a focused strategy

core products

key markets

efficient operations

stella-jones

annual report 2001

(thousands of dollars, except per share data and ratios)

Year ended December 31,	2001	2000	1999	1998	1997
Results					
Sales	**$87,829**	$87,045	$68,995	$67,718	$61,410
January 1998 ice storm sales	**—**	—	—	14,296	—
Total Sales	**87,829**	87,045	68,995	82,014	61,410
EBITDA	**5,045**	8,928	8,732	8,680	5,858
Net earnings	**488**	3,156	3,625	3,821	1,846
Cash flow from operations*	**3,064**	5,287	4,870	5,371	3,677
Financial position					
Working capital	**20,669**	21,086	22,376	21,765	21,533
Total assets	**80,854**	74,494	57,994	53,547	49,395
Long-term debt**	**11,843**	10,618	8,917	7,831	10,614
Shareholders' equity	**31,615**	31,570	29,990	27,165	23,286
Per share data					
Earnings per share	**0.05**	0.35	0.39	0.41	0.20
Earnings per share (diluted)	**0.05**	0.35	0.37	0.39	0.19
Cash flow from operations*	**0.34**	0.59	0.53	0.58	0.40
Book value	**3.50**	3.53	3.24	2.92	2.51
Working capital	**2.29**	2.36	2.42	2.34	2.32
Average number of shares outstanding (000's)	**9,002**	9,028	9,298	9,291	9,292
Shares outstanding at year end (000's)	**9,043**	8,947	9,245	9,305	9,272
Average number of diluted shares outstanding (000's)	**9,015**	9,087	9,853	9,855	9,973
Dividend per share	**$ 0.07**	$ 0.07	$ 0.07	—	—
Financial ratios					
Return on average equity	**1.5%**	10.3%	12.7%	15.1%	8.2%
Long-term debt** to equity	**0.37:1**	0.34:1	0.30 : 1	0.29 : 1	0.46 : 1

* Before change in non-cash working capital balances.
** Including current portion.

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Corporate Information

Annual Meeting of Shareholders
May 8, 2002
9:30 a.m.
Hotel Inter-Continental Montreal
Salon Saint-Jacques
360 Saint-Antoine Street West
Montreal, Quebec

Our Profile

Stella-Jones Inc. is the leading Canadian producer of pressure treated wood products.

Stella-Jones' products include treated wood poles for electrical utilities and telecommunications companies, railway ties, highway guardrail posts, marine and foundation pilings, and construction and bridge timbers. The Company also provides customized services to lumber companies and wholesalers for the treatment of consumer lumber products, such as decks and fencing.

Stella-Jones is committed to offering the best in price, quality, service and environmental practices. With 207 employees across Canada, the Company is the only producer of pressure treated wood products operating on a national scale and serves markets worldwide.

	Wood Poles	Railway Ties	Industrial Treated Wood	Consumer Lumber
Products	Poles Crossarms	Crossties Switchties	Foundation pilings Marine pilings Marine timbers Construction timbers Highway guardrail posts Bridge timbers	Wood board Lattice Fence board Plywood Dimensional lumber for use in patios, decks, fences and other outdoor applications
Wood Species	Red pine Jack pine Lodgepole pine Southern yellow pine Douglas fir Western red cedar Scots pine	Maple Oak Birch Red pine Jack pine Lodgepole pine Hemlock	Hemlock Douglas fir Red pine Jack pine Lodgepole pine Western red cedar	White pine Red pine Jack pine Fir
Preservatives	Chromated copper arsenate (CCA) Pentachlorophenol Creosote Ammoniacal copper zinc arsenate (ACZA)	Creosote Creosote / oil	Chromated copper arsenate (CCA) Pentachlorophenol Creosote Ammoniacal copper zinc arsenate (ACZA)	Chromated copper arsenate (CCA)
Customers	Utilities Telecommunications companies Crown corporations Contractors	Railway companies Mining corporations Industry Railway maintenance contractors	Governmental departments – Transportation – Public works – Forestry – Harbours Contractors Industry Wholesalers Retailers	Wholesalers Lumber companies
Geographic Markets	Canada United States Mexico Central America South America Middle East Africa Asia Caribbean	Canada United States South America	Canada United States	Canada

Stella-Jones' objective is to be the performance leader in the wood preserving industry and a model corporate citizen, exercising environmental responsibility and integrity.

Stella-Jones will achieve these goals by focusing on customer satisfaction, core products, key market segments, innovative work practices and the optimal use of its resources.

Stella-Jones is committed to providing a safe, respectful and productive environment for its employees, where problem solving, initiative and high standards of performance are rewarded.

Stella-Jones' earnings for 2001 were extremely disappointing. However, there were several contributing factors, some of which were outside our control: the slide into recession in the USA and Canada, the depressed state of the whole forest products industry worldwide, and the strength of the Canadian and US dollars against the euro which adversely impacted our export margins.

Against this background, it is encouraging that we posted a modest profit in 2001. We have thereby maintained the excellent record of the business, both in its present structure as Stella-Jones and previously as the Wood Preserving Division of Domtar, of never reporting a loss.

In April 2001, George Kosanovich resigned as President and Chief Operating Officer, and I wish to thank him for his good work within the Company and in our industry. We subsequently appointed Brian McManus to the same positions effective June 1, 2001. Brian was already well versed in the operations of the Company through his participation in an executive MBA study on Stella-Jones in 1999, and as a partner in the Company's firm of financial advisers.

In response to the slowing economy in the second half of the year, we concentrated very closely on refocusing the business, on tighter inventory control, on a cost reduction program across all our operations and exiting low-margin business at some locations. The response to these measures has been very positive. Already, clear benefits are apparent and the Board is forecasting a progressive improvement in profitability through 2002. We anticipate a return to much more acceptable profits by this year-end despite a general trading environment in our main markets which is still very slow.

In light of the disappointing results, your Board has decided not to recommend payment of a dividend in respect of the fiscal year 2001.

Mr. Ray McManus has been associated with Stella-Jones since its inception in 1992 and was a Director since 1994. He resigned from this position effective May 16, 2001. On behalf of the Board, I would like to thank him for his invaluable advice and commitment to the Company during this period. His position on the Board has been taken by Mr. George Bunze, Vice Chairman and Chief Financial Officer of Kruger Inc. We can consider ourselves fortunate to have secured the services of such a well-known and respected member of the North American forest products industry.

I wish to thank all our employees for their hard work and dedication in a particularly difficult year. I would also like to reassure our customers that the measures we have taken, and are continuing to take, to strengthen our Company will enhance the services we provide to them.

(Signed)

Tom A. Bruce Jones
Chairman of the Board and Chief Executive Officer

As part of our refocused business strategy, we financial resources and aligning them more each of our market segments.

Against the backdrop of a general economic downturn, fiscal 2001 proved a disappointing year for Stella-Jones. Sales remained relatively steady at $87.8 million, compared with $87.0 million the previous year. However, due to increased pressure on margins, net earnings dropped to $488,000 or $0.05 per share, from $3.2 million or $0.35 per share last year. Clearly, these results are unsatisfactory to both management and our shareholders.

Stella-Jones is operating in an increasingly competitive environment, both in our North American and export markets. In order for Stella-Jones to compete effectively in today's economy, it must be a low-cost operator. We have therefore accelerated the cost and efficiency improvement program begun in 1999.

In addition, during the second half of 2001, we conducted a strategic review of all our operations, market segments and competitive position within the overall treated wood products market. Subsequent to this review, we adopted a change in our market strategy which will see a greater concentration on core product lines, combined with further streamlining of our production capabilities and a continuing emphasis on cost reduction.

A refocused business strategy

We are confident that the decisions and actions taken near the end of fiscal 2001 will considerably improve the Company's profitability in the coming years.

We have compressed all our operations to improve efficiency and reduce costs. Our goal is to do more with less. By centralizing a number of functions as well as streamlining and improving others, we have substantially reduced our fixed and administrative costs for 2002. In addition, greater teamwork and multi-tasking, combined with changes in our operations, have reduced our direct and variable costs.

We reviewed all our market segments to assess the true contribution of each one independently. In the future, we intend to concentrate our sales efforts both domestically and internationally on those segments that can provide adequate margins relative to the costs and risks involved.

are optimizing our physical and closely with opportunities in

These initiatives, in addition to having a positive effect on net earnings, will free cash resources previously required for higher levels of working capital. Our improved cash position, along with reduced capital expenditures in 2002, will secure our financial condition for the future.

Through the coming year, we will continue to optimize our physical and financial resources, aligning them more closely with opportunities in each of our market segments. Our immediate goal is to maximize our profitability and reduce our short-term indebtedness. As our financial position improves, we will re-evaluate the optimal use of our resources to take advantage of new avenues for profitable growth.

Focused on value creation

The constantly changing marketplace and regulatory environment in which we operate force us to continually reassess our position. We will remain vigilant with regard to our competitive landscape, our operations and our customers for opportunities that will enable us to build value for our shareholders.

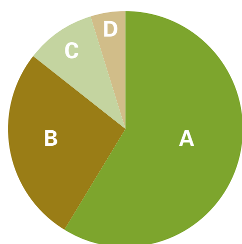
I would like to thank all our employees for their support and their contribution to the implementation of our refocused business strategy. We are optimistic that our actions today will ensure a solid future for our organization, our customers and our shareholders.

(Signed)

Brian McManus
President and Chief Operating Officer

Sales by product

(% of revenues)



A Wood poles **58%**

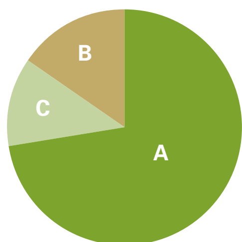
B Railway ties **27%**

C Industrial treated wood **10%**

D Consumer lumber **5%**

Sales by geographic region

(% of revenues)



A Canada **73%**

B United States **15%**

C Overseas **12%**

Management's Discussion and Analysis of Financial Condition and Results of Operations

Operating Results

Sales for the year ended December 31, 2001 totalled $87.8 million, compared with sales of $87.0 million in 2000. This year's sales saw the inclusion of a full twelve-month contribution from Guelph Utility Pole Company Ltd. ("Guelph"), acquired on March 31, 2000, versus the nine months of Guelph sales included in last year's results.

The marginal increase in sales of 1% over last year was achieved despite significant reductions in export, consumer lumber and industrial treated wood sales. These reductions were more than offset by strong demand for railway ties in Eastern Canada and overall increased sales of domestic utility poles. Guelph's consumer lumber sales in the Ontario market helped compensate for decreased sales in this product category in Quebec and the Maritimes. Railway tie sales increased $3.3 million or 16.4% over 2000 sales levels, while domestic utility pole sales increased $0.9 million or 2% in the same period. Export sales declined by $2.5 million or 19.3% for the year ended December 31, 2001 over the prior year. Industrial treated wood and consumer lumber sales were down a combined $1.1 million or 7.7% in 2001 versus 2000.

Sales to the United States increased by $1.5 million, or 12.9%, over the year 2000, while Canadian sales posted an increase of $1.8 million or 2.9% for the same period. The sales decline in our export markets reflects increased competition from new entrants into our traditional markets and the relative strength of the Canadian dollar versus the euro.

Gross margin decreased to 12.7% of sales in 2001 from 16.9% of sales in 2000. A significant erosion in export margins and increases in domestic white wood and energy costs were primarily responsible for this decrease.

Selling and administrative expenses amounted to $6.2 million, an increase of $0.4 million over the $5.8 million incurred in 2000. The inclusion of a full year of Guelph's expenses and non-recurring charges related to an acquisition investigation and unplanned plant closures at Delson account for this increase.

Amortization of capital assets increased slightly to $2.5 million, up from $2.4 million in 2000. This increase is primarily due to the amortization expense recorded on new capital investments at our Guelph and New Westminster facilities.

Financial expenses increased by 15% to $1.8 million in 2001 from $1.6 million in 2000, due to the financing of higher levels of inventory and receivables subsequent to the Guelph acquisition as well as to support export sales.

Income tax expense was $0.3 million for the year ended December 31, 2001, representing an effective tax rate of 36% which was comparable with the previous year.

Net earnings amounted to $0.5 million or $0.05 per share in 2001, compared with $3.2 million or $0.35 per share in 2000. As a percentage of sales, net earnings decreased to 0.6% of sales from 3.6% in 2000.

Liquidity and Capital Resources

Cash flow from operations decreased to $3.1 million in 2001 from $5.3 million in 2000. Working capital changes provided an additional $0.3 million in cash for the year ended December 31, 2001, compared with $7.0 million of cash used for working capital changes in 2000.

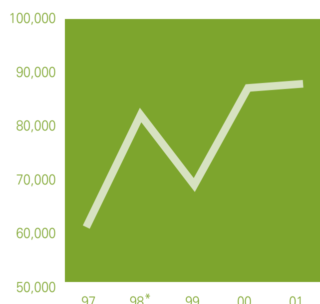
The Company's working capital stood at $20.7 million as at December 31, 2001, remaining stable compared with last year. The Company's current ratio was 1.54:1 as at December 31, 2001, versus 1.69:1 for the previous year due to the increase in inventories and accounts payable and accrued liabilities. The long-term debt to equity ratio remained a very acceptable 0.37:1 in 2001 versus 0.34:1 in 2000.

From June 30, 2001 to December 31, 2001, the Company was in breach of certain financial ratio covenants contained in its bank operating credit and term loan facilities in effect at that time. The Company remained current with respect to all its payment obligations to its bankers. Company's management was of the opinion that more favourable financial and covenant arrangements, better suited to the Company's operating situation, could be obtained. On February 15, 2002, the Company entered into new credit facilities with a new bank comprising a demand operating loan of $25 million and a term loan of $5 million, which will be used to repay the prior facilities. Over the coming year, the Company will also be arranging approximately $1.5 million of additional long-term financing by way of capital leases or mortgage loans for capital expenditures made in 2001.

Inventory stood at $45.3 million as at December 31, 2001, an increase of $8.0 million over the inventory level of $37.3 million at the end of the previous year. This increase represents a build-up of export inventory to fulfil contracts destined for delivery in the first quarter of 2002, as well as planned increases in Western Canada to meet anticipated demand.

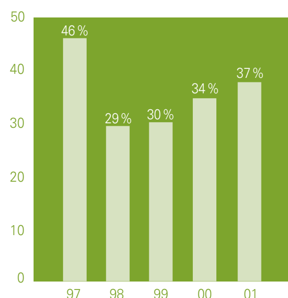
Sales

(in thousands of dollars)



* Includes January 1998 ice storm sales of $14,296,000.

Long-term debt as a percentage of shareholders' equity



Shareholders' equity remained unchanged at $31.6 million in 2001, representing a book value of $3.50 per share.

Capital expenditures amounted to $1.9 million in 2001, a 27% decrease over the capital expenditures of $2.6 million in the previous year. The principal capital investments this year were made at Guelph, New Westminster and Truro. Significant improvements were made to our materials-handling capabilities at our Guelph facility while equipment upgrades at Truro and New Westminster accounted for another major portion. Environmental-related capital investments of approximately $550,000 were also incurred at Guelph and New Westminster during the year.

Dividends

On March 13, 2002, the Board of Directors decided that, in light of the Company's reduced profitability in the year 2001 and limited cash availability, a dividend would not be declared in 2002.

Risks and Uncertainties

Management considers that Stella-Jones may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. Nevertheless, Stella-Jones' overall competitiveness in this industry is strengthened by its access to a high-quality timber supply provided by its long-term cutting licenses and its long-standing relationships with private woodland owners and other suppliers.

The possibility of major changes in environmental laws and regulations is another risk faced by the Company. Management believes that its commitment to the environmental integrity of the Company's plants and operations, supported by any required investments towards that end, will allow Stella-Jones to continue to meet the applicable regulatory requirements.

Exchange rate risk is limited because of the natural hedge between sales and purchases in US funds. The Company also enters into hedging arrangements to mitigate significant changes in the value of the Canadian dollar.

Outlook

Management's commitment to the revised business and marketing strategy has already been evidenced by the steps taken in the latter half of 2001 to rationalize markets and downsize operations. In addition to the immediate effect of the salary freeze for non-unionized employees and the permanent reductions in manpower at several of our plants, we expect that financial results will progressively improve throughout the year as the impact of our other efficiency and streamlining changes take hold. The margin erosion experienced in all our sectors of activity will be addressed on both a regional and product-by-product basis, and the necessary remedial action taken.

In 2002, we will continue to focus our marketing activities on those product sectors that can produce satisfactory returns. This will mean pulling back, on a regional basis, from competing in low-margin, high-maintenance product lines. This will also provide an opportunity to reduce indirect manufacturing expenses and inventory levels of non-core product. We fully expect that this will lead to reduced overall sales, but a much improved earnings line.

Consumer lumber will continue to be an area where the Company can achieve significant growth, building on our solid presence in the Ontario market through our Guelph subsidiary. The recently announced phase-out by December 31, 2003 of Chromated Copper Arsenate (CCA) as a preservative for consumer applications in the United States will most likely be adopted in Canada as well. We do not expect that this will have an adverse impact on our consumer lumber business, which currently represents about 5% of our sales. The major preservative suppliers are working with Health Canada to obtain approval of an alternative arsenic-free preservative. We will be ready to offer treatment services with the new preservative as soon as the market requests it.

Another area for concern in 2002 is the increasing competitiveness of our international export markets. The additional risk of adequately servicing these overseas destinations and financing long-term receivables is difficult to justify in the face of new low-cost competition from Eastern Europe, South Africa and Chile and the exchange disadvantage against the euro. We will continue to closely monitor this sector for opportunities that can provide adequate margins relative to the costs and risks involved.

The year 2002 will see the Company enhance operational performance as its main avenue for increasing profitability. Management is committed to Stella-Jones being the lowest cost and most efficient operation in the country. We will capitalize on our national presence and our size to continue to service our primary customer base of the larger blue-chip utility and railroad customers. Moreover, each of our regional operations will focus on effectively competing in their local markets. This is where we see our growth opportunities in the short term.

As our financial situation and cash generation improves over the course of the coming year, we will again actively pursue acquisition opportunities. We still believe that industry consolidation is inevitable, and we plan to play a dominant role.

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheets of Stella-Jones Inc. as at December 31, 2001 and 2000 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed)

PricewaterhouseCoopers LLP
Chartered Accountants
Montreal, Quebec
February 15, 2002

Consolidated balance sheets

as at December 31, 2001 and 2000	**2001** **$**	2000 $
Assets		
Current assets		
Accounts receivable (notes 4 and 7)	**10,377,778**	11,509,848
Inventories (notes 5 and 7)	**45,315,782**	37,347,768
Prepaid expenses	**1,924,084**	1,221,059
Income taxes	**459,097**	731,122
Future income taxes (note 9a))	**578,000**	907,000
	58,654,741	51,716,797
Property, plant and equipment (notes 6 and 7)	**22,012,730**	22,608,919
Future income taxes (note 9a))	**187,000**	168,000
	80,854,471	74,493,716
Liabilities		
Current liabilities		
Bank indebtedness (note 7a))	**16,230,749**	18,279,045
Accounts payable and accrued liabilities	**16,906,361**	9,169,403
Income taxes	**—**	418,768
Current portion of long-term debt (note 7)	**4,848,569**	2,763,240
	37,985,679	30,630,456
Long-term debt (note 7)	**6,994,790**	7,855,103
Future income taxes (note 9a))	**3,726,000**	3,965,000
Employee future benefits (note 10)	**533,043**	473,199
	49,239,512	42,923,758
Shareholders' Equity		
Capital stock (note 8)	**16,480,200**	16,296,602
Retained earnings	**15,134,759**	15,273,356
	31,614,959	31,569,958
	80,854,471	74,493,716

Approved by the Board of Directors

(Signed)

Tom A. Bruce Jones
Director

(Signed)

Richard Bélanger
Director

Consolidated statements of earnings

for the years ended December 31, 2001 and 2000	2001 $	2000 $
Sales	**87,828,972**	87,044,980
Expenses		
Cost of sales	**76,630,823**	72,341,628
Selling and administrative	**6,153,355**	5,775,277
Amortization of property, plant and equipment	**2,479,554**	2,430,306
	85,263,732	80,547,211
Operating earnings	**2,565,240**	6,497,769
Financial expenses (note 7h))	**1,798,523**	1,567,230
Earnings before income taxes	**766,717**	4,930,539
Provision for income taxes (note 9b))		
Current	**208,000**	2,121,000
Future	**71,000**	(345,998)
	279,000	1,775,002
Net earnings for the year	**487,717**	3,155,537
Net earnings per common share (note 8b))	**0.05**	0.35
Diluted net earnings per common share (notes 2a) and 8b))	**0.05**	0.35

Consolidated statements of retained earnings

for the years ended December 31, 2001 and 2000	2001 $	2000 $
Balance – Beginning of year		
As previously reported	**15,273,356**	13,151,765
Change in accounting policy (note 2b))	**—**	(266,037)
As restated	**15,273,356**	12,885,728
Net earnings for the year	**487,717**	3,155,537
Excess of redemption price over stated capital of common shares repurchased (note 8e))	**—**	(124,557)
Dividends on common shares	**(626,314)**	(643,352)
Balance – End of year	**15,134,759**	15,273,356

Consolidated statements of cash flows

for the years ended December 31, 2001 and 2000	2001 $	2000 $
Cash flows from		
Operating activities		
Net earnings for the year	**487,717**	3,155,537
Adjustments for		
Amortization of property, plant and equipment	**2,479,554**	2,430,306
Gain on disposal of property, plant and equipment	**(34,592)**	(10,700)
Employee future benefits	**59,844**	58,162
Future income taxes	**71,000**	(345,998)
	3,063,523	5,287,307
Change in non-cash working capital components		
Decrease (increase) in		
Accounts receivable	**1,132,070**	(891,411)
Inventories	**(7,968,014)**	(216,503)
Prepaid expenses	**(703,025)**	(194,191)
Income taxes	**272,025**	(731,122)
Increase (decrease) in		
Accounts payable and accrued liabilities (note 6b))	**7,999,534**	(4,326,890)
Income taxes	**(418,768)**	(654,485)
	313,822	(7,014,602)
	3,377,345	(1,727,295)
Financing activities		
Increase (decrease) in bank indebtedness	**(2,048,296)**	11,546,273
Increase in long-term debt	**4,000,000**	1,841,034
Repayment of long-term debt	**(3,032,374)**	(4,792,526)
Proceeds from issuance of common shares	**183,598**	87,063
Redemption of common shares	**—**	(753,171)
Dividends	**(626,314)**	(643,352)
	(1,523,386)	7,285,321
Investing activities		
Business acquisition (note 3)	**—**	(3,213,547)
Purchase of property, plant and equipment (note 6b))	**(1,903,959)**	(2,355,179)
Proceeds from disposal of property, plant and equipment	**50,000**	10,700
	(1,853,959)	(5,558,026)
Net change in cash and cash equivalents during the year	**—**	—
Cash and cash equivalents – Beginning and end of year	**—**	—
Supplemental disclosure		
Interest paid	**1,794,120**	1,648,779
Income taxes paid	**344,177**	3,499,107

1 Accounting policies

Principles of consolidation
These consolidated financial statements include the accounts of the Company and its subsidiary, Guelph Utility Pole Company Ltd., using the purchase method.

Measurement uncertainty
The preparation of financial statements in conformity with generally accepted accounting principles 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 dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. Estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

Fair market value of financial instruments
The Company has estimated the fair market value of its financial instruments based on current interest rates, market value and current pricing of financial instruments with similar terms. Unless otherwise disclosed herein, the carrying value of these financial instruments, especially those with current maturities such as cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities, approximates their fair market value.

Revenue recognition
Sales are recognized upon delivery of the products if the payment terms are not subject to acceptance criteria. If an acceptance period is stipulated, revenues are recognized upon customer acceptance.

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

Inventories
Inventories of raw materials are valued at the lower of average cost and replacement cost. Finished goods are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead expenses.

Property, plant and equipment
Property, plant and equipment are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis using rates based on the estimated useful lives of the assets which are generally as follows:

Buildings	up to 40 years
Production, anti-pollution and office equipment and rolling stock	2 to 20 years

Income taxes
The Company applies the liability method to account for income taxes. Under this method, future income taxes at the balance sheet date are determined using the differences between the accounting and tax bases of assets and liabilities and the enacted income tax rates to be in effect when these differences are expected to reverse. Future tax assets are recognized when it is more likely than not that the assets will be realized.

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

Foreign currency translation
Transactions denominated in a foreign currency are translated by applying exchange rates in effect at the transaction date. At year-end, monetary assets and liabilities denominated in a foreign currency are translated using the exchange rate at that date. Any resulting foreign currency translation gains or losses are included in the statement of earnings.

2 Changes in accounting policies

a) Effective January 1, 2001, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") related to the calculation of earnings per share. In accordance with the transitional provisions of the recommendations, the Company has restated the diluted net earnings per common share for the prior year. This accounting change had the effect of increasing previously disclosed diluted net earnings per common share in 2000 by $0.01.

b) Effective January 1, 2000, the Company adopted the recommendations of the CICA related to the accounting for employee future benefits. In accordance with the transitional provisions of this new standard, the Company has applied the recommendations on a retroactive basis without restating the prior years. The cumulative effect of applying the new standard is a charge of $415,037 ($266,037 after tax) and has been reflected as a decrease to opening retained earnings.

3 Business acquisition

On March 31, 2000, the Company acquired all of the issued and outstanding shares of Guelph Utility Pole Company Ltd. The acquisition has been accounted for using the purchase method. Guelph Utility Pole Company Ltd.'s results of operations have been included in the consolidated financial statements starting April 1, 2000. The net assets acquired consist of the following:

	$
Assets acquired	
Short-term assets	6,531,157
Property, plant and equipment	7,214,542
	13,745,699
Liabilities assumed	
Short-term liabilities	5,264,338
Future income taxes	1,537,998
Long-term debt	1,004,816
	7,807,152
	5,938,547
Consideration	
Cash, including transaction costs of $288,547	3,213,547
Promissory note (note 7b))	2,725,000
	5,938,547

4 Accounts receivable

	2001 **$**	2000 $
Trade	**9,545,947**	10,702,566
Other	**831,831**	807,282
	10,377,778	11,509,848

5 Inventories

	2001 **$**	2000 $
Raw materials	**30,034,468**	27,472,659
Finished goods	**15,281,314**	9,875,109
	45,315,782	37,347,768

6 Property, plant and equipment

			2001
	Cost **$**	**Accumulated amortization** **$**	**Net** **$**
Buildings	**4,720,231**	**978,972**	**3,741,259**
Production equipment	**21,446,236**	**7,827,235**	**13,619,001**
Rolling stock	**1,085,137**	**903,564**	**181,573**
Anti-pollution equipment	**6,391,207**	**2,005,760**	**4,385,447**
Office equipment	**591,468**	**506,018**	**85,450**
	34,234,279	**12,221,549**	**22,012,730**

			2000
	Cost $	Accumulated amortization $	Net $
Buildings	4,651,514	754,607	3,896,907
Production equipment	20,502,717	6,190,887	14,311,830
Rolling stock	1,214,007	949,502	264,505
Anti-pollution equipment	5,655,508	1,646,014	4,009,494
Office equipment	591,468	465,285	126,183
	32,615,214	10,006,295	22,608,919

6 Property, plant and equipment (continued)

a) Property, plant and equipment include assets under capital leases with a cost of $1,449,665 and accumulated amortization of $726,741 (2000 – $3,748,409 and $1,986,295 respectively).

b) During the year, property, plant and equipment were acquired at an aggregate cost of $1,898,773 (2000 – $2,647,415), of which $257,390 was acquired by means of capital leases and $182,608 (2000 – $445,184) by assuming directly related accounts payable and accrued liabilities. Cash payments of $1,903,959 (2000 – $2,355,179) were made for property, plant and equipment purchases.

c) As at December 31, 2001, the net carrying value of property, plant and equipment not yet in service was $269,838 (2000 – $683,408).

7 Long-term debt

	2001 $	2000 $
Non-revolving term loan (note 7a))	**7,000,000**	3,000,000
Promissory note (note 7b))	**1,771,250**	2,316,250
Loans from ultimate shareholders, unsecured and subordinated, bearing interest at 8.5%, repayable in 2003	**900,000**	900,000
Mortgage loans (note 7c))	**1,498,003**	2,386,873
Demand loan, repaid during the year	**—**	1,145,000
Obligation under capital leases (note 7g))	**674,106**	870,220
	11,843,359	10,618,343
Less: Current portion	**4,848,569**	2,763,240
	6,994,790	7,855,103

a) From June 30, 2001 to December 31, 2001, the Company was in breach of certain financial ratio covenants contained in its bank operating credit and term loan facilities in effect at that time. On February 15, 2002, the Company entered into new credit facilities with a new bank comprising a demand operating loan of $25,000,000, which includes a bid and performance bond guarantee facility up to a maximum of $5,000,000, and a non-revolving term loan of $5,000,000. These loans will be used to repay the prior facilities.

The demand operating loan will bear interest at the bank's prime rate plus 0.75% or at the bank's U.S. base rate plus 0.75% or at LIBOR plus 2.25%. The non-revolving term loan will bear interest at the bank's prime rate plus 1.25% or at the bank's fixed cost of funds plus 2.25% and is repayable in four equal semi-annual instalments of $1,250,000 beginning on July 1, 2002, or on demand in the event of a material adverse change in the Company's financial condition or prospects. Under the prior credit facilities, the term loan bore interest at a weighted average rate of 4.5% as at December 31, 2001 (December 31, 2000 – 8.0%).

A first ranking moveable hypothec over the universality of the Company's property and a first ranking security in favour of the bank under Section 427 of the Bank Act will be given as collateral for the new facility. The Company must also respect certain covenants relating to this facility.

b) Pursuant to the acquisition of Guelph Utility Pole Company Ltd., the Company issued to the vendor a promissory note bearing interest at prime rate, subject to a floor of 5% and a ceiling of 7%, and repayable in quarterly instalments of $136,250.

c) The mortgage loans bear interest at a weighted average rate of 7.9% as at December 31, 2001 (December 31, 2000 – 7.9%) and certain specific capital assets have been pledged as collateral. The loans are repayable in monthly instalments and mature at various dates to February 2004.

d) The Company's accounts receivable and inventories have also been pledged as collateral for various bid and performance bonds.

e) The aggregate fair value of the Company's long-term debt was estimated at $11,609,363 as at December 31, 2001 (December 31, 2000 – $10,304,199) based on discounted future cash flows using interest rates available to the Company for issues with similar terms and average maturities.

f) The aggregate amount of the principal portion of the long-term debt payments, excluding the obligation under capital leases, required in each of the next four years to meet retirement provisions is as follows:

	$
Years ending December 31, 2002	4,550,230
2003	4,598,310
2004	1,884,463
2005	136,250
	11,169,253

7 Long-term debt (continued)

g) Future minimum payments under capital leases are as follows:

		$
Years ending December 31,	2002	337,123
	2003	227,442
	2004	150,049
	2005	24,521
Total future minimum lease payments		739,135
Less: Interest (weighted average rate of 7.1%)		65,029
Balance of obligation		674,106
Less: Current portion		298,339
		375,767

h) Financial expenses detail as follows:

	2001	2000
	$	$
Interest on long-term debt	**764,889**	944,715
Other interest	**1,033,634**	622,515
	1,798,523	1,567,230

8 Capital stock

a) Capital stock includes the following:

Authorized

An unlimited number of preferred shares issuable in series
An unlimited number of common shares

Issued

		2001		2000
	Shares	**$**	Shares	$
Balance – Beginning of year	**8,947,348**	**16,296,602**	9,244,764	16,838,153
Stock option plan	**80,000**	**155,675**	38,000	68,400
Share purchase plan	**16,114**	**27,923**	9,713	18,663
Repurchase of shares under normal course issuer bid process	**—**	**—**	(345,129)	(628,614)
Balance – End of year	**9,043,462**	**16,480,200**	8,947,348	16,296,602

b) Net earnings per common share are calculated using the weighted average number of common shares outstanding during the year. Diluted net earnings per common share are calculated using the weighted average number of common shares outstanding during the year based on the application of the treasury stock method for the calculation of the dilutive effect of stock options and other dilutive securities.

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

	2001	2000
	$	$
Net earnings applicable to common shares	**487,717**	3,155,537
Weighted average number of common shares outstanding	**9,002,112**	9,027,963
Effect of dilutive stock options	**13,309**	59,375
Weighted average number of diluted common shares outstanding	**9,015,421**	9,087,338
Net earnings per common share	**0.05**	0.35
Diluted net earnings per common share	**0.05**	0.35

c) Stock Option Plan

The Company has a stock option plan for directors, officers and employees whereby the Board of Directors or a committee appointed for such purpose 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 or such committee. The stated purpose of the Stock Option 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 Stock Option Plan adopted on June 13, 1994 and amended on May 3, 1995 and on March 15, 2001, the aggregate number of common shares in respect of which options may be granted is 800,000 and no optionee is able to hold options to purchase common shares exceeding 5% of the number of common shares outstanding from time to time. One-fifth of the options granted may be exercised within each year following the grant date. The exercise price of an option shall not be lower than the closing price of the common shares on the Toronto Stock Exchange on the last trading day preceding the granting of the option and the term of the option may not exceed ten years. Options will not be assignable and will terminate on cessation of service with the Company.

8 Capital stock (continued)

No compensation cost is recognized when stock options are issued. Any consideration paid on exercise of stock options is credited to capital stock.

Changes in the number of options outstanding were as follows:

	2001		2000	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	484,100	2.06	554,300	2.16
Granted	322,495	2.16	15,000	2.20
Cancelled	(227,500)	1.93	(47,200)	3.53
Exercised	(80,000)	1.95	(38,000)	1.80
Outstanding – End of year	499,095	2.19	484,100	2.06
Options exercisable – End of year	223,099	2.24	326,600	2.11

The following options were outstanding as at December 31, 2001:

	Options outstanding		Options exercisable		
Year granted	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $	Expiration date
1995	41,600	3.28	41,600	3.28	2005
1996	37,500	2.10	37,500	2.10	2006
1997	52,500	1.76	52,500	1.76	2007
1998	15,000	1.93	12,000	1.93	2008
1999	15,000	1.93	9,000	1.93	2009
2000	15,000	2.20	6,000	2.20	2010
2001	322,495	2.16	64,499	2.16	2011
	499,095		223,099		

d) Employee Share Purchase Plan

The aggregate number of common shares reserved for issuance under the Employee Share Purchase Plan is 120,000. Under this plan, employees are eligible to purchase common shares from the Company at a price of 90% of the market value. In 2001, 16,114 shares (2000 – 9,713) were issued under this plan at an average price of $1.73 per share (2000 – $1.92). As at December 31, 2001, the total number of shares issued under this plan is 84,691 (December 31, 2000 – 68,577).

e) Normal Course Issuer Bid

In 1999, the Company began a normal course issuer bid to purchase a maximum of 465,573 of its own common shares up to September 14, 2000. During the year ended December 31, 2000, the Company purchased 345,129 common shares for $753,178. The excess of the redemption price over the stated capital has been charged to retained earnings.

9 Income taxes

a) Current future income tax assets relate mainly to accrued liabilities, long-term future income tax assets relate mainly to employee future benefits and long-term future income tax liabilities relate mainly to property, plant and equipment.

b) The effective income tax rate differs from the basic federal and provincial rates due to the following:

	2001 %	2000 %
Basic federal rate less provincial deduction	29.12	29.12
Combined provincial tax rates	13.31	13.55
	42.43	42.67
Manufacturing and processing profit deduction	(8.09)	(7.31)
Other	2.05	0.64
Effective income tax rate	36.39	36.00

10 Employee future benefits

The Company offers employees benefits consisting of group health and dental care, life insurance and complementary retirement benefits. These plans are not funded.

a) The following information pertains to the Company's plans as established by independent actuaries:

	2001 $	2000 $
Change in accrued benefit obligation		
Balance – Beginning of year	**473,199**	415,037
Current year service costs	**27,972**	26,044
Interest on obligation	**35,893**	32,118
Benefit payments	**(4,021)**	—
Actuarial loss	**78,330**	—
Balance – End of year	**611,373**	473,199
Net obligation – End of year	**611,373**	473,199
Less: Unamortized net actuarial loss	**78,330**	—
Accumulated benefit obligation	**533,043**	473,199
Component of net benefit cost for the year		
Current year service cost	**27,972**	26,044
Interest on obligation	**35,893**	32,118
Net benefit cost	**63,865**	58,162

b) The significant actuarial assumptions are the following:

	2001	2000
Discount rate	**6.50%**	7.40%
Salary escalation rate	**4.50%**	4.50%

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2001. The rate was assumed to decrease gradually by 1% per year, to reach 5% in 2005 and remain at that level thereafter.

11 Contingencies and commitments

a) The Company has issued guarantees for $4,226,694 (December 31, 2000 – $4,572,384) under various bid and performance bonds.

b) As at December 31, 2001, the Company has issued no letter of credit for future purchases (December 31, 2000 – $1,478,225).

c) Future minimum payments under operating leases are as follows:

		$
Years ending December 31,	2002	500,936
	2003	333,090
	2004	85,576
	2005	70,000
	2006	70,000
Thereafter		2,000,000
		3,059,602

d) The Company's operations are subject to federal and provincial 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.

12 Financial instruments

Currency risks
The Company is exposed to currency risks due to its export of goods manufactured in Canada. These risks are partially covered by purchases.

Interest rate risks
As at December 31, 2001, the Company is exposed to an interest rate risk on long-term debt because 74% (December 31, 2000 – 61%) of the Company's long-term debt is at variable rates.

Credit risks
The geographic distribution of customers and procedures regarding commercial risk management limit the concentration of credit risks.

Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. The Company reduces this risk by dealing primarily with utility and telecommunications companies and other major corporations.

13 Related party transactions

The Company had the following transactions with related parties:

	2001	2000
	$	$
Parent company		
Marketing and technical service fees paid	**200,000**	200,000
Expenses charged	**—**	(200,000)
Ultimate shareholders		
Marketing and technical service fees paid	**100,000**	100,000
Interest on loans	**141,263**	140,634

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

As at December 31, the balance sheets include the following amounts with related parties:

	2001	2000
	$	$
Accounts payable to the parent company	**50,000**	50,000
Accounts payable to ultimate shareholders	**63,774**	89,763

14 Segmented information

The Company operates within one dominant business segment, the production and sale of pressure treated wood. Operating plants are located in Nova Scotia, Quebec, Ontario and British Columbia.

As at December 31, 2001, export sales amounted to $24,052,000 (2000 – $23,496,000), including $13,412,000 (2000 – $10,318,000) to the United States. The other export sales are attributed to various foreign countries located primarily in Central America, South America, the Middle East, Africa and Asia.

Directors

Richard Bélanger, C.A.
President and Chief Executive Officer,
Bois Daaquam Inc.
(Forest products company)
Sainte-Foy, Quebec

Tom A. Bruce Jones
Chairman of the Board and Chief
Executive Officer,
Stella-Jones Inc.
Chairman of the Board,
James Jones & Sons Limited
(Forest products company)
Larbert, Scotland

George J. Bunze
Vice-Chairman and
Chief Financial Officer
Kruger Inc.
(Manufacturer of specialty
wood and paper products)
Montreal, Quebec

Gianni Chiarva
Vice-Chairman of the Board,
Stella-Jones Inc.
President,
Stella S.p.A.
(Manufacturer of utility poles)
Chairman of the Board,
Sirti S.p.A.
(Designs, maintains and installs
telecommunications, transmission
and electrical systems)
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Corporate Director,
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Brian McManus
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Nycol Pageau-Goyette
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Executive Officer

Gianni Chiarva
Vice-Chairman of the Board

Brian McManus
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Vice-President, Finance

Marla Eichenbaum
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Bernard Lucas
Vice-President and General Manager,
Western Region

Gordon Murray
Vice-President, Environment and
Technology and General Manager,
Atlantic Region

Martin Poirier
General Manager, Central Region

Rémi Godin, C.G.A.
Comptroller

Subsidiary – Senior Management

Guelph Utility Pole Company Ltd.
Rick Thompson, General Manager

Transfer Agent and Registrar

Computershare Trust Company
of Canada

Auditors

PricewaterhouseCoopers LLP

Legal Counsel

Fasken Martineau DuMoulin LLP

Stock Information

Shares listed: Toronto Stock Exchange

Ticker symbol: SJ

Initial public offering: 1994

Majority Shareholder:
Stella Jones International S.A. (69%)

52-week high/low
(Jan. 1, 2001 – Dec. 31, 2001): $2.50/$1.80

Share price at March 14, 2002: $2.05

Common shares outstanding as at
December 31, 2001: 9.0 million

Dividend policy: The Board of Directors considers a dividend on an annual basis, conditional on profitability and cash availability. No dividend was declared for the year ended December 31, 2001.

	2001	2000	1999	1998	1997
Close	$2.00	$2.30	$2.50	$1.75	$ 2.00
Price/earnings	40.00	6.57	6.41	4.27	10.00
Price/book value	0.57	0.65	0.77	0.60	0.80

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