$275 up to September 1, 2024. Interest rates on the bond range from 5.62% to 5.81% and are payable semi-annually on March 1 and September 1. The bond is secured by all the machinery and equipment of the Russellville, Arkansas facility.
- l) As part of the Thompson acquisition, SJ Corp issued an unsecured promissory note of \$6,617 bearing interest at 2.67%. The note is repayable in 10 equal instalments up to December 2021. The note was initially recorded at a fair value of \$5,357 using an interest rate of 7.0%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.
- m) SJ Corp borrowed US\$750 from the Company's parent company, Stella Jones International S.A., by way of a subordinated promissory note. The note was for a term of six years, bearing interest at LIBOR plus 4.5% and was repayable in full on the sixth anniversary of the date of disbursement or August 3, 2011. The note was unsecured and subordinated in right of payment to the prior payment in full of the U.S. subsidiaries' loans to all of its secured lenders. On August 3, 2011, the Company repaid the subordinated promissory note in its entirety to Stella Jones International S.A.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

13 LONG-TERM DEBT (CONTINUED)

- n) Unsecured promissory note bearing interest at 8.0%, payable in quarterly instalments of US\$53, including interest, and matures on October 1, 2013.
- o) Promissory note payable to the Hickman-Fulton Rural Electric Cooperative Corporation, bearing interest at a fixed rate of 3.0% and repayable in 84 equal monthly instalments of principal and interest of approximately US\$7 starting January 15, 2008. The note is secured by a US\$500 irrevocable letter of credit issued by a regional financial institution at an annual fee of 1.0% and expiring December 17, 2017. The note was initially recorded in the consolidated financial statements at a fair value of US\$462 using an interest rate of 5.55%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.
- p) Promissory note payable to the Hickman-Fulton Rural Electric Cooperative Corporation, bearing no interest and repayable in 108 equal monthly instalments of US\$4 starting January 1, 2009. The note is secured by a US\$450 irrevocable letter of credit issued by a regional financial institution, at an annual fee of 1.0% and expiring December 17, 2017. The note was initially recorded in the consolidated financial statements at a fair value of US\$354 using an interest rate of 6.0%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.
- q) On August 11, 2011, the Company repaid a mortgage loan having a balance of US\$915. The remaining mortgage loan bears interest at a rate of 2.5% as at December 31, 2011 (December 31, 2010 – 3.8%; January 1, 2010 – 5.7%), and certain specific assets with a net book value of \$883 (December 31, 2010 – \$1,891; January 1, 2010 – \$5,950) have been pledged as collateral. The mortgage loan is denominated in U.S. dollars amounting to US\$642 (December 31, 2010 – US\$1,726; January 1, 2010 – US\$3,620). The remaining mortgage loan is repayable in monthly instalments of \$9 (December 31, 2010 – \$21; January 1, 2010 – \$89), including interest, and matures in December 2016.
- r) The repayment requirements on the long-term debt during the next five years and thereafter are as follows:

	Principal \$
2012	1,955
2013	9,431
2014	1,151
2015	1,091
2016	161,694
Thereafter	7,502
	182,824
Fair value adjustment	(2,417)
	180,407

- s) The aggregate fair value of the Company's long-term debt was estimated at \$179,973 as at December 31, 2011 (2010 – \$127,923) based on discounted future cash flows, using interest rates available to the Company for issues with similar terms and average maturities.

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

14 PROVISIONS AND OTHER LONG-TERM LIABILITIES

	Provisions				Other long-term liabilities			Grand total \$
	Reforestation \$	Site remediation \$	Others \$	Total \$	RSU \$	Non-competes payable		
						Total \$	Total \$	
Balance as at January 1, 2010	1,159	88	—	1,247	15	4,602	4,617	5,864
Provisions charged to income:								
Addition	209	1,311	2,375	3,895	408	—	408	4,303
Payment	(283)	(290)	—	(573)	—	(1,311)	(1,311)	(1,884)
Interest accretion	—	—	—	—	—	389	389	389
Exchange differences	—	—	(104)	(104)	—	(195)	(195)	(299)
Balance as at December 31, 2010	1,085	1,109	2,271	4,465	423	3,485	3,908	8,373
Provisions charged to income:								
Addition	543	2,485	3,754	6,782	747	—	747	7,529
Payment	(312)	(3,003)	(351)	(3,666)	—	(1,218)	(1,218)	(4,884)
Interest accretion	—	—	(44)	(44)	—	279	279	235
Exchange differences	—	19	227	246	—	36	36	282
Balance as at December 31, 2011	1,316	610	5,857	7,783	1,170	2,582	3,752	11,535

Analysis of provisions and other long-term liabilities

	As at December 31, 2011 \$	As at December 31, 2010 \$	As at January 1, 2010 \$
Current			
Provisions	7,169	3,746	315
Other long-term liabilities	2,249	959	920
Total current	9,418	4,705	1,235
Non-current			
Provisions	614	719	932
Other long-term liabilities	1,503	2,949	3,697
Total non-current	2,117	3,668	4,629
	11,535	8,373	5,864

PROVISIONS

Reforestation

Stella-Jones Canada Inc. has asset retirement obligations relating to reforestation and site remediation that have been estimated using a pre-tax rate that reflects current market assessment of the time value of money and the risk specific to the obligation of 4.0% (2010 – 6.6%) to approximate the present value of future expenditures.

Reforestation obligations represent discounted cash flow estimates of future silviculture costs relating to logged areas that are the Company's responsibility to reforest.

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

14 PROVISIONS AND OTHER LONG-TERM LIABILITIES (CONTINUED)

PROVISIONS (CONTINUED)

Reforestation (continued)

Future non-discounted reforestation expenditures are estimated at between \$338 and \$731 in each of the next three years. There are uncertainties in estimating future reforestation costs due to potential regulatory changes as well as the impact of weather-related changes on reforested areas. Accordingly, the actual cost of reforestation may differ from current estimates.

Site remediation

Site remediation obligations represent discounted cash flow estimates relating to future environmental remediation costs of former treating sites.

As part of the Tangent acquisition, the Company acquired a lease on April 1, 2010 for land on which the Terre Haute, Indiana operations are located. Under the lease, the Company is required to return the land to its original condition. In 2010, the Company decided to close the Terre Haute facility. In order to restore the site to its original condition, remediation work was required, for which a provision of \$1,311 was recorded in 2010.

Others

Other provisions comprise \$4,507 in legal litigation provisions, \$1,057 in a provision set up to acquire the land of the Memphis facility, which is presently being leased, and \$293 in other provisions.

OTHER LONG-TERM LIABILITIES

Restricted stock units

On December 18, 2009, certain key executives of the Company were granted RSUs as part of a long-term incentive plan. This plan had been approved by the Company's Board of Directors on December 10, 2009. The number of RSUs initially granted was based on a percentage of the executive's salary, divided by the average trading price of the Company's common shares on the TSX for the five days immediately preceding the grant date. In the case of the President, the number of RSUs initially granted was a fixed number recommended by the Company's Remuneration Committee. Additional RSUs may be issued annually conditional upon the Company attaining a minimum 12.5% return on capital employed.

As at December 31, 2011, the provision for previously issued RSUs was valued at \$1,170 (\$423 as at December 31, 2010). The number of additional RSUs to be issued will be calculated in the same manner as the initial grant. No RSUs were granted in 2010 and 2011.

The RSUs are full-value phantom shares payable in cash on the third anniversary of their date of grant, provided the executive is still employed by the Company. The amount to be paid is determined by multiplying the number of RSUs by the six-month average trading price of the Company's common shares on the TSX immediately preceding the anniversary.

Non-competes payable

As part of a previous acquisition, the Company entered into non-compete agreements for which an intangible asset was recorded (note 9). The payable portion of the non-compete agreements was fair-valued at a rate of 10.2%.

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

15 CAPITAL STOCK

	2011	2010
Number of shares outstanding – Beginning of year*	15,923	12,684
Stock option plan*	22	25
Exchange of subscription receipts for common shares*	—	3,202
Employee share purchase plans*	10	12
Number of shares outstanding – End of year*	15,955	15,923

* Number of shares is presented in thousands.

a) Capital stock consists of the following:

Authorized

An unlimited number of preferred shares issuable in series

An unlimited number of common shares

b) Earnings per share

The following table provides the reconciliation between basic earnings per common share and diluted earnings per common share:

	2011	2010
Net income applicable to common shares	\$55,709	\$34,441
Weighted average number of common shares outstanding*	15,946	15,163
Effect of dilutive stock options*	61	41
Weighted average number of diluted common shares outstanding*	16,007	15,204
Basic earnings per common share **	\$3.49	\$2.27
Diluted earnings per common share **	\$3.48	\$2.26

* Number of shares is presented in thousands.

** Basic and diluted earnings per common share are presented in dollars per share.

c) Stock option plan

The Company has a stock option plan (the "Plan") for directors, officers and employees whereby the Board of Directors or a committee appointed for such purpose ("Committee") may, from time to time, grant to directors, officers or employees of the Company options to acquire common shares in such numbers, for such terms and at such exercise prices as are determined by the Board of Directors or such Committee. The stated purpose of the Plan is to secure for the Company and its shareholders the benefits of incentives inherent in share ownership by directors, officers and employees of the Company.

Under the Plan adopted on June 13, 1994 and amended on May 3, 1995, March 15, 2001, May 3, 2007 and December 10, 2010, the aggregate number of common shares in respect of which options may be granted is 1,200,000 and no optionee may hold options to purchase common shares exceeding 5% of the number of common shares issued and outstanding from time to time. The exercise price of an option shall not be lower than the closing price of the common shares on the TSX on the last trading day immediately preceding the date of the granting of the option. Each option shall be exercisable during a period established by the Board of Directors or Committee, and the term of the option may not exceed 10 years. Options will not be assignable and will terminate, in the case of an employee, either 30 or 180 days following cessation of service with the Company, depending on the circumstances of such cessation, and in the case of a director who is not an employee of the Company, either 30 or 180 days following the date on which such optionee ceases to be a director of the company, depending on the circumstances.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

15 CAPITAL STOCK (CONTINUED)

Changes in the number of options outstanding under the Plan were as follows:

	2011		2010	
	Number of options*	Weighted average exercise price** \$	Number of options*	Weighted average exercise price** \$
Outstanding – Beginning of year	181	22.70	198	20.29
Exercised	(22)	18.02	(24)	4.83
Granted	—	—	7	28.29
Outstanding – End of year	159	23.36	181	22.70
Options exercisable – End of year	120	22.97	128	21.40

* Number of options is presented in thousands.

** Weighted average exercise price is presented in dollars per option.

The following options were outstanding under the Plan as at December 31, 2011:

Year granted	Options outstanding		Options exercisable		
	Number of options*	Weighted average exercise price** \$	Number of options*	Weighted average exercise price** \$	Expiration date
2005	25	13.00	25	13.00	2015
2006	48	19.57	48	19.57	2016
2007	23	39.58	23	39.58	2017
2009	56	24.05	21	24.05	2016
2010	7	28.29	3	28.29	2020
	159		120		

* Number of options is presented in thousands.

** Weighted average exercise price is presented in dollars per option.

d) Stock-based compensation

The Company records expenses for the fair value of the stock options granted under the Plan using the Black-Scholes option pricing model. This model determines the fair value of stock options granted and amortizes it to income over the vesting period.

No options were granted during 2011. On May 7, 2010, 7,500 options were granted at a fair value of \$83 and the expense amortized to income for this period was \$25. The fair value was estimated with the following weighted average assumptions:

	2010
Risk-free interest rate	2.80%
Dividend yield	1.60%
Expected lives	10 years
Volatility	38.00%
Weighted average of fair value of options granted during the year	\$11.13

In 2011, the total expense relating to stock-based compensation amortized to earnings was \$221 (2010 – \$305).

15 CAPITAL STOCK (CONTINUED)

e) Employee share purchase plans

The aggregate number of common shares reserved for issuance under the Company's two employee share purchase plans is 250,000.

Under the first plan, Company employees who are Canadian residents are eligible to purchase common shares from the Company at an amount equal to 90% of the market price. Employees who hold common shares in the employee share purchase plan for 18 months following the date of acquisition of such shares receive additional common shares of the Company equivalent to 10% of the amount of their contributions made on the date of acquisition. In 2011, 6,849 common shares (2010 – 8,513) were issued to Canadian resident employees at an average price of \$31.79 per share (2010 – \$23.45).

Under the second plan, Company employees who are U.S. residents are eligible to purchase common shares from the Company at market price. Employees who hold common shares in the employee share purchase plan for 18 months following the date of acquisition of such shares receive additional common shares of the Company equivalent to 10% of the amount of their contributions made on the date of acquisition. In 2011, 3,586 common shares (2010 – 3,545) were issued to U.S. resident employees at an average price of \$35.25 per share (2010 – \$25.81).

As at December 31, 2011, the total number of common shares issued under these plans is 180,323 (2010 – 169,888).

16 EXPENSES BY NATURE

	2011 \$	2010 \$
Raw materials and consumables used	427,396	385,436
Employee benefit expenses	49,243	44,967
Depreciation and amortization	8,715	10,353
Other expenses incurred in manufacturing process	17,849	17,199
Freight	29,491	25,068
Other expenses	19,486	17,333
	552,180	500,356
	2011 \$	2010 \$
Employee benefit expenses		
Salaries, wages and benefits	47,794	42,407
Share options granted to directors and employees	221	305
Pension costs	(345)	870
Group registered retirement savings plans	1,573	1,385
	49,243	44,967

Employee benefit expenses are included in cost of sales and selling and administrative expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

16 EXPENSES BY NATURE (CONTINUED)

	2011 \$	2010 \$
Other losses, net		
Gain on derivative financial instruments	—	(19)
Loss on disposal of property, plant and equipment	505	—
Foreign exchange loss	554	44
	1,059	25

17 INCOME TAXES

	2011 \$	2010 \$
Current tax		
Current tax on income for the year	23,558	16,426
Adjustments in respect of prior years	(411)	570
Total current tax	23,147	16,996
Deferred tax		
Origination and reversal of temporary differences	(1,384)	(2,188)
Impact of change in tax rate	(44)	88
Adjustment in respect of prior years	2,501	788
Total deferred tax	1,073	(1,312)
Income tax expense	24,220	15,684

The tax on the Company's income before income tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to income of the consolidated entities as follows:

	2011 \$	2010 \$
Income before income tax	79,929	50,125
Tax calculated at domestic tax rates of 28.21% (2010 – 30.05%) applicable to income in the respective countries	22,458	15,062
Tax effects of:		
Difference in tax rate of foreign subsidiaries	3,325	678
Unrecorded tax benefits	—	(52)
Income not subject to tax	(2,434)	(1,860)
Expenses not deductible for tax purposes	95	1,122
Remeasurement of deferred tax – change in tax rate	(44)	88
Adjustment in respect of prior years	2,065	1,397
Exchange revaluation of deferred tax	45	—
Manufacturing and processing tax credit	(1,290)	(751)
Income tax expense	24,220	15,684

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

17 INCOME TAXES(CONTINUED)

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	2011	2010
	\$	\$
Deferred tax assets		
To be recovered after more than 12 months	—	464
To be recovered within 12 months	4,995	3,206
Deferred tax liabilities		
To be reversed after more than 12 months	(48,359)	(38,063)
To be reversed within 12 months	(53)	(292)
Deferred tax liability, net	(43,417)	(34,685)

The gross movement on the deferred income tax account is as follows:

	2011	2010
	\$	\$
As at January 1	(34,685)	(14,284)
Statement of income charge	(1,073)	1,311
Tax charge (credit) relating to components of other comprehensive income	642	(171)
Tax charge (credit) directly to equity	—	853
Tax charge (credit) relating to acquisition	(7,638)	(23,828)
Foreign exchange	(663)	1,434
As at December 31	(43,417)	(34,685)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

17 INCOME TAXES(CONTINUED)

The movement in deferred income tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

Deferred tax assets	Financing fees \$	Reserves \$	Derivative financial instruments \$	Deferred pension benefits \$	Capital loss unrealized on foreign exchange on debts \$	Total \$
As at January 1, 2010	—	1,747	224	313	—	2,284
Charged (credited) to statement of income	(156)	649	332	97	—	922
Charged (credited) to other comprehensive income	—	—	(76)	—	—	(76)
Charged (credited) to equity	845	—	—	8	—	853
Charged (credited) to goodwill	—	953	—	—	—	953
Exchange differences	—	(145)	(14)	—	—	(159)
As at December 31, 2010	689	3,204	466	418	—	4,777
Charged (credited) to statement of income	36	2,092	—	122	282	2,532
Charged (credited) to other comprehensive income	—	—	(51)	56	(282)	(277)
Charged (credited) to equity	—	—	—	—	—	—
Charged (credited) to goodwill	—	—	—	—	—	—
Exchange differences	6	137	7	—	—	150
As at December 31, 2011	731	5,433	422	596	—	7,182

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(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

17 INCOME TAXES(CONTINUED)

Deferred tax liabilities	Property, plant and equipment \$	Deferred pension benefits \$	Intangible assets \$	Derivative financial instruments \$	Investment tax credit \$	Capital gain unrealized on foreign exchange gain on debts \$	Total \$
As at January 1, 2010	(14,434)	(413)	(885)	(656)	(180)	—	(16,568)
Charged (credited) to statement of income	(1,878)	(130)	1,558	746	93	—	389
Charged (credited) to other comprehensive income	—	252	—	(90)	—	(257)	(95)
Charged (credited) to equity	—	—	—	—	—	—	—
Charged (credited) to goodwill	(4,472)	—	(20,309)	—	—	—	(24,781)
Exchange differences	674	—	919	—	—	—	1,593
As at December 31, 2010	(20,110)	(291)	(18,717)	—	(87)	(257)	(39,462)
Charged (credited) to statement of income	(4,399)	(333)	1,185	—	(20)	(38)	(3,605)
Charged (credited) to other comprehensive income	—	624	—	—	—	295	919
Charged (credited) to equity	—	—	—	—	—	—	—
Charged (credited) to goodwill	(2,633)	—	(5,005)	—	—	—	(7,638)
Exchange differences	(442)	—	(371)	—	—	—	(813)
As at December 31, 2011	(27,584)	—	(22,908)	—	(107)	—	(50,599)

The Company did not recognize deferred income tax assets of \$198 (2010 – nil) in respect of capital losses amounting to \$1,483 (2010 – nil) that can be carried forward indefinitely against future taxable capital gain.

Deferred income tax liabilities have not been recognized for the withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries. Such amounts are permanently reinvested. Unremitted earnings totalled \$51,713 as at December 31, 2011 (2010 – \$34,153).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

18 EMPLOYEE FUTURE BENEFITS

The Company recognizes costs for several types of employee future benefits. Other post-employment benefits are offered to certain retired employees and consist of group health and dental care, life insurance and complementary retirement benefits. Stella-Jones Canada Inc. contributes to a multi-employer plan for certain hourly employees and to four defined benefit pension plans for salaried and certain non-union hourly wage employees. All other active employees are entitled to a group registered retirement savings plan to which the Company matches 1.5 times employee contributions to a maximum of 4%. The recognized costs for employee future benefits were as follows:

	2011 \$	2010 \$
Post-retirement benefits	(1,109)	324
Defined benefit pension plans	449	252
Contributions to multi-employer plan	315	294
Contributions to group registered retirement savings plans	1,573	1,385

- a) The post-retirement benefits program is not funded. For this program, the Company measures its accrued benefit obligations for accounting purposes as at December 31 of each year. The most recent actuarial valuation of this plan was as at January 1, 2009, and the next required valuation will be as at January 1, 2012.

On June 1, 2011 the following changes were made to the post-retirement benefits program:

- All employees who retire on or after June 1, 2011 are eligible to an annual allocation to a Health Spending Account upon retirement. This coverage replaces the current health care coverage.
- Current retirees maintain their coverage under their current plan.
- Employees maintain their post-retirement life insurance coverage.

The change in plan provisions was treated as a prior service cost. This prior service cost is amortized over the remaining service lifetime to full eligibility of the active group that is not vested and is recognized immediately for the vested group. As at June 1, 2011, the prior service cost resulting from the plan change was calculated to be \$(1,336).

The following information as established by independent actuaries pertains to the Company's post-retirement benefits program:

	2011 \$	2010 \$
Accrued benefit obligation		
Balance – Beginning of year	2,572	2,257
Current service cost	124	183
Past service cost	(1,336)	—
Interest cost	103	141
Benefits payments	(42)	(42)
Actuarial loss	209	33
Balance – End of year	1,630	2,572
Plan assets		
Fair value – Beginning of year	—	—
Employer's contributions	42	42
Benefits paid	(42)	(42)
Fair value – End of year	—	—
Accrued benefit obligation	1,630	2,572

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

18 EMPLOYEE FUTURE BENEFITS (CONTINUED)

The significant assumptions used are as follows:

	2011	2010
	%	%
Accrued benefit obligation as at December 31		
Discount rate	4.30	5.40
Rate of compensation increase	2.00	2.00
Benefit costs for the year ended December 31		
Discount rate	5.40	5.85
Rate of compensation increase	2.00	2.00

For measurement purposes, a 9.5% annual rate of increase in the per capita cost of covered health care benefits was assumed starting in 2009. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%. Therefore, the rate used to calculate the cost per capita of health care cost increases in 2011 was 8.5%. An increase or decrease of 1% in this rate would have the following impact:

	Increase of 1%	Decrease of 1%
Impact on accrued benefit obligation	77	(66)
Impact on benefit costs	34	(27)

The items of the Company's post-retirement benefits program costs recognized during the year are as follows:

	2011	2010
	\$	\$
Current service cost	124	183
Interest cost	103	141
Past service cost	(1,336)	—
Post-retirement benefits program costs recognized	(1,109)	324

	2011	2010
	\$	\$
Consolidated statement of comprehensive income		
Year ended December 31		
Actuarial losses	(209)	(33)
Total recognized in other comprehensive income before income tax	(209)	(33)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

18 EMPLOYEE FUTURE BENEFITS (CONTINUED)

Cumulated actuarial losses recognized in other comprehensive income (loss)	2011	2010
	\$	\$
Balance of actuarial losses at January 1	(25)	—
Net actuarial losses recognized in the year	(153)	(25)
Balance of actuarial losses at December 31	(178)	(25)

- b) The Stella-Jones Canada Inc. defined benefit pension plans base the benefits on the length of service and final average earnings. The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year.

Actuarial valuations are updated every three years, and the latest valuations performed for the four existing pension plans are as follows:

	Date of last actuarial valuation
Plan 1	December 31, 2010
Plan 2	December 31, 2010
Plan 3	December 31, 2010
Plan 4	December 31, 2011

Information about Stella-Jones Canada Inc.'s defined benefit pension plans other than the multi-employer defined benefit plan, in aggregate, is as follows:

	2011	2010
	\$	\$
Accrued benefit obligation		
Balance – Beginning of year	10,272	8,480
Current service cost	388	309
Past service cost	186	—
Interest cost	568	550
Benefits payments	(413)	(371)
Actuarial loss	1,754	1,304
Balance – End of year	12,755	10,272
Plan assets		
Fair value – Beginning of year	11,391	10,167
Expected return on assets	681	596
Actuarial gains (losses)	(824)	334
Employer's contributions	1,267	654
Employee's contributions	12	11
Benefits paid	(413)	(371)
Fair value – End of year	12,114	11,391
Accrued benefit asset (liability)	(641)	1,119

December 31, 2011 and 2010
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18 EMPLOYEE FUTURE BENEFITS (CONTINUED)

Included in the above accrued benefit obligation and fair value of plan assets at year-end are the following amounts in respect of benefit plans that are not fully funded:

	2011	2010
	\$	\$
Accrued benefit obligation	5,010	3,924
Fair value of plan assets	4,357	3,537
Funded status – Plan deficit	(653)	(387)

The percentage of plan assets consists of the following for the year ended December 31:

	2011	2010
	%	%
Equity securities	57	57
Debt securities	41	37
Short-term investments and cash	2	6
	100	100

The significant weighted average assumptions used are as follows:

	2011	2010
	%	%
Accrued benefit obligation as at December 31		
Discount rate	4.50	5.50
Inflation assumption	2.30	2.50
Rate of compensation increase	4.00	3.50
Expected long-term rate of return on plan assets	7.00	7.00
Benefit costs for the year ended December 31		
Discount rate	5.50	6.50
Inflation assumption	2.50	2.50
Rate of compensation increase	3.50	3.50
Expected long-term rate of return on plan assets	7.00	7.00

The items of Stella-Jones Canada Inc.'s defined benefit plan costs recognized during the year are as follows:

	2011	2010
	\$	\$
Current service cost, net of employee's contributions	376	298
Interest cost	568	550
Expected return on plan assets	(681)	(596)
Past service cost	186	—
Defined benefit plan expense	449	252

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

18 EMPLOYEE FUTURE BENEFITS (CONTINUED)

Expected contributions to the defined benefit pension plans for the year ending December 31, 2012 are \$738.

The actual return on plan assets was \$(145) (2010 – \$930), compared to an expected return on plan assets of \$681 (2010 – \$596); this produced an actuarial gain (loss) of \$(825) (2010 – \$334).

Consolidated statement of comprehensive income	2011	2010
	\$	\$
Year ended December 31		
Actuarial losses	(2,575)	(1,006)
Total recognized in other comprehensive income before income tax	(2,575)	(1,006)
Cumulated actuarial losses recognized in other comprehensive income (loss)	2011	2010
	\$	\$
Balance of actuarial losses at January 1	(754)	—
Net actuarial losses recognized in the year	(1,952)	(754)
Balance of actuarial losses at December 31	(2,706)	(754)

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(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

19 INTEREST IN JOINT VENTURE

The consolidated financial statements include the Company's 50% proportionate share, as indicated below, of the income, expenses, assets and liabilities of its Kanaka joint venture:

	2011	2010
	\$	\$
Assets		
Current assets		
Accounts receivable	92	214
Other receivable	284	187
Income taxes receivable	62	—
Inventories	1,422	464
Prepaid expenses	9	9
	1,869	874
Non-current assets		
Property, plant and equipment	662	741
Other assets	—	77
	2,531	1,692
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 11(d))	2,585	1,630
Accounts payable and accrued liabilities	27	62
	2,612	1,692
Shareholders' equity		
Accumulated other comprehensive loss	(81)	—
	2,531	1,692
Income		
Sales	3,587	2,671
Cost of sales	3,587	2,671
	—	—
Net income		
Cash flows provided by (used in)		
Operating activities	(943)	753
Financing activities	955	(734)
Investing activities	(12)	(19)
	—	—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

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20 COMMITMENTS AND CONTINGENCIES

- a) The Company is involved from time to time in various claims and legal proceedings arising in the ordinary course of business. It is the opinion of management that a final determination of these proceedings cannot be made at this time but should not materially affect the Company's financial position or results of operations.
- b) The Company has issued guarantees amounting to \$27,924 (2010 – \$30,723) under letters of credit and various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on. As a result, no provisions have been recorded in the consolidated financial statements.
- c) Future minimum payments under operating leases related to land, equipment and rolling stock are as follows:

	\$
2012	6,901
2013	5,139
2014	3,707
2015	2,269
2016	1,184
Thereafter	8,784
	<u>27,984</u>

- d) The Company's operations are subject to Canadian federal and provincial as well as U.S. federal and state environmental laws and regulations governing, among other matters, air emissions, waste management and wastewater effluent discharges. The Company takes measures to comply with such laws and regulations. However, the measures taken are subject to the uncertainties of changing legal requirements, enforcement practices and developing technological processes.
- e) The Company has contracts whereby third party licensees that harvest certain areas assume the responsibility for reforestation. Should the third party licensees fail to perform, the Company is responsible for these additional future reforestation costs, which are currently estimated to be \$738 (2010 – \$727). Payments, if any, required as a result of this contingency will be expensed in the period in which they are determined and are not included in the provision for reforestation.
- f) The Company has also provided an environmental indemnity agreement to the bank with respect to the Maple Ridge property, the site of Kanaka's operations, with liability limited to one half of the monies which become due and owing to the bank under such indemnity.

21 FINANCIAL INSTRUMENTS

FINANCIAL INSTRUMENTS, CARRYING VALUES AND FAIR VALUES

The Company has determined that the fair value of its short-term financial assets and financial liabilities approximates their carrying amounts as at the statement of financial position dates because of the short-term maturity of those instruments. The fair values of the long-term receivables and interest-bearing financial liabilities also approximate their carrying amounts unless otherwise disclosed elsewhere in these consolidated financial statements. The fair value of foreign exchange forward contracts and swap agreements has been recorded using mark-to-market information.

21 FINANCIAL INSTRUMENTS (CONTINUED)**CREDIT RISK**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's receivables from customers.

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Management believes that the credit risk of accounts receivable is limited because the Company deals primarily with railroad companies, public service companies and utility and telecommunication companies as well as other major corporations.

Management has established a credit policy under which each new customer is analyzed individually for creditworthiness before the Company's standard payment and delivery terms and conditions are offered. The Company's review includes external ratings, where available, and credit references from other suppliers. Purchase limits are established for each customer, which represent the maximum open amount not requiring additional approval from management. A monthly review of the accounts receivable aging is performed by management for each selling location. Customers that fail to meet the Company's benchmark creditworthiness may transact with the Company only on a prepayment basis.

Note 6 provides details on the receivable aging as well as on the provision for doubtful accounts for the years ended December 31, 2011 and 2010. In 2011, the Company had one customer representing 14% of its sales (2010 – 16%). As at December 31, 2011, the accounts receivable balance from this customer amounted to \$3,936 (2010 – \$2,025).

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, on a long-term basis, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring losses or risking damage to its reputation.

The Company ensures that it has sufficient credit facilities to support working capital, meet expected operational expenses and service financial obligations. Inventories are a significant component of working capital because of the long periods required to air-season wood, which can occasionally exceed nine months before a sale is made.

The Company monitors all financial liabilities and ensures it will have sufficient liquidity to meet these future payments. The operating activities of the Company are the primary source of cash flows. The Company also has a committed revolving facility (note 13(a)) made available by a syndicate of lenders which can be used for working capital and general corporate requirements. The following table details the maturities of the financial liabilities as at December 31, 2011:

	Carrying amount \$	Contractual cash flows \$	Less than 1 year \$	Between 1 and 3 years \$	Between 3 and 5 years \$	More than 5 years \$
Bank indebtedness*	2,585	2,657	2,657	—	—	—
Accounts payable and accrued liabilities	43,693	43,693	43,693	—	—	—
Long-term debt obligations*	180,094	207,154	7,715	21,288	170,325	7,826
Interest rate swaps net settlement	—	3,996	1,134	1,815	1,047	—
Non-competes payable	2,582	2,848	1,265	1,583	—	—
	228,954	260,348	56,464	24,686	171,372	7,826

* Including capital and interest

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

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21 FINANCIAL INSTRUMENTS (CONTINUED)

MARKET RISK

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimizing the return on risk.

CURRENCY RISK

The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to sales and purchases in U.S. dollars by its Canadian-based operations and to U.S. dollar denominated long-term debt held by its Canadian companies. The Company monitors its transactions in U.S. dollars generated by Canadian-based operations and enters into hedging transactions to mitigate its currency risk. The Company's basic hedging activity consists of entering into foreign exchange forward contracts for the sale of U.S. dollars and the purchase of certain goods and services in U.S. dollars. The Company also considers foreign exchange forward contracts for the purchase of U.S. dollars for significant purchases of goods and services that were not covered by natural hedges.

On January 1, 2009, the Company ceased hedge accounting on its foreign exchange forward contracts. As these contracts were designated as cash flow hedges, their fair value increment was recorded under accumulated other comprehensive loss and was recognized in income over the designated underlying period of foreign exchange forward contracts from March 2009 to December 2010. For the year ended December 31, 2010, the loss recognized in income was \$160.

The Company had no foreign exchange forward contracts as at December 31, 2010. In 2011, the Company resumed hedge accounting on foreign exchange forward contracts. The following table summarizes the Company's derivative financial instruments relating to the sale of foreign currencies through foreign exchange forward contracts as at December 31, 2011:

	Foreign exchange forward contract	Notional amount US\$	Average exchange rate	Notional equivalent CA\$	Fair value CA\$
Current asset	Sell US\$/Buy CA\$	1,500	1.0387	1,558	32
Current asset	Sell US\$/Buy CA\$	1,500	1.0392	1,559	31
Current asset	Sell US\$/Buy CA\$	1,500	1.0397	1,559	31
Current asset	Sell US\$/Buy CA\$	1,500	1.0400	1,560	31
Current asset	Sell US\$/Buy CA\$	1,500	1.0402	1,560	30
Current asset	Sell US\$/Buy CA\$	1,500	1.0404	1,561	29
Current asset	Sell US\$/Buy CA\$	1,500	1.0406	1,561	29
Current asset	Sell US\$/Buy CA\$	1,500	1.0407	1,561	28
Current asset	Sell US\$/Buy CA\$	1,500	1.0408	1,561	28
Current asset	Sell US\$/Buy CA\$	1,500	1.0409	1,561	27
Current asset	Sell US\$/Buy CA\$	1,500	1.0410	1,562	27
Current asset	Sell US\$/Buy CA\$	1,500	1.0411	1,562	26
		18,000	1.0403	18,725	349

21 FINANCIAL INSTRUMENTS (CONTINUED)**CURRENCY RISK (CONTINUED)**

The contracts mature at various dates up to December 31, 2012, and the fair value was determined by obtaining mark-to-market values as at December 31, 2011. This type of measurement falls under Level 2 in the fair value hierarchy as per IFRS 7, *Financial Instrument: Disclosures*. A description of each level of the hierarchy is as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for these assets or liabilities, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: Inputs for the assets or liabilities that are not based on observable market data (unobservable inputs).

A 10% strengthening of the U.S. dollar against the Canadian dollar would have resulted in a loss on foreign exchange forward contracts recognized in other comprehensive income of approximately \$1,181 for the year ended December 31, 2011 (2010 – nil). For a 10% weakening of the U.S. dollar against the Canadian dollar, there would be an equal and opposite impact.

The following table provides information on the impact of a 10% strengthening of the U.S. dollar against the Canadian dollar on net income for the years ended December 31, 2011 and 2010. For a 10% weakening of the U.S. dollar against the Canadian dollar, there would be an equal and opposite impact on net income and comprehensive income (loss):

	2011	2010
	\$	\$
Gain (loss) to net income	(298)	112

This analysis considers the impact of foreign exchange variance on financial assets and financial liabilities denominated in U.S. dollars which are on the statement of financial position of the Canadian entities:

	2011	2010
	\$	\$
Assets		
Accounts receivable	1,721	2,060
Liabilities		
Accounts payable and accrued liabilities	1,825	939
Long-term debt	2,875	—
	4,700	939

The foreign exchange impact for the U.S. dollar-denominated long-term debt, in the Canadian entities, has been excluded for the most part from the sensitivity analysis for other comprehensive income, as the long-term debt is designated as a hedge of net investment in foreign operations (see note 13(a)).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

21 FINANCIAL INSTRUMENTS (CONTINUED)

INTEREST RATE RISK

As at December 31, 2011, the Company has limited exposure to interest rate risk on long-term debt after giving effect to its interest rate swaps; 85% (2010 – 65%) of the Company's long-term debt is at fixed rates.

The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short- and long-term debt. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as cash flow hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

The committed revolving facility defined in note 13(a) is made available by a syndicate of bank lenders. The financing of these loans is tied to the Canadian bank's prime rate, the BA rate, the U.S. bank's base rate or LIBOR. The Company has minimized its exposure to interest rate fluctuations by entering into interest rate swaps as detailed below. The impact of a 10% increase in these rates on the average annual balance of operating credit facilities, for borrowings that have not been swapped, would have increased interest expense by \$105 for the year ended December 31, 2011 (2010 – \$39).

The following tables summarize the Company's interest rate swap agreements as at December 31:

Notional amount	Related debt instrument	Fixed rate %	Maturity date	2011
				Notional equivalent CA\$
CA\$10,000	Committed revolving facility	1.09*	August 2014	10,000
CA\$10,000	Committed revolving facility	1.57*	August 2016	10,000
US\$25,000	Committed revolving facility	1.16*	December 2016	25,425
US\$15,000	Committed revolving facility	1.45*	August 2016	15,255
US\$15,000	Committed revolving facility	0.75*	August 2014	15,255
US\$15,000	Committed revolving facility	2.57*	June 2012	15,255
US\$5,000	Committed revolving facility	5.80	July 2015	5,085
US\$5,000	Committed revolving facility	5.54	July 2015	5,085
US\$1,000	Committed revolving facility	4.69	December 2015	1,017
US\$5,600	Bond – County of Fulton, Kentucky	2.99	December 2015	5,695

Notional amount	Related debt instrument	Fixed rate %	Maturity date	2010
				Notional equivalent CA\$
CA\$2,700	Term facility	5.81	February 2011	2,700
US\$10,000	Term facility	1.53*	April 2011	9,946
US\$15,000	Bank indebtedness	2.57*	June 2012	14,919
US\$5,000	Term loan with a U.S. bank	5.80	July 2015	4,973
US\$5,000	Term loan with a U.S. bank	5.54	July 2015	4,973
US\$1,000	Mortgage loan	4.69	December 2015	995
US\$5,600	Bond – County of Fulton, Kentucky	2.99	December 2015	5,570

* Plus applicable spread

21 FINANCIAL INSTRUMENTS (CONTINUED)

INTEREST RATE RISK (CONTINUED)

The Company's interest rate swaps are designated as cash flow hedges. The cash flow hedge documentation allows the Company to substitute the underlying debt as long as the hedge effectiveness is demonstrated. As at December 31, 2011, all cash flow hedges were effective.

The fair value of these financial instruments has been determined by obtaining mark-to-market values as at December 31, 2011 from different third parties. This type of measurement falls under Level 2 in the fair value hierarchy as per IFRS 7 and is defined in the currency risk section.

The fair value of the interest rate swap agreements based on cash settlement requirements as at December 31, 2011 is a loss of \$1,549 (2010 – loss of \$1,379), of which \$171 and \$1,378 respectively are recorded in current and non-current liabilities under derivative financial instruments. A 10% decrease in interest rates as at December 31, 2011 would have increased the loss recognized in other comprehensive income by approximately \$155 (2010 – \$138). For a 10% increase in the interest rates, there would be an equal and opposite impact on the loss.

22 CAPITAL DISCLOSURES

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its organic growth strategy and undertake selective acquisitions, while at the same time taking a conservative approach to financial leverage and management of financial risk. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or acquire or sell assets to improve its financial performance and flexibility.

The Company's capital is composed of total debt which includes bank indebtedness, and shareholders' equity which includes capital stock.

	2011	2010
	\$	\$
Total debt	182,679	157,751
Shareholders' equity	331,912	280,102
Total capital	514,591	437,853
Total debt to total capitalization ratio	0.35:1	0.36:1

The Company's primary uses of capital are to finance non-cash working capital and capital expenditures for capacity expansion as well as acquisitions. The Company currently funds these requirements out of its internally generated cash flows and committed revolving facility. However, future corporate acquisitions may require new sources of financing.

The primary measure used by the Company to monitor its financial leverage is the total debt to total capitalization ratio, which it aims to maintain within a range of 0.20:1 to 0.75:1. The total debt to total capitalization ratio is defined as total debt divided by total capital.

The Company is subject to certain covenants on its committed revolving facility. The covenants include a minimum requirement for funded debt to earnings before interest, taxes, depreciation and amortization and a minimum fixed charge coverage ratio. The Company monitors the ratios on a monthly basis. The ratios are also reviewed by the Company's Audit Committee and Board of Directors on a quarterly basis. Other than the covenants required for the credit facilities, the Company is not subject to any externally imposed capital requirements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

December 31, 2011 and 2010

(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

23 RELATED PARTY TRANSACTIONS

a) Transactions

The Company had the following transactions with related parties:

	2011	2010
	\$	\$
Parent company		
Marketing and technical service fees paid	200	200
Interest on promissory note	26	32
Ultimate shareholders		
Marketing and technical service fees paid	100	100
Other		
Legal fees charged by a firm in which a director of the Company is a partner	359	186

These transactions occurred in the normal course of operations and have been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

As at December 31, the consolidated statement of financial position includes the following amounts with related parties:

	2011	2010
	\$	\$
Accounts payable to ultimate shareholders	25	—
Accounts payable to parent company	50	12
Long-term debt payable to parent company	—	746
Accounts payable to a firm in which a director of the Company is a partner	10	24

b) Key management compensation

Key management includes directors (executive and non-executive), and certain senior management. The compensation paid or payable to key management for employee services is as follows:

	2011	2010
	\$	\$
Salaries, compensation and benefits	2,041	2,142
Share-based payments	124	171
	2,165	2,313

24 SEGMENT INFORMATION

The Company operates within one business segment: the production and sale of pressure-treated wood and related services. Operating plants are located in the Canadian provinces of Nova Scotia, Quebec, Ontario, Alberta and British Columbia, and in the U.S. states of Pennsylvania, Virginia, West Virginia, Kentucky, Wisconsin, Alabama, Indiana, Louisiana, Tennessee, Minnesota, Arkansas and Washington. The Company also operates a distribution centre in the province of Newfoundland and Labrador.

December 31, 2011 and 2010
(amounts expressed in thousands of Canadian dollars, except as otherwise indicated)

24 SEGMENT INFORMATION (CONTINUED)

Sales attributed to countries based on location of customer are as follows:

	2011 \$	2010 \$
Canada	227,952	215,327
U.S.	412,196	345,719
	640,148	561,046

Sales by product as at December 31 are as follows:

	2011 \$	2010 \$
Railway ties	338,790	283,192
Utility poles	194,807	166,681
Industrial products	78,890	81,401
Residential lumber	27,661	29,772
	640,148	561,046

Property, plant and equipment attributed to the countries based on location are as follows:

	2011 \$	2010 \$
Canada	47,992	45,748
U.S.	71,449	59,015
	119,441	104,763

Intangible assets with a net book value of \$61,998 (2010 – \$54,986) and goodwill with a value of \$91,720 (2010 – \$73,973) are attributed to the Company's U.S. operations.

25 SUBSEQUENT EVENT

On March 15, 2012, the Board of Directors approved a quarterly dividend of \$0.15 per common share payable on April 30, 2012 to shareholders of record at the close of business on April 2, 2012.