

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

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



Éric Vachon, CPA, CA
Senior Vice-President and
Chief Financial Officer

Saint-Laurent, Quebec
March 21, 2013

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, 2012 and 2011 and the consolidated statements of change in shareholders' equity, income, comprehensive income and cash flows for the years then ended, 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 audit 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, 2012 and 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP¹

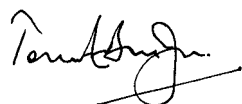
Montréal, Quebec
March 21, 2013

¹ CPA auditor, CA, public accountancy permit No. A119714

	Note	2012 \$	2011 \$
Assets			
Current assets			
Cash	10	14,000	—
Accounts receivable	5	89,563	76,511
Derivative financial instruments	19	—	349
Inventories	6	413,400	243,590
Prepaid expenses		10,014	8,348
Income taxes receivable		7,886	1,721
		534,863	330,519
Non-current assets			
Property, plant and equipment	7	189,028	119,441
Intangible assets	8	93,105	71,062
Goodwill	8	135,834	91,720
Derivative financial instruments	19	198	—
Other assets	9	2,835	4,314
		955,863	617,056
Liabilities and Shareholders' Equity			
Current liabilities			
Bank indebtedness	10	14,000	2,585
Accounts payable and accrued liabilities	11	65,836	43,693
Derivative financial instruments	19	—	171
Current portion of long-term debt	12	6,358	1,465
Current portion of provisions and other long-term liabilities	13	3,862	9,418
		90,056	57,332
Non-current liabilities			
Long-term debt	12	343,250	178,629
Deferred income taxes	16	38,809	43,417
Provisions and other long-term liabilities	13	8,297	2,117
Employee future benefits	17	4,774	2,271
Derivative financial instruments	19	1,926	1,378
		487,112	285,144
Shareholders' equity			
Capital stock	14	210,636	131,272
Contributed surplus		1,229	1,342
Retained earnings		264,211	201,268
Accumulated other comprehensive loss		(7,325)	(1,970)
		468,751	331,912
		955,863	617,056

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, CPA, CMA
Director

CONSOLIDATED STATEMENTS OF CHANGE IN SHAREHOLDERS' EQUITY
For the years ended December 31, 2012 and 2011
(expressed in thousands of Canadian dollars)

	<u>Accumulated other comprehensive loss</u>							Total share- holders' equity
	Capital stock	Contributed surplus	Retained earnings	Foreign currency translation adjustment	Translation of long-term debts designated as net investment hedges	Unrecognized losses on cash flow hedges	Total	
	\$	\$	\$	\$	\$	\$	\$	\$
Balance – January 1, 2012	131,272	1,342	201,268	(2,239)	1,046	(777)	(1,970)	331,912
Comprehensive income								
Net income for the year	—	—	73,070	—	—	—	—	73,070
Other comprehensive income (loss)	—	—	(30)	(6,711)	1,731	(375)	(5,355)	(5,385)
Comprehensive income for the year	—	—	73,040	(6,711)	1,731	(375)	(5,355)	67,685
Dividends on common shares	—	—	(10,097)	—	—	—	—	(10,097)
Stock option plan	719	—	—	—	—	—	—	719
Exercise of stock options	—	(231)	—	—	—	—	—	(231)
Issuance of common shares (Note 4)	78,202	—	—	—	—	—	—	78,202
Employee share purchase plans	443	—	—	—	—	—	—	443
Stock-based compensation	—	118	—	—	—	—	—	118
	79,364	(113)	(10,097)	—	—	—	—	69,154
Balance – December 31, 2012	210,636	1,229	264,211	(8,950)	2,777	(1,152)	(7,325)	468,751

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

	<u>Accumulated other comprehensive loss</u>							Total share- holders' equity \$
	Capital stock \$	Contributed surplus \$	Retained earnings \$	Foreign currency translation adjustment \$	Translation of long-term debts Foreign currency translation adjustment \$	designated 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
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 INCOME
For the years ended December 31, 2012 and 2011
(expressed in thousands of Canadian dollars, except earnings per common share)

	Note	2012 \$	2011 \$
Sales		717,494	640,148
Expenses			
Cost of sales		565,668	515,286
Selling and administrative		42,543	35,835
Other losses (gains), net		(313)	1,059
	15	607,898	552,180
Operating income		109,596	87,968
Financial expenses			
Interest on long-term debt		8,319	6,777
Other interest		—	1,262
		8,319	8,039
Income before income taxes		101,277	79,929
Provision for (recovery of) income taxes			
Current	16	30,486	23,147
Deferred	16	(2,279)	1,073
		28,207	24,220
Net income for the year		73,070	55,709
Basic earnings per common share	14	4.54	3.49
Diluted earnings per common share	14	4.53	3.48

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

	2012	2011
	\$	\$
Net income for the year	73,070	55,709
Other comprehensive income (loss)		
Items that may subsequently be reclassified to net income		
Net change in gains (losses) on translation of financial statements of foreign operations	(6,711)	6,232
Change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations	1,708	(1,211)
Income tax on change in gains (losses) on translation of long-term debts designated as hedges of net investment in foreign operations	23	14
Change in gains (losses) on fair value of derivatives designated as cash flow hedges	(528)	178
Income tax on change in gains (losses) on fair value of derivatives designated as cash flow hedges	153	(44)
Items that will not subsequently be reclassified to net income		
Change in actuarial losses on post-retirement benefit obligations	(53)	(2,784)
Income tax on change in actuarial losses on post-retirement benefit obligations	23	679
	(5,385)	3,064
Comprehensive income for the year	67,685	58,773

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

	Note	2012 \$	2011 \$
Cash flows provided by (used in)			
Operating activities			
Net income for the year		73,070	55,709
Adjustments for			
Depreciation of property, plant and equipment		5,312	4,523
Amortization of intangible assets		5,393	4,192
Interest accretion		739	1,239
Asset revaluation following Kanaka's step acquisition		(1,623)	—
Loss on disposal of property, plant and equipment		2,597	505
Employee future benefits		(330)	(1,965)
Stock-based compensation		118	221
Asset impairment		—	2,206
Financial expenses		8,319	8,039
Income taxes		30,486	23,147
Deferred income taxes		(2,279)	1,073
Restricted stock units obligation		(729)	747
Other		(276)	(9)
		120,797	99,627
Changes in non-cash working capital components and others			
Accounts receivable		32,220	(11,968)
Inventories		(60,076)	(30,204)
Prepaid expenses		(205)	(3,408)
Income taxes receivable		(284)	(79)
Accounts payable and accrued liabilities		(15,196)	6,153
Asset retirement obligations		(496)	(270)
Provisions and other long-term liabilities		(4,541)	3,359
		(48,578)	(36,417)
Interest paid		(7,202)	(8,594)
Income tax paid		(36,501)	(21,822)
		28,516	32,794
Financing activities			
Decrease in bank indebtedness		(7,085)	(4,792)
Increase in deferred financing costs		(849)	(122)
Increase in long-term debt		174,550	98,286
Repayment of long-term debt		(70,163)	(80,108)
Non-competes payable		(1,296)	(1,218)
Dividend on common shares		(10,097)	(7,972)
Proceeds from issuance of common shares		78,481	788
		163,541	4,862
Investing activities			
Decrease (increase) in other assets		334	(459)
Business acquisition	4	(167,284)	(29,015)
Increase in intangible assets		(471)	(658)
Purchase of property, plant and equipment		(14,790)	(7,834)
Proceeds on disposal of assets		4,154	310
		(178,057)	(37,656)
Net change in cash and cash equivalents during the year		14,000	—
Cash and cash equivalents – Beginning of year		—	—
Cash and cash equivalents – End of year		14,000	—

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. 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 primarily in these two countries. The Company's headquarters are located at 3100 de la Côte-Vertu Blvd., 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

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were approved by the Board of Directors on March 21, 2013.

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for derivative financial instruments and certain long-term liabilities 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 and Canadalux S.à.r.l. The foreign operations that have a different functional currency from that of the Company are SJ Holding, SJ Corp, Stella-Jones U.S. Finance Corporation and Canadalux S.à.r.l.

Following the acquisition of McFarland Cascade Holdings, Inc. ("MCHI") on November 30, 2012, (Note 4), in addition to MCHI, the Company added the following significant subsidiaries which are foreign operations that have a different functional currency from that of the Company: Electric Mills Wood Preserving LLC, Shelby County Forest Products L.L.C., Cascade Pole and Lumber Company, McFarland Cascade Pole & Lumber Company, L. D. McFarland Company, Limited and Forest Products Research Laboratory, LLC. Also as part of the MCHI acquisition, the Company added the following Canadian significant subsidiaries: Selkirk Forest Products Company, MCP Acquisition Holdings Ltd., Kanaka Creek Pole Company Limited ("Kanaka") and Selkirk Timber Company.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of consolidation (continued)

a) Subsidiaries (continued)

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 value 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

As a result of the MCHI acquisition, the Company's interest in Kanaka has increased to 100%. Up to November 30, 2012, the consolidated statements of the Company included the accounts of a 50% interest in Kanaka, considered a joint venture which was 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 (gains), net, except for qualifying cash flow hedges which are recognized in other comprehensive income and deferred in accumulated other comprehensive loss in shareholders' equity.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Foreign currency translation (continued)

b) Foreign currency transactions (continued)

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 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 \$14,938 for the year ended December 31, 2012 (2011 – \$11,493).

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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	5 to 10 years
Customer relationships	Declining balance	10% to 15%
Non-compete agreements	Straight-line	3 to 6 years
Creosote registration	—	Indefinite

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets (continued)

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.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Leases

The Company leases certain property, plant and equipment.

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.

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 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 financial expense.

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

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Provisions (continued)

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. Tax adjustment from prior years are also recorded in current tax. 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. During the year, the tax provision calculation is based on an estimated of the annual tax rate.

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 consolidated 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 income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

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 healthcare 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 consolidated 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 consolidated 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 consolidated 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated 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 consolidated 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, if any.

- 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

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 and 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.

Earnings per share

Basic earnings per share is calculated by dividing the net income 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 period.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The chief operating decision maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the senior management team, which makes strategic and operational decisions.

Changes in accounting policies

The IASB has amended the following accounting standard which was adopted by the Company:

IAS 1 – Presentation of Financial Statements

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

IAS 1 had been amended to require entities to separate items presented in OCI into two groups, based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled such as revaluation gains on property, plant and equipment will be presented separately from items that may be recycled in the future, such as deferred gains and losses on cash flow hedges. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

The title used by IAS 1 for the statement of comprehensive income has changed to *Statement of profit or loss and other comprehensive income*. However, IAS 1 still permits entities to use other titles.

The Company applied the amended standard effective July 1, 2012, and this application had no significant impact on the Company’s consolidated financial statements.

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 consolidated 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 assessed that the adoption of these standards will not have a significant impact on the Company’s consolidated financial statements.

In June 2011, the IASB amended IAS 19, *Employee Benefits*, which has not yet been adopted by the Company. The Company has assessed that the adoption of this standard will not have a significant impact on its consolidated 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 assessed that the adoption of this standard will not have a significant impact on its consolidated financial statements.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Impact of accounting pronouncements not yet implemented (continued)

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*.

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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Amendments to other standards (continued)

IAS 19 – Employee Benefits (continued)

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.

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 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 equity 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, determination of the fair value of the assets acquired and liabilities assumed 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 impairment tests on goodwill and intangible assets with indefinite useful lives. The recoverable amounts of the CGUs have been determined based on fair value less cost to sell calculations. These calculations require the use of estimates. See Note 8 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 BUSINESS ACQUISITION

- a) On November 30, 2012, the Company completed the acquisition of 100% of the shares of MCHI, a provider of treated wood products based in the state of Washington.

MCHI is a supplier of utility poles, as well as crossarms, piling and crane mats. It is also a provider of treated lumber for outdoor home projects, including composite decking, railings and related accessories. It serves its customer base through four wood treating facilities located in Tacoma, Washington; Eugene, Oregon; Electric Mills, Mississippi; and Galloway, British Columbia; as well as through an extensive distribution network.

Total cash outlay associated with the acquisition was approximately \$230,165 (US\$231,647), excluding acquisition costs of approximately \$2,979 (US\$2,877), recognized in the consolidated statement of income under selling and administrative expenses. This amount includes \$162,888 (US\$163,936) paid to MCHI's shareholders and \$67,277 (US\$67,711) used to reimburse MCHI's debts with financial institutions.

The following fair value determination of the 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, significant changes could occur mainly with respect to intangible assets, goodwill, consideration payable and deferred income tax.

4 BUSINESS ACQUISITION (continued)

The following is a summary of the 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	153,374
Property, plant and equipment	59,636
Cutting rights	1,159
Customer relationships	27,427
Customer backlog	379
Goodwill	44,504
Deferred income tax assets	1,867
	288,346
Liabilities assumed	
Bank indebtedness	18,500
Accounts payable and accrued liabilities	22,550
Long-term debt	67,277
Site remediation provision	5,910
Employee future benefits	2,765
Deferred income tax liabilities	1,308
Total net assets acquired and liabilities assumed	170,036
Consideration transferred	
Cash	230,165
Payment of long-term debt	(67,277)
Consideration payable	7,148
Consideration transferred for shares	170,036

The Company's valuation of intangible assets has identified customer relationships and customer backlog. The assigned useful lives are 20 years for customer relationships and 4 months for customer backlog. Significant assumptions used in the determination of intangible assets, as defined by management, are year-over-year sales growth, discount rate and operating income before depreciation and amortization margin. Goodwill is amortized and deductible for tax purposes, and represents the future economic value associated with the increased distribution network, acquired workforce and synergies with the Company's operations. For impairment test purposes, goodwill is allocated to CGU's. In the case of the MCHI acquisition, goodwill is allocated to plants specialized in the treatment of utility poles. Note 8 provides a roll-forward of the net book value balances of intangible assets and goodwill.

The fair value of trade receivables, included in non-cash working capital, is \$35,527 and the contractual amount is \$35,876, of which \$349 is expected to be uncollectible.

Consideration payable represents a purchase consideration adjustment related to actual net working capital and certain other assets acquired on closing. As at December 31, 2012, management has not received all information required to finalize the amount payable and therefore it is considered preliminary. Adjustments to the estimated purchase consideration, if any, will affect the amount of goodwill recognized on the acquisition.

4 BUSINESS ACQUISITION (continued)

Financing for the acquisition was secured through private placements of subscription receipts which successfully closed on November 30, 2012, as well as a draw-down of \$152,615 (US\$153,598) on the Company's committed revolving credit facility. With respect to the private placements, the Company issued 1,176,500 subscription receipts at a price of \$68.00 per subscription receipt for aggregate gross proceeds of \$80,002. A syndicate of underwriters took up a private placement of 721,200 subscription receipts and Stella Jones International S.A. purchased 455,300 subscription receipts on a private placement basis (Note 21). The subscription receipts were exchanged on the basis of one common share of the Company per subscription receipt. Total proceeds net of legal and underwriting fees of the subscription receipts were \$77,550. The transaction was recorded at \$78,202, net of a deferred income tax adjustment of \$652. On November 21, 2012, the company amended and restated its committed revolving credit facility to increase its borrowing limit to \$350,000 (Note 12).

In the month of December 2012, the acquiree's sales and loss before income taxes amounted to \$15,937 and \$77, respectively. On a pro forma basis, management's estimate of sales and income before income taxes of the combined operations of the Company and MCHI for the 12-month period ended December 31, 2012 would have been approximately \$986,621 and \$111,593 respectively, had the MCHI acquisition occurred as of January 1, 2012. To arrive at the pro forma estimates, management considered the financing structure resulting from the acquisition as well as the adjustment of fair value and harmonization of accounting policies and assumed that the fair value adjustment made at the acquisition date would have been the same had the acquisition occurred on January 1, 2012.

- b) On July 3, 2012, the Company acquired certain assets of PLS Pole Yard, Inc. ("PLS"), a provider of untreated wood poles operating a wood pole peeling yard located in Rochester, Washington. Total cash outlay associated with the acquisition was \$4,396 (US\$4,342), excluding acquisition costs of \$396 (US\$394), recognized in the consolidated statement of income under selling and administrative expenses, and was financed through existing credit facilities.

The following fair value determination of the assets acquired and liabilities assumed is based on management's best estimates. No significant adjustments were made to the preliminary fair value determination.

The following is a final summary of the 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	\$
Inventories	1,971
Property, plant and equipment	713
Customer relationships	800
Goodwill	1,285
	<u>4,769</u>
Liabilities assumed	
Non-compete agreement	191
Fiber supply agreement	182
	<u>373</u>
Total net assets acquired and liabilities assumed	<u>4,396</u>
Consideration transferred	
Cash	4,396
	<u>4,396</u>
Consideration transferred for shares	<u>4,396</u>

4 BUSINESS ACQUISITION (continued)

The Company's valuation of intangible assets has identified customer relationships. The assigned useful life for customer relationships is 18 years and 6 months. Significant assumptions used in the determination of intangible assets, as defined by management, are year-over-year growth, discount rate and operating income before depreciation and amortization margin. Goodwill is amortized and deductible for tax purposes, and represents the future economic value associated with raw material sourcing, acquired workforce and synergies with the Company's operations. For impairment test purposes, goodwill is allocated to CGU's. In the case of the PLS acquisition, goodwill is allocated to plants specialized in the treatment of utility poles.

The newly acquired pole peeling assets have been integrated directly into the Company's existing operations and are now used for the Company's internal requirements. Accordingly, it is impractical to provide the required pro forma disclosures on post-acquisition sales and income before taxes for these assets as the Company does not maintain such detailed financial information.

- c) 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).

The following fair value determination of the assets acquired and liabilities assumed is based on management's best estimates. No significant adjustments were made to the preliminary fair value determination. 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 final summary of the 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	11,051
Property, plant and equipment	9,452
Cash surrender value of life insurance	150
Customer relationships	12,154
Customer backlog	344
Non-deductible goodwill	16,261
	<hr/> 49,412
Liabilities assumed	
Accounts payable and accrued liabilities	2,835
Long-term debt	3,460
Site remediation provision	455
Deferred income tax liabilities	7,451
	<hr/>
Total net assets acquired and liabilities assumed	35,211
Consideration transferred	
Cash	29,015
Unsecured note payable to vendor	5,322
Consideration payable	874
	<hr/>
Consideration transferred for shares	35,211

4 BUSINESS ACQUISITION (continued)

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 the customer backlog. Significant assumptions used in the determination of intangible assets, as defined by management, are year-over-year growth, discount rate and operating income before depreciation and amortization margin. 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. For impairment test purposes, goodwill is allocated to CGU's. In the case of the Thompson acquisition, goodwill is allocated to plants specialized in the treatment of railway ties.

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 installments over a 10-year period. The fair value of the vendor note was determined to be \$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 the adjustment of fair value and harmonization of accounting policies and assumed that the fair value adjustment made at the acquisition date would have been the same had the acquisition occurred on January 1, 2011.

5 ACCOUNTS RECEIVABLE

	2012	2011
	\$	\$
Trade receivables	82,252	72,673
Less: Provision for doubtful accounts	(1,080)	(414)
Trade receivables – net	81,172	72,259
Other receivables	8,391	4,252
	89,563	76,511

5 ACCOUNTS RECEIVABLE (continued)

As at December 31, 2012, trade receivables of \$31,655 (2011 – \$25,900) were past due but not impaired.

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

	2012	2011
	\$	\$
Current	49,517	46,359
Past due 1-30 days	24,195	18,066
Past due 31-60 days	5,457	5,918
Past due more than 60 days	3,083	2,330
	82,252	72,673

As at December 31, 2012, trade receivables of \$1,080 (2011 - \$414) were impaired and provided for. Details of the provision for doubtful accounts are as follows:

	2012	2011
	\$	\$
Balance – Beginning of year	414	279
Provision	740	210
Bad debt write-off	(60)	(81)
Foreign exchange adjustments	(14)	6
Balance – End of year	1,080	414

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

6 INVENTORIES

	2012	2011
	\$	\$
Raw materials	312,686	187,660
Finished goods	100,714	55,930
	413,400	243,590

7 PROPERTY, PLANT AND EQUIPMENT

	Land \$	Roads \$	Buildings \$	Production and anti- pollution equipment \$	Rolling stock \$	Office equipment \$	Total \$
As at January 1, 2011							
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
Business acquisition	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
Year ended							
December 31, 2012							
Opening net book amount	10,746	1,660	24,419	74,846	5,764	2,006	119,441
Business acquisition	11,039	—	15,578	25,719	6,554	1,459	60,349
Additions	207	300	902	14,600	325	915	17,249
Disposals	—	—	(97)	(1,560)	(213)	—	(1,870)
Depreciation	—	—	(810)	(3,024)	(1,163)	(315)	(5,312)
Depreciation included in inventory	—	(483)	(23)	(100)	(57)	(2)	(665)
Transfer to assets held for sale	—	—	—	(131)	(604)	—	(735)
Kanaka's step acquisition (Note 4)	1,623	—	42	242	186	—	2,093
Exchange differences	(137)	—	(340)	(916)	(126)	(3)	(1,522)
Closing net book amount	23,478	1,477	39,671	109,676	10,666	4,060	189,028
As at December 31, 2012							
Cost	23,478	3,606	46,421	144,082	14,766	5,828	238,181
Accumulated depreciation	—	(2,129)	(6,750)	(34,406)	(4,100)	(1,768)	(49,153)
Net book amount	23,478	1,477	39,671	109,676	10,666	4,060	189,028

7 PROPERTY, PLANT AND EQUIPMENT (continued)

During 2012, the Company did not capitalize any interest as part of property, plant and equipment additions. Additions to production and anti-pollution equipment costs in 2011 included \$58 of interest capitalized at an average borrowing rate of 3.23%.

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 was reversed in 2011.

In November 2012, the Company sold the assets of its Kennecott, Utah, rail service operations. Total proceeds of the sale generated \$4,044 of which \$1,019 was recorded as a gain in the consolidated statement of income as other losses (gains), net. During the year, a total asset value of \$2,866 was re-classed to assets held for sale of which the net book value of property, plant and equipment represented \$735.

As a result of the MCHI acquisition, Stella-Jones has remeasured its previously held interest in 50% of Kanaka and a gain of \$1,623 has been recorded in the consolidated statement of income in other losses (gains), net and \$470 has been included in inventory.

In 2012, the Company began the construction of a new wood treating facility located in Cordele, Georgia. This new facility will be primarily devoted to the production of railway ties. As at December 31, 2012, the construction in progress value for the facility was \$4,458.

8 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 statement 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 ranging from 8.9% to 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 range between 3 and 6 years.

As part of a past 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.

Impairment tests for goodwill

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

8 INTANGIBLE ASSETS AND GOODWILL (continued)

Impairment tests for goodwill (continued)

The recoverable amount of a CGU is determined based on fair value less cost to sell (FVLCTS) calculations. FVLCTS 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. Post-tax cash flow projections are discounted using a real post-tax discount rate of 10.0%. Two 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 FVLCTS have considered the current economic environment.

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. An addition of 1% to the discount rate or a 1% decrease in cash flows would not give rise to an impairment.

The carrying value of goodwill is allocated to the following CGUs

CGUs	2012 \$	2011 \$
Plants specialized in the treatment of utility poles	45,825	—
Plants specialized in the treatment of railway ties	90,009	91,720
	135,834	91,720

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 10.0%. 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. An addition of 1% to the discount rate or a 1% decrease in cash flows would not give rise to an impairment.

8 INTANGIBLE ASSETS AND GOODWILL (continued)

The net book amount of intangible assets was as follows:

	Intangible assets					Total	Goodwill
	Cutting rights	Standing timber	Customer relationships	Non-competes	Creosote registration		
	\$	\$	\$	\$	\$		
As at January 1, 2011							
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
Year ended							
December 31, 2012							
Opening net book balance	6,200	2,864	28,067	2,170	31,761	71,062	91,720
Additions	—	471	—	889	—	1,360	—
Addition of PLS	—	—	800	—	—	800	1,285
Addition of MCHI	1,159	—	27,806	—	—	28,965	44,504
Adjustment of Thompson – goodwill	—	—	—	—	—	—	286
Transfer to assets held for sale	—	—	(1,674)	—	—	(1,674)	—
Amortization	—	—	(4,434)	(959)	—	(5,393)	—
Amortization included in inventory	(189)	(509)	—	—	—	(698)	—
Exchange differences	—	—	(586)	(41)	(690)	(1,317)	(1,961)
Closing net book amount	7,170	2,826	49,979	2,059	31,071	93,105	135,834
As at December 31, 2012							
Cost	7,951	6,481	64,074	6,551	31,071	116,128	135,834
Accumulated amortization	(781)	(3,655)	(14,095)	(4,492)	—	(23,023)	—
Net book amount	7,170	2,826	49,979	2,059	31,071	93,105	135,834

8 INTANGIBLE ASSETS AND GOODWILL (continued)

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.

In November 2012, the Company sold the assets of its Kennecott, Utah, rail service operations. Total proceeds of the sale generated \$4,044 of which \$1,019 was recorded as a gain in the consolidated statement of income as other losses (gains), net. During the year, a total asset value of \$2,866 was re-classed to assets held for sale of which the net book value of intangible assets represented \$1,674.

9 OTHER ASSETS

	2012	2011
	\$	\$
Advances and notes receivable	501	541
Assets held for sale	498	3,164
Long-term bank fees	1,010	455
Other	826	154
	2,835	4,314

10 BANK INDEBTEDNESS

	Note	2012	2011
		\$	\$
Proportionate share of Kanaka's demand operating loan	10(a)	—	2,585
Bankers' acceptances	10(b)	14,000	—
		14,000	2,585

- a) As a result of the MCHI acquisition, the Company controls 100% of the Kanaka operations. On November 30, 2012, the Kanaka credit facility was terminated and the demand operating loan was repaid in its entirety using funds from the Company's committed revolving credit facility (Note 12).
- b) As part of the MCHI acquisition (Note 4), the Company assumed and reimbursed debts with financial institutions. Upon reimbursement, all MCHI credit facilities were terminated. Certain cash amounts paid to financial institutions were held as collateral against banker's acceptance loans maturing in January and February 2013. As at December 31, 2012, \$14,000 in banker's acceptances were still outstanding with an equivalent amount presented under cash.

11 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	Note	2012	2011
		\$	\$
Trade payables		24,813	22,367
Amounts due to related parties	21	294	85
Accrued expenses		24,169	14,888
Other payables		16,560	6,353
		65,836	43,693

12 LONG-TERM DEBT

	Note	2012 \$	2011 \$
Committed revolving credit facility	12(a)	298,056	124,989
Unsecured, subordinated and non-convertible debenture	12(b)	24,873	25,425
Unsecured and non-convertible debenture	12(c)	9,949	10,170
Subordinated note	12(d)	5,424	5,899
Bond – County of Fulton, Kentucky	12(e)	4,034	4,363
Bond – Arkansas Development Finance Authority	12(f)	2,447	2,649
Unsecured promissory note	12(g)	4,877	5,374
Unsecured promissory note	12(h)	200	394
Promissory notes and mortgage loans	12(i)	—	1,144
		349,860	180,407
Deferred financing costs		(252)	(313)
		349,608	180,094
Less: Current portion of long-term debt		6,417	1,524
Less: Current portion of deferred financing costs		(59)	(59)
Total current portion of long-term debt		6,358	1,465
		343,250	178,629

- a) On November 21, 2012, the Company and SJ Holding, as borrowers, entered into an agreement to amend and restate in its entirety their existing revolving credit agreement dated July 28, 2011. This third restated and amended agreement makes available a committed revolving credit facility in the amount of \$350,000 (previously \$170,000), to be used to repay and refinance existing indebtedness, for working capital and general corporate purposes and to finance a portion of the MCHI acquisition. The \$350,000 committed revolving credit facility has been made available for a five-year term by a syndicate of lenders to the Company and SJ Holding. Borrowings may be obtained in the form of Canadian prime rate loans, acceptances, 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 0.00% to 1.00% based on a pricing grid (previously 0.25% to 1.50%). The interest rate margin with respect to acceptances, LIBOR loans and fees for letters of credit will range from 1.00% to 2.00% (previously 1.25% to 2.50%) based on a pricing grid. As at December 31, 2012, borrowings by Canadian entities denominated in U.S. dollars represented \$232,455 (US\$233,646), of which \$221,067 (US\$222,200) was designated as a hedge of net investment in foreign operations.

During the year, the Company entered into interest rate swap agreements fixing certain rates as described in Note 19, Financial instruments.

As collateral for the committed revolving credit 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.

12 LONG-TERM DEBT (continued)

- b) 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.
- c) 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.
- d) Pursuant to a business acquisition on February 28, 2007, SJ Corp issued a note payable to J.H. Baxter & 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.
- e) 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 property, plant and equipment of the Fulton facility, which have a net book value of US\$8,013 as at December 31, 2012. 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.

- f) 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.
- g) 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.

12 LONG-TERM DEBT (continued)

- h) Unsecured promissory note at 8.0%, payable in quarterly instalments of US\$53, including interest, and matures on October 1, 2013.
- i) During 2012, the Company reimbursed two promissory notes payable to the Hickman-Fulton Rural Electric Cooperative Corporation as well as its last remaining mortgage loan.
- j) The repayment requirements on the long-term debt during the next five years and thereafter are as follows:

	Principal \$
2013	6,709
2014	1,057
2015	1,083
2016	35,931
2017	299,192
Thereafter	7,801
	351,773
Fair value adjustment	(1,913)
	349,860

- k) The aggregate fair value of the Company's long-term debt was estimated at \$350,194 as at December 31, 2012 (2011 – \$179,973) based on discounted future cash flows, using interest rates available to the Company for issues with similar terms and average maturities.

13 PROVISIONS AND OTHER LONG-TERM LIABILITIES

	Provisions				Other long-term liabilities			Grand total \$
	Reforestation \$	Site remediation		Others \$	Total \$	Non- competes		
		RSU \$	payable \$			Total \$		
Balance as at January 1, 2011	1,085	1,109	2,271	4,465	423	3,485	3,908	8,373
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
Addition	417	1,328	1,059	2,804	1,995	889	2,884	5,688
Addition related to acquisitions	—	6,365	—	6,365	—	373	373	6,738
Provision reversal	—	—	(1,655)	(1,655)	—	—	—	(1,655)
Payment	(541)	(1,700)	(3,945)	(6,186)	(2,724)	(1,296)	(4,020)	(10,206)
Interest accretion	—	—	—	—	—	208	208	208
Exchange differences	—	(9)	(88)	(97)	—	(52)	(52)	(149)
Balance as at December 31, 2012	1,192	6,594	1,228	9,014	441	2,704	3,145	12,159

13 PROVISIONS AND OTHER LONG-TERM LIABILITIES (continued)

Analysis of provisions and other long-term liabilities:

	2012	2011
	\$	\$
Current		
Provisions	2,262	7,169
Other long-term liabilities	1,600	2,249
Total current	3,862	9,418
Non-current		
Provisions	6,752	614
Other long-term liabilities	1,545	1,503
Total non-current	8,297	2,117
	12,159	11,535

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% (2011 – 4.0%) 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.

Future non-discounted reforestation expenditures are estimated at between \$361 and \$466 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 current and former treating sites for a period ranging from 1 to 21 years.

As part of the MCHI acquisition, the Company recorded \$5,910 of provisions for site remediation. The remaining balance of \$228 is related to ongoing compliance efforts.

Others

Other provisions comprise \$244 in legal litigation provisions and \$984 in a provision set up to acquire the land of the Memphis facility, which is presently being leased.

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.

13 PROVISIONS AND OTHER LONG-TERM LIABILITIES (continued)**Other long-term liabilities (continued)**

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.

The RSUs granted on December 18, 2009 reached their third year anniversary on December 18, 2012 and were fully paid.

On March 19, 2012, the Company granted RSUs as part of the long-term incentive plan.

As at December 31, 2012, the provision for RSUs was valued at \$441 (\$1,170 as at December 31, 2011). The number of additional RSUs to be issued will be calculated in the same manner as the initial grant. No RSUs were granted in 2011.

Non-competes payable

The Company entered into non-compete agreements as part of the PLS and previous acquisitions.

14 CAPITAL STOCK

	Note	2012 \$	2011 \$
Number of shares outstanding – Beginning of year*		15,955	15,923
Stock option plan*		29	22
Share issuance*	4	1,176	—
Employee share purchase plans*		8	10
Number of shares outstanding – End of year*		17,168	15,955

* 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:

	2012	2011
Net income applicable to common shares	\$ 73,070	\$ 55,709
Weighted average number of common shares outstanding*	16,078	15,946
Effect of dilutive stock options*	67	61
Weighted average number of diluted common shares outstanding*	16,145	16,007
Basic earnings per common share **	\$ 4.54	\$ 3.49
Diluted earnings per common share **	\$ 4.53	\$ 3.48

* Number of shares is presented in thousands.

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

14 CAPITAL STOCK (continued)

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.

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

	2012		2011	
	Number of options*	Weighted average exercise price** \$	Number of options*	Weighted average exercise price** \$
Outstanding – Beginning of year	159	23.36	181	22.70
Exercised	(29)	17.00	(22)	18.02
Granted	—	—	—	—
Outstanding – End of year	130	24.76	159	23.36
Options exercisable – End of year	100	24.85	120	22.97

The following options were outstanding under the Plan as at December 31, 2012:

Date granted	Options outstanding		Options exercisable		
	Number of options*	Exercise price** \$	Number of options*	Exercise price** \$	Expiration date
December 2005	11	13.00	11	13.00	December 2015
July 2006	34	19.50	34	19.50	July 2016
August 2006	3	20.55	3	20.55	August 2016
August 2007	23	39.58	23	39.58	August 2017
December 2009	52	24.05	24	24.05	December 2016
May 2010	7	28.29	5	28.29	May 2020
	131		100		

* Number of options is presented in thousands.

** Exercise price is presented in dollars per option.

14 CAPITAL STOCK (continued)

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 2012 and 2011.

In 2012, the total expense relating to stock-based compensation amortized to earnings was \$118 (2011 – \$221).

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 2012, 4,811 common shares (2011 – 6,849) were issued to Canadian resident employees at an average price of \$47.58 per share (2011 – \$31.79).

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 2012, 3,111 common shares (2011 – 3,586) were issued to U.S. resident employees at an average price of \$52.76 per share (2011 – \$35.25).

As at December 31, 2012, the total number of common shares issued under these plans is 188,245 (2011 – 180,323).

15 EXPENSES BY NATURE

	2012	2011
	\$	\$
Raw materials and consumables	461,925	427,396
Employee benefit expenses	57,065	49,243
Depreciation and amortization	10,705	8,715
Other expenses incurred in manufacturing process	20,609	17,849
Freight	36,669	29,491
Other expenses	20,925	19,486
	607,898	552,180
	2012	2011
	\$	\$
Employee benefit expenses		
Salaries, wages and benefits	54,273	47,794
Share options granted to directors and employees	118	221
Pension costs	913	(345)
Group registered retirement savings plans	1,761	1,573
	57,065	49,243

15 EXPENSES BY NATURE (continued)

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

	2012	2011
	\$	\$
Other losses (gains), net		
Asset revaluation following Kanaka's step acquisition	(1,623)	—
Losses on disposal of long-term assets	2,201	505
Foreign exchange loss (gain)	(891)	554
	(313)	1,059

16 INCOME TAXES

	2012	2011
	\$	\$
Current tax		
Current tax on income for the year	30,620	23,558
Adjustments in respect of prior years	(134)	(411)
Total current tax	30,486	23,147
Deferred tax		
Origination and reversal of temporary differences	(1,879)	(1,384)
Impact of change in tax rate	(285)	(44)
Adjustment in respect of prior years	(115)	2,501
Total deferred tax	(2,279)	1,073
Income tax expense	28,207	24,220

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:

	2012	2011
	\$	\$
Income before income tax	101,278	79,929
Tax calculated at domestic tax rates of 26.59% (2011 – 28.21%) applicable to income in the respective countries	26,930	22,458
Tax effects of:		
Difference in tax rate of foreign subsidiaries	6,511	3,325
Income not subject to tax	(2,611)	(2,434)
Expenses not deductible for tax purposes	(10)	95
Remeasurement of deferred tax – change in tax rate	(285)	(44)
Adjustment in respect of prior years	(249)	2,065
Exchange revaluation of deferred tax	(2)	45
Manufacturing and processing tax credit	(2,077)	(1,290)
Income tax expense	28,207	24,220

16 INCOME TAXES (continued)

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

	2012	2011
	\$	\$
Deferred tax assets		
To be recovered after more than 12 months	13,088	1,749
To be recovered within 12 months	8,338	5,433
Deferred tax liabilities		
To be reversed after more than 12 months	(60,235)	(50,599)
To be reversed within 12 months	—	—
Deferred tax liability, net	(38,809)	(43,417)

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

	2012	2011
	\$	\$
As at January 1	(43,417)	(34,685)
Statement of income charge	2,279	(1,073)
Tax charge (credit) relating to components of other comprehensive income	199	642
Tax charge (credit) directly to equity	652	—
Tax charge (credit) relating to acquisition	695	(7,638)
Foreign exchange	783	(663)
As at December 31	(38,809)	(43,417)

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 follow:

	Financing fees	Reserves	Derivative financial instruments	Deferred pension benefits	Capital loss unrealized on foreign exchange on debts	Intan- gible assets	Net oper- ating loss	Total
	\$	\$	\$	\$	\$	\$	\$	\$
Deferred tax assets								
As at January 1, 2011	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
Charged (credited) to statement of income	(431)	(693)	—	(117)	(23)	(1,022)	62	(2,224)
Charged (credited) to other comprehensive income	—	—	153	23	23	—	—	199
Charged (credited) to equity	652	—	—	—	—	—	—	652
Charged (credited) to goodwill	—	3,700	—	1,060	—	10,869	60	15,689
Exchange differences	(3)	(102)	2	8	—	23	—	(72)
As at December 31, 2012	949	8,338	577	1,570	—	9,870	122	21,426

16 INCOME TAXES (continued)

	Property, plant and equipment \$	Deferred pension benefits \$	Intangible assets \$	Investment tax credit \$	Capital gain unrealized on foreign exchange gain on debts \$	Total \$
Deferred tax liabilities						
As at January 1, 2011	(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)
Charged (credited) to statement of income	726	—	3,776	1	—	4,503
Charged (credited) to other comprehensive income	—	—	—	—	—	—
Charged (credited) to equity	—	—	—	—	—	—
Charged (credited) to goodwill	(15,016)	—	22	—	—	(14,994)
Exchange differences	393	—	462	—	—	855
As at December 31, 2012	(41,481)	—	(18,648)	(106)	—	(60,235)

16 INCOME TAXES (continued)

The Company did not recognize deferred income tax assets of \$378 (2011 – \$198) in respect of capital losses amounting to \$2,848 (2011 – \$1,483) 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 \$86,133 as at December 31, 2012 (2011 – \$51,713).

17 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.

Following the MCHI acquisition, the Company now contributes to two US defined benefit pension plans.

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% of salary. The recognized costs for employee future benefits were as follows:

	2012	2011
	\$	\$
Post-retirement benefits	154	(1,109)
Defined benefit pension plans	430	449
Contributions to multi-employer plan	329	320
Contributions to group registered retirement savings plans	1,761	1,573

- 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 July 1, 2012, and the next required valuation will be as at July 1, 2015.

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 Health Spending Account upon retirement. This coverage replaces the current health care coverage.
- Current retirees maintain their coverage under their current plan.

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).

17 EMPLOYEE FUTURE BENEFITS (continued)

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

	2012	2011
	\$	\$
Accrued benefit obligation		
Balance – Beginning of year	1,630	2,572
Current service cost	81	124
Past service cost	—	(1,336)
Interest cost	73	103
Benefits payments	(50)	(42)
Actuarial loss (gain)	(12)	209
Balance – End of year	1,722	1,630
Plan assets		
Employer's contributions	50	42
Benefits paid	(50)	(42)
Fair value – End of year	—	—
Accrued benefit obligation	1,722	1,630

The significant assumptions used are as follows:

	2012	2011
	%	%
Accrued benefit obligation as at December 31		
Discount rate	4.00	4.30
Rate of compensation increase	2.00	2.00
Benefit costs for the year ended December 31		
Discount rate	4.30	5.40
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 2012 was 8.0%. 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	63	(54)
Impact on benefit costs	3	(3)

17 EMPLOYEE FUTURE BENEFITS (continued)

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

	2012	2011
	\$	\$
Current service cost	81	124
Interest cost	73	103
Past service cost	—	(1,336)
Post-retirement benefits program costs recognized	154	(1,109)

	2012	2011
	\$	\$
Consolidated statement of comprehensive income		
Year ended December 31		
Actuarial gains (losses)	12	(209)
Total recognized in other comprehensive income before income tax	12	(209)

	2012	2011
	\$	\$
Accumulated actuarial losses recognized in other comprehensive income (loss)		
Balance of actuarial losses as at January 1	(178)	(25)
Net actuarial gains (losses) recognized in the year	12	(153)
Balance of actuarial losses as at December 31	(166)	(178)

- b) The Stella-Jones Canada Inc. defined benefit pension plans base the benefits on the length of service and final average earnings. The MCHI defined benefit pension plans base the benefits on the length of service and flat dollar amounts payable monthly. 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 six 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
Plan 5	December 31, 2012
Plan 6	December 31, 2012

17 EMPLOYEE FUTURE BENEFITS (continued)

Information about the Company's defined benefit pension plans other than the multi-employer defined benefit plan, in aggregate, is as follows:

	2012	2011
	\$	\$
Accrued benefit obligation		
Balance – Beginning of year	12,755	10,272
Addition of subsidiaries	6,001	—
Current service cost	560	388
Past service cost	—	186
Interest cost	605	568
Benefits payments	(611)	(413)
Actuarial loss	363	1,754
Balance – End of year	19,673	12,755
Plan assets		
Fair value – Beginning of year	12,114	11,391
Addition of subsidiaries	3,266	—
Expected return on assets	720	681
Actuarial gains (losses)	241	(824)
Employer's contributions	876	1,267
Employee's contributions	15	12
Benefits paid	(611)	(413)
Fair value – End of year	16,621	12,114
Accrued benefit liability	(3,052)	(641)

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:

	2012	2011
	\$	\$
Accrued benefit obligation	17,308	5,010
Fair value of plan assets	13,963	4,357
Funded status – Plan deficit	(3,345)	(653)

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

	2012	2011
	%	%
Equity securities	46	57
Debt securities	52	41
Short-term investments and cash	2	2
	100	100

17 EMPLOYEE FUTURE BENEFITS (continued)

The significant weighted average assumptions used are as follows:

	2012	2011
	%	%
Accrued benefit obligation as at December 31		
Discount rate	3.90	4.50
Inflation assumption	2.00	2.30
Rate of compensation increase	3.00	4.00
Benefit costs for the year ended December 31		
Discount rate	4.50	5.50
Inflation assumption	2.30	2.50
Rate of compensation increase	4.00	3.50

The items of the Company's defined benefit plan costs recognized during the year are as follows:

	2012	2011
	\$	\$
Current service cost, net of employee's contributions	545	376
Interest cost	605	568
Expected return on plan assets	(720)	(681)
Past service cost	—	186
Defined benefit plan expense	430	449

Expected contributions to the defined benefit pension plans for the year ending December 31, 2013 are \$811.

The actual return on plan assets was \$961 (2011 – \$(145)), compared to an expected return on plan assets of \$720 (2011 – \$681); this produced an actuarial gain (loss) of \$241 (2011 – \$(825)).

Consolidated statement of comprehensive income	2012	2011
	\$	\$
Year ended December 31		
Actuarial losses	(65)	(2,575)
Total recognized in other comprehensive income before income tax	(65)	(2,575)
Accumulated actuarial losses recognized in other comprehensive income (loss)		
	2012	2011
	\$	\$
Balance of actuarial losses as at January 1	(2,706)	(754)
Net actuarial losses recognized in the year	(42)	(1,952)
Balance of actuarial losses as at December 31	(2,748)	(2,706)

18 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. No provision in relation to those claims has been recognized in these consolidated financial statements, as legal advice indicates that it is not probable that a significant liability will arise.
- b) The Company has issued guarantees amounting to \$44,061 (2011 – \$27,924) 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:

	\$
2013	10,789
2014	8,032
2015	5,988
2016	4,605
2017	3,229
Thereafter	17,490
	<u>50,133</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 \$730 (2011 – \$738). 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.

19 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 consolidated 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 interest rate swap agreements has been recorded using mark-to-market information.

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.

19 FINANCIAL INSTRUMENTS (continued)

Credit risk (continued)

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 5 provides details on the receivable aging as well as on the provision for doubtful accounts for the years ended December 31, 2012 and 2011. In 2012, the Company had one customer representing 14% of its sales (2011 – 14%). As at December 31, 2012, the accounts receivable balance from this customer amounted to \$1,278 (2011 – \$3,936).

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 credit facility (Note 12(a)) made available by a syndicate of lenders which can be used for working capital and general corporate requirements. As at December 31, 2012, an amount of \$298,056 was drawn against the Company's committed revolving credit facility. The following table details the maturities of the financial liabilities as at December 31:

	2012					
	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	14,000	14,000	14,000	—	—	—
Accounts payable and accrued liabilities	65,836	65,836	65,836	—	—	—
Long-term debt obligations	349,608	388,324	15,188	18,457	346,440	8,239
Interest rate swaps net settlement	—	5,010	1,355	2,427	1,228	—
Non-competes payable	2,704	2,953	1,740	915	298	—
	432,148	476,123	98,119	21,799	347,966	8,239

19 FINANCIAL INSTRUMENTS (continued)

Liquidity risk (continued)

	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

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.

The Company had no foreign exchange forward contracts as at December 31, 2012. 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

19 FINANCIAL INSTRUMENTS (continued)

Currency risk (continued)

The contracts matured 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 Instruments: 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 nil for the year ended December 31, 2012 (2011 – \$1,181). 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, 2012 and 2011. 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:

	2012	2011
	\$	\$
Loss to net income	(1,631)	(298)

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

	2012	2011
	\$	\$
Assets		
Accounts receivable	168	1,721
Liabilities		
Accounts payable and accrued liabilities	2,148	1,825
Long-term debt	14,373	2,875
	16,521	4,700

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 (Note 12(a)).

Interest rate risk

As at December 31, 2012, the Company has mitigated its exposure to interest rate risk on long-term debt after giving effect to its interest rate swaps; 67% (2011 – 85%) 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.

19 FINANCIAL INSTRUMENTS (continued)

Interest rate risk (continued)

The committed revolving credit facility defined in Note 12(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 \$85 for the year ended December 31, 2012 (2011 – \$105).

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

				2012
Notional amount	Related debt instrument	Fixed rate %	Maturity date	Notional equivalent CA\$
CA\$10,000	Committed revolving credit facility	1.09*	August 2014	10,000
CA\$10,000	Committed revolving credit facility	1.57*	August 2016	10,000
US\$25,000	Committed revolving credit facility	0.71*	December 2017	24,873
US\$25,000	Committed revolving credit facility	0.69*	December 2017	24,873
US\$25,000	Committed revolving credit facility	0.71*	December 2017	24,873
US\$25,000	Committed revolving credit facility	0.70*	December 2017	24,873
US\$25,000	Committed revolving credit facility	1.16*	December 2016	24,873
US\$15,000	Committed revolving credit facility	1.45*	August 2016	14,294
US\$15,000	Committed revolving credit facility	0.75*	August 2014	14,294
US\$5,000	Committed revolving credit facility	5.80	July 2015	4,975
US\$5,000	Committed revolving credit facility	5.54	July 2015	4,975
US\$1,000	Committed revolving credit facility	4.69	December 2015	995
US\$5,600	Bond – County of Fulton, Kentucky	2.99	December 2015	5,571

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

* Plus applicable spread.

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, 2012, all cash flow hedges were effective.

19 FINANCIAL INSTRUMENTS (continued)

Interest rate risk (continued)

The fair value of these financial instruments has been determined by obtaining mark-to-market values as at December 31, 2012 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, 2012 is a loss of \$1,728 (2011 – loss of \$1,549), of which \$198 and \$1,926 respectively are recorded in non-current assets and non-current liabilities under derivative financial instruments. A 10% decrease in interest rates as at December 31, 2012 would have increased the loss recognized in other comprehensive income by approximately \$173 (2011 – \$155). For a 10% increase in the interest rates, there would be an equal and opposite impact on the loss.

20 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.

	2012	2011
	\$	\$
Total debt	363,608	182,679
Shareholders' equity	468,751	331,912
Total capital	832,359	514,591
Total debt to total capitalization ratio	0.44:1	0.35:1

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 credit 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.

21 RELATED PARTY TRANSACTIONS

a) Transactions

The Company had the following transactions with related parties:

	2012	2011
	\$	\$
Stella Jones International S.A.*		
Marketing and technical service fees paid	200	200
Interest on promissory note	—	26
Stella International S.A. and James Jones & Sons Limited**		
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	458	359

* Stella Jones International S.A. holds, directly or indirectly, approximately 38.7% of the outstanding common shares of the Company.

** Stella International S.A. and James Jones & Sons Limited hold 51.0% and 49.0% of all voting shares of Stella Jones International S.A., respectively.

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

On November 30, 2012, in connection with the MCHI acquisition, the Company completed a private placement of subscription receipts with Stella Jones International S.A. The gross amount paid was \$30,960.

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

	2012	2011
	\$	\$
Accounts payable to Stella International S.A. and James Jones & Sons Limited	25	25
Accounts payable to Stella Jones International S.A.	50	50
Accounts payable to a firm in which a director of the Company is a partner	219	10
	294	85

b) Key management compensation

Key management includes certain directors (executive and non-executive), and certain senior management.

The compensation paid or payable to key management for employee services is as follows:

	2012	2011
	\$	\$
Salaries, compensation and benefits	4,417	2,041
Share-based payments	81	124
	4,498	2,165

22 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, Arkansas, Oregon, Mississippi, Washington and Georgia (facility under construction). The Company also operates a large distribution network across North America.

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

	2012	2011
	\$	\$
Canada	228,356	227,952
U.S.	489,138	412,196
	717,494	640,148

Sales by product as at December 31 are as follows:

	2012	2011
	\$	\$
Railway ties	404,461	338,790
Utility poles	218,491	194,807
Industrial products	59,035	78,890
Residential lumber	35,507	27,661
	717,494	640,148

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

	2012	2011
	\$	\$
Canada	59,380	47,992
U.S.	128,193	71,449
	187,573	119,441

Intangible assets with a net book value of \$83,109 (2011 – \$61,998) are attributed to the Company's U.S. operations.

Goodwill with a value of \$135,834 (2011 – \$91,720) is allocated to the U.S., the location where the CGUs hold the majority of their business activities.

23 SUBSEQUENT EVENT

On March 21, 2013, the Board of Directors approved a quarterly dividend of \$0.20 per common share payable on April 30, 2013 to shareholders of record at the close of business on April 2, 2013.