SET FOR PROFITABLE GROWTH

Annual Report 2003

Stella-Jones Inc.

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 specializes in providing 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 eight treating facilities and some 250 employees across Canada, the Company is the only producer of pressure treated wood products operating on a national scale and serving markets worldwide.

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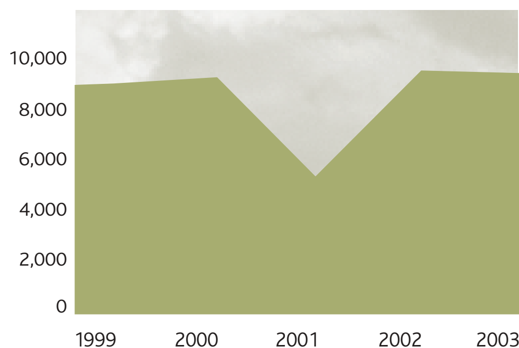
Our Operations

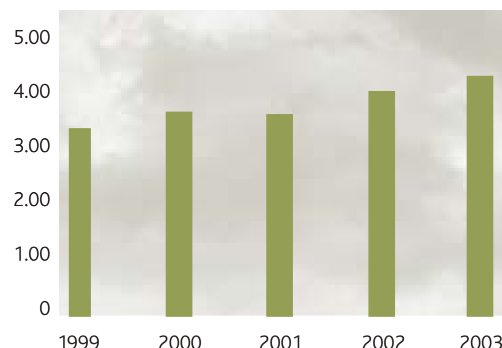
	Wood Poles	Railway Ties	Industrial Treated Wood	Consumer Lumber
Products	Poles Crossarms	Crossties Switchties	Foundation pilings Marine pilings Marine timbers Construction timbers Highway guardrail posts Bridge timbers	Wood board Lattice Fence board Plywood Dimensional lumber for use in patios, decks, fences and other outdoor applications
Wood Species	Red pine Jack pine Lodgepole pine Southern yellow pine Douglas fir Western red cedar	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)	Amine copper quaternary (ACQ)
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	Canada United States	Canada United States

Financial Highlights

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)
(thousands of dollars)



Book Value per Common Share
(dollars)



(thousands of dollars, except per share data and ratios) *For the years ended December 31*	**2003** **$**	2002 $	2001 $	2000 $	1999 $
Operating results					
Net sales	**92,033**	96,652	87,829	87,045	68,995
EBITDA[1]	**9,564**	9,620	5,045	8,928	8,732
Net earnings	**3,754**	3,721	488	3,156	3,625
Cash flow from operations[2]	**6,825**	5,818	3,064	5,287	4,870
Financial position					
Working capital	**25,874**	21,418	20,669	21,086	22,376
Total assets	**93,351**	69,436	80,854	74,494	57,994
Long-term debt[3]	**12,783**	7,028	11,843	10,618	8,917
Shareholders' equity	**42,286**	35,355	31,615	31,570	29,990
Per share data					
Net earnings per common share	**0.40**	0.41	0.05	0.35	0.39
Diluted net earnings per common share	**0.39**	0.41	0.05	0.35	0.37
Cash flow from operations[1,2]	**0.68**	0.64	0.34	0.59	0.53
Book value	**4.22**	3.91	3.50	3.53	3.24
Working capital	**2.58**	2.37	2.29	2.36	2.42
Average number of shares outstanding (000s)	**9,456**	9,048	9,002	9,028	9,298
Shares outstanding at year end (000s)	**10,013**	9,053	9,043	8,947	9,245
Average number of diluted shares outstanding (000s)	**9,628**	9,078	9,015	9,087	9,853
Dividend per share	**$0.08**	–	$0.07	$0.07	$0.07
Financial ratios					
Return on average equity	**9.7%**	11.1%	1.5%	10.3%	12.7%
Long-term debt[3] to equity	**0.30:1**	0.20:1	0.37:1	0.34:1	0.30:1

[1] *Earnings before interest, taxes, depreciation and amortization (EBITDA) and cash flow from operations per share are financial measures not prescribed by Canadian generally accepted accounting principles and are not likely to be comparable to similar measures presented by other issuers. Management considers them to be useful information to assist knowledgeable investors in evaluating the cash generating capabilities of the Company. EBITDA is derived from the Company's consolidated financial statements without adjustment for unusual or non-recurring items.*

[2] *Before change in non-cash working capital balances*

[3] *Including current portion*

Our Mission

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.

Chairman's Message

Forest products companies experienced another tough year in 2003, and Stella-Jones was no exception.

Of our main traditional markets, railway tie sales held up fairly well, but sales of wood poles were far short of forecast as utility companies deferred expenditures on replacement and refurbishment programs for their overhead line networks. Happily for future prospects, such programs cannot be indefinitely postponed if the integrity of these strategically important networks is to be maintained. Severe power outages over the past year in the U.S., Canada, Italy and United Kingdom should have delivered warnings to power utilities everywhere of the risks they run in failing to maintain service to their customers by deferring their maintenance projects.

Offsetting reductions in pole sales, our development of new business in consumer lumber in Ontario, Quebec and the Maritimes continued impressively in 2003. The acquisition of most of the assets of Cambium Group Inc. (Cambium), concluded on July 31, 2003, brought into the Stella-Jones orbit three additional treating facilities, together with additional timber cutting rights in Quebec. All the acquired assets and their key operating personnel were quickly integrated into Stella-Jones, and treating functions were successfully rationalized between the different plants to maximize production potential and optimize customer service.

The financial results for 2003 therefore include consolidation of figures from the former Cambium operations for the final five months of the year. While our net profit of $3.8 million was marginally higher than 2002's profit of $3.7 million, we believe that 2004 should show a significant improvement in profitability as we reap the full benefit of the synergies from the Cambium acquisition. The Board is therefore recommending payment on May 14, 2004 of an unchanged semi-annual dividend of $0.04 per share to shareholders of record on April 2, 2004.

We had a larger than usual capital expenditure program in 2003 at $3.8 million. By far, the largest item in this figure was $2.9 million for the installation of a thermal oxidizer at Delson to control air emissions and odours. This is further evidence of Stella-Jones' commitment to operate at or beyond the highest standards in the industry in Canada.

In May 2003, I proposed to the Board that I should relinquish my position as Chief Executive Officer (CEO) of Stella-Jones, whilst remaining Chairman. With effect from May 7, 2003, Brian McManus was appointed President and CEO. This fulfilled two purposes: to recognize Brian's sterling performance since joining the Company in June 2001, and to accord with best practices of corporate governance by splitting the roles of the Chairman and the CEO. As a further incentive for our President to continue to improve the performance of the Company, the Board also approved, subject to Toronto Stock Exchange and shareholder approval, a special share option program for him exercisable on or after May 6, 2008.

Two further senior management promotions were announced during the last twelve months: that of George Labelle to Senior Vice-President and Chief Financial Officer, and that of Martin Poirier to Vice-President and General Manager, Central Region. I congratulate both George and Martin, who, together with Gordon Murray, Vice-President, Environment and Technology and General Manager, Atlantic Region, played important roles in the speedy and successful closure of the Cambium negotiations.

Although I have singled out these three individuals for mention, I would also like on behalf of the Board to thank all our employees, including those who joined Stella-Jones in July 2003, for their commitment and contribution during an exciting year.

(Signed)

Tom A. Bruce Jones, CBE
Chairman of the Board

President's Message

During 2003, we continued to advance the key elements of our strategic plan. We focused on our core competencies, streamlined operations and made a significant acquisition, setting the stage for profitable growth in the years ahead.

Highlights
The Canadian market for wood poles remained soft throughout 2003, with many utilities postponing replacement and infrastructure upgrade plans. As a key industry player, these trends had a direct effect on our top line.

The softness in the wood pole market was mitigated by our ability to swiftly shift our focus to stronger markets, together with our operating flexibility, which allowed us to adjust our cost structure in the face of this unforeseen change in demand. Early in the year, we capitalized on our alliance with a major lumber wholesaler to successfully increase our share of the consumer treated wood market. This was due in large part to our reputation for superior customer service and the quality of custom treating we have been providing to the market.

Throughout the year, we maintained our drive to be the low-cost producer in the industry. This was accomplished by focusing on strategic markets, staying out of sectors in which we had limited competitive advantage and by continuously improving organizational efficiency.

Financial performance
The prevailing softness in our key market coupled with our strategic withdrawal from certain sectors of the overseas export market translated into lower revenues during the past fiscal year.

Sales slipped 4.8% during the year ended December 31, 2003, to $92.0 million compared with $96.7 million in 2002, with most of the decline occurring during the first half. Earnings increased to $3.8 million or $0.40 per share compared with $3.7 million or $0.41 per share in the previous year. The per share earnings decrease was due to the issuance of an additional 950,000 common shares in July 2003 as part of the Cambium acquisition described hereafter.

The Company significantly increased its liquidity during 2003 with working capital standing at $25.9 million at year-end compared with $21.4 million one year earlier.

The Cambium acquisition

A highlight of 2003 was our acquisition of the majority of the assets of Cambium Group Inc., a privately held producer and marketer of industrial treated wood products, which took effect on July 31, 2003.

The acquisition improved our market share by consolidating production with a major competitor in Eastern Canada. It also brought three additional treating plants into the Stella-Jones fold, two in Quebec and a third facility in Newfoundland.

These new treating facilities, which bring the Company's total to eight, will enable us to better serve our customers by specializing individual plant activities to increase efficiency.

The acquisition will also add approximately $20 million in revenues to our annual results and have a direct effect on our bottom line. Our balance sheet remains strong, since much of the purchase price was financed through the issuance of stock and long-term debt.

The newly acquired plants make an excellent strategic fit with our existing operations, by adding capacity without the encumbrance of additional overhead. Producing similar products and operating in similar markets, they offer numerous opportunities for generating synergies.

Measures have already been implemented to streamline and rationalize our new assets in order to bring them in line with Stella-Jones' strategic priorities and current operations. Benefits from these actions will begin to accrue in 2004.

Looking ahead

We are optimistic about the outlook for the utility pole market. The country's pole infrastructure is ageing, and many locations should see significant replacements in coming years.

Beyond the concrete measures that we have taken to accelerate top and bottom-line growth, our strong balance sheet gives a range of options for strategic growth.

Accordingly, we will continue to act as a market consolidator and will pursue acquisitions where conditions warrant – the fit must be good with existing operations, and the purchase must be accretive to earnings.

Thank you for your support

In conclusion, I want to offer a heartfelt welcome to our new employees who joined the Stella-Jones team during the past year. Your help in executing our business plan is much appreciated.

I also want to thank our other employees, customers, Board members and stakeholders for contributing to make 2003 a success. With your collective support and the progress made in 2003, we are confident that all the elements are in place to make 2004 even better.

(Signed)

Brian McManus
President and Chief Executive Officer

Management's Discussion and Analysis

This Management's Discussion and Analysis (MD&A) section provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2003 compared with the fiscal year ended December 31, 2002. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2003 and the notes thereto. Management's Statement of Responsibility for Financial Information and a description of the role of the Board of Directors and the Audit Committee in overseeing management in the performance of its responsibilities for financial reporting can be found on page 15 of this annual report.

The MD&A contains statements that are forward-looking in nature. Such statements involve known and unknown risks and uncertainties that may cause the actual results of the Company to be materially different from those expressed or implied by such forward-looking statements. Such items include, among others: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency rates and other factors referenced herein and in the Company's continuous disclosure filings.

The Company's audited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and are reported in Canadian dollars.

Operating results

Sales for the year ended December 31, 2003 were $92.0 million, a decrease of $4.7 million from last year's sales of $96.7 million. Sales include the five-month contribution of the operations of the three treating plants acquired from Cambium Group Inc. (Cambium) on July 31, 2003 (See Business acquisition on page 9). This contribution was offset by a $7.6 million reduction in overseas export sales and softness in domestic utility pole and railway tie sales. Sales of treating services for consumer lumber were up significantly in 2003 compared to 2002.

The reduction in overseas export sales was forecasted in last year's MD&A and, as anticipated, had little impact on the Company's overall profitability in 2003, given the low margins on the previous year's export sales.

In terms of product groups, railway tie sales were down approximately 10.3% compared to last year. In 2002, fourth quarter tie sales were unusually high as railroads took early deliveries of 2003 requirements, which was not repeated in the fourth quarter of this year. Domestic pole sales, despite the contribution of the new plants and an expanded customer base, were down approximately 3.1% versus 2002. In our estimation, utility customers did not take a sufficient quantity of poles in 2003 for their originally planned maintenance requirements.

Industrial treated wood sales were up approximately 38.4% compared to the prior year, reflecting the strong presence in this market previously held by Cambium. The addition of these new sales in the last five months of the year, coupled with the Company's existing strong position in the West Coast piling and marine markets, produced these improved results.

Residential lumber custom treating sales were up sharply in 2003, increasing 71.3%, due to our strategic alliance with a major lumber wholesaler and the early conversion of our consumer-dedicated production cylinders to the new preservative approved for consumer applications, Amine Copper Quaternary (ACQ). All our consumer treating plants were completely converted well in advance of Health Canada's phase out deadline of December 31, 2003 for treating with Chromated Copper Arsenate (CCA) in consumer applications. We also installed a new dedicated ACQ cylinder at our Guelph facility in early 2003. These parallel production facilities ensure that we have the required capacity to continue to treat utility poles with CCA, still an important and approved preservative for industrial applications.

Sales to the United States continue to represent a significant portion of our revenues, accounting for 17.5% or $16.1 million of sales in 2003, compared with $17.9 million or 18.5% of sales in 2002. It should be noted, however, that as our sales are reported in Canadian dollars, the conversion of U.S. dollar-denominated sales into Canadian dollars negatively impacted the dollar figure reported to shareholders for 2003.

In terms of volume, sales to the United States were only down approximately 2.2% compared with last year, despite the competitive disadvantage of a stronger Canadian dollar on new business. However, a number of longer-term pole supply and railway tie contracts with U.S. power utilities and railroads are hedged for currency exposure to ensure satisfactory margins.

Gross margin increased to 16.2% of sales in 2003, compared to 15.4% in 2002. This improvement reflects the full year effect of the cost reductions, operational efficiencies and product rationalizations completed in 2002.

Selling and administrative expenses totalled $5.0 million for the year, down marginally from the $5.2 million incurred in the prior year, despite the additional overhead costs associated

Selected annual information

For the years ended December 31 *(thousands of dollars, except per share data)*	**2003** **$**	2002 $	2001 $
Net sales	**92,033**	96,652	87,829
Net earnings	**3,754**	3,721	488
Net earnings per common share	**0.40**	0.41	0.05
Diluted net earnings per common share	**0.39**	0.41	0.05
Total assets	**93,351**	69,436	80,854
Total long-term debt[1]	**12,783**	7,028	11,843
Dividend per share	**0.08**	–	0.07

[1] *Including current portion*

Sales by product
(% of revenues)

Wood poles	52%
Railway ties	26%
Industrial treated wood	12%
Consumer lumber	10%

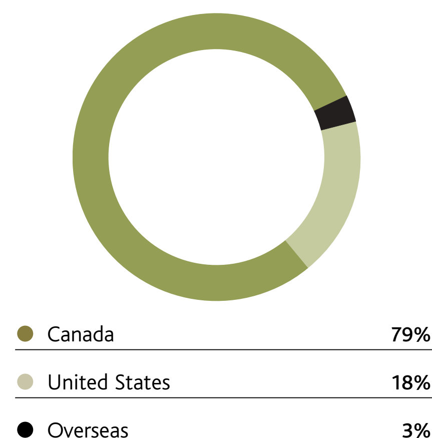
with the operations of the three acquired treating plants in the last five months of the year. We have been successful in integrating these treating plants without adding significant new selling expenses, given the similarity in our markets and products. The incremental costs of providing administrative services for the combined entities has benefited from economies of scale and other synergies, as most general management personnel were not part of the acquired staff. We are also seeing the full annual effects of the staff reductions introduced in the latter part of 2001 in our pre-acquisition plants.

The impact on operating earnings from the changes in foreign exchange rates, primarily the weakening of the U.S. dollar, was a foreign exchange loss of $385,000 in fiscal 2003, an increase of $307,000 over the foreign exchange loss of $78,000 in 2002. The Company monitors its transactions in U.S. dollars, and our basic hedging activity consists of entering into forward exchange contracts for the sale of U.S. dollars and by purchasing certain goods and services in U.S. dollars. We will also consider forward exchange contracts for the purchase of U.S dollars for significant purchases of goods and services that are not covered by natural hedges. At December 31, 2003, the Company had on hand foreign exchange contracts for the future sale of U.S. dollars totalling $9,000,000 at rates ranging from C$1.4820 to C$1.6125/US$1.00 (average – C$1.5866 /US$1.00), and expiry dates ranging from April 2004 to December 2007 and foreign exchange contracts for the future purchase of U.S. dollars totalling $2,200,000 at rates ranging from C$1.3090 to C$1.3140/US$1.00 and expiry dates ranging from January 2004 to April 2004. The unrecognized net foreign exchange gain on these contracts totalled approximately $1,700,000 as at December 31, 2003, compared to an unrealized loss of $269,000 at year-end 2002.

Amortization of property, plant and equipment amounted to $2.6 million in 2003, an increase of $162,000 over 2003, reflecting the additional amortization of the property, plant and equipment acquired on July 31, 2003.

Financial expenses amounted to $1.3 million for the year ended December 31, 2003, unchanged from the $1.3 million incurred for the corresponding period in 2002. In the first half of the year, our improved financial condition allowed us to both reduce our general overall borrowing levels and to negotiate lower rates on our bank operating line and term loan. With the additional borrowings in July 2003 to finance our acquisition and the related increase in working capital requirements, we finished the year with a comparable expense to 2002.

Sales by geographic region
(% of revenues)



Canada	79%
United States	18%
Overseas	3%

Income tax expense was $1.8 million for 2003, a decrease of $169,000 from the previous year, and represented an effective tax rate of 33%.

Net earnings totalled $3.8 million, or $0.40 per share in 2003, compared with $3.7 million, or $0.41 per share in 2002. The per share earnings decrease was due to the issuance of an additional 950,000 common shares in July 2003 as part of the financing for the Cambium acquisition.

Business acquisition

On July 31, 2003, the Company acquired most of the assets of Cambium, a privately held producer and marketer of pressure treated wood products, primarily in the industrial market. Assets acquired included treating plants in Gatineau (Quebec) and Sorel-Tracy (Quebec), a pole-peeling plant in Senneterre (Quebec), as well as all related inventories and accounts receivable. The acquisition also comprised all the shares of I.P.B.-W.P.I. International Inc. (I.P.B.), a wholly owned subsidiary of Cambium which operates a treating plant in Clarenville (Newfoundland). The purchase price totalled $15.3 million, of which approximately $14.1 million was for the net assets acquired from Cambium and $1.2 million was for the shares of I.P.B.

The operations of the three acquired treating plants in the period from August 1, 2003 to December 31, 2003 are included in the consolidated operating results for the year ended December 31, 2003. The acquisition has been accretive to earnings and we expect an improvement in the contribution from these operations in 2004 as a result of lower average raw material costs and operational efficiencies. The integration of the new plants has gone smoothly, and by year end, we had effectively completed our plans and preparations for streamlining and specializing production amongst our eight treating plants.

Quarterly results

The table below presents selected financial information for the Company's last eight quarters ending with the most recently completed financial year:

Quarterly results

2003

For the quarters ended (thousands of dollars, except per share data)	**March 31 $**	**June 30 $**	**Sept. 30 $**	**Dec. 31 $**	**Total $**
Net sales	**19,079**	**27,203**	**24,419**	**21,332**	**92,033**
Operating earnings before amortization of property, plant and equipment[1]	**1,611**	**3,484**	**2,526**	**1,944**	**9,565**
Operating earnings[1]	**1,017**	**2,888**	**1,814**	**1,210**	**6,929**
Net earnings	**500**	**1,662**	**934**	**658**	**3,754**
Net earnings per common share	**0.06**	**0.18**	**0.10**	**0.06**	**0.40**
Diluted net earnings per common share	**0.06**	**0.18**	**0.09**	**0.06**	**0.39**

2002

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
Net sales	21,681	32,481	22,553	19,937	96,652
Operating earnings before amortization of property, plant and equipment[1]	1,856	3,508	2,387	1,869	9,620
Operating earnings[1]	1,245	2,896	1,755	1,252	7,148
Net earnings	511	1,622	923	665	3,721
Net earnings per common share	0.06	0.18	0.10	0.07	0.41
Diluted net earnings per common share	0.06	0.18	0.10	0.07	0.41

[1] *Operating earnings before amortization of property, plant and equipment and operating earnings are financial measures not prescribed by Canadian generally accepted accounting principles (GAAP) and are not likely to be comparable to similar measures presented by other issuers. Management considers they represent useful information for comparison with other similar operations in our industry, as they present financial results related to industry practice, not affected by non-cash charges or capital structures. Operating earnings before amortization of property, plant and equipment and operating earnings are readily reconcilable to net earnings presented in our Canadian GAAP financial statements, as there are no adjustments for unusual or non-recurring items.*

The quarterly results of the past two fiscal years demonstrate the usual seasonal pattern of our operations. The second and third quarters provide the strongest revenue and operating results, as pole, tie and industrial lumber users take delivery of their products during this period for their summer maintenance and construction projects. Consumer lumber treatment sales also follow the same seasonal pattern.

Fourth quarter results

Sales for the fourth quarter of 2003 amounted to $21.3 million, an increase of $1.4 million over the $19.9 million of sales in the fourth quarter of the prior year. The majority of the sales increases were in the industrial treated wood sector and in domestic utility pole sales. These improvements were offset by declines in export and tie sales in the fourth quarter of 2003 versus 2002.

Gross margins were down approximately 2.7% in the quarter compared to last year, reflecting changes in product mix that was weighted toward lower margined industrial treated wood sales.

The fourth quarter results showed a net profit of $658,000 or $0.06 per share, versus a net profit of $665,000 or $0.07 per share in the fourth quarter of 2002.

Liquidity and capital resources

The increase in current assets of $13.6 million as at December 31, 2003 versus December 31, 2002 is principally the result of the inventory increases associated with the three new treating plants and increased tie inventories required for 2004 contracted sales. The increase in property, plant and equipment of $10.2 million represents the property, plant and equipment acquired from Cambium and the purchase of new property, plant and equipment during 2003.

The increase in current bank indebtedness of $8.3 million in the period from December 31, 2002 to December 31, 2003 results from the use of our operating line to finance a portion of the Cambium acquisition and to support the increase in our inventory levels for 2004. Shortly after year end, we borrowed an additional $4,000,000 under a new term loan arrangement and these funds served to reduce our operating line by the same amount. There are no capital payments required under this new loan until January 2005. The increased levels of accounts payable and accrued liabilities as at December 31, 2003, an increase of $3.8 million over the amount owing as at December 31, 2002, are consistent with the additional inventory requirements for the increased activity expected in 2004.

Cash flow from operations for the year ended December 31, 2003 was $6.8 million, an increase of $1.0 million from the $5.8 million generated in the same period in 2002. The cash flow required for changes in working capital resulting from the Cambium acquisition brought total cash from operating activities to $4.9 million in fiscal 2003, down from the $11.1 million generated from operating activities as at the end of last year.

The Company's acquisition for cash of the majority of the assets of Cambium on July 31, 2003, was the primary use of funds in 2003. Financing for this transaction totalling $15.3 million was provided by a private placement with a shareholder of the seller of 950,000 common shares of the Company at a price of $4.10 per share ($3.9 million), as well as 190,000 warrants permitting the subscription to an equivalent number of common shares of the Company, exercisable at any time until July 31, 2008. The shareholder also subscribed to a non-convertible and unsecured five-year debenture in the amount of $2,500,000 bearing interest at a rate of 8% a year. The balance of the purchase price was financed through the Company's existing operating line and a new $4,000,000 term loan.

The Company's available operating line was increased by $5,000,000 in July 2003 and, as at December 31, 2003, stood at $30,000,000. The operating line is renewable on an annual basis. The Company also entered into a second bank credit facility in July 2003 which comprises a non-revolving term loan of $4,000,000 that was borrowed in connection with the Cambium acquisition and a term loan facility of $1,000,000 to finance future acquisitions of property, plant and equipment. Subsequent to year end in January 2004, the Company borrowed an additional $4,000,000 by way of a non-revolving bank term loan to finance future capital acquisitions. The Company therefore has in place sufficient capital resources to finance its planned capital acquisition program for fiscal 2004 and to adequately support its current working capital requirements. The Company is in full compliance with all its financial covenants.

Working capital at December 31, 2003 was $25.9 million, an increase of $4.5 million over the working capital of $21.4 million as at December 31, 2002. The Company's current ratio was 1.72:1 at year end versus 1.80:1 one year earlier. This ratio was further improved with the long-term borrowing of $4,000,000 in January 2004. Our long-term debt to equity ratio, which was 0.20:1 as at December 31, 2002, increased to only 0.30:1 as at December 31, 2003, due to the use of both long-term debt and equity to finance the Cambium acquisition.

Another major use of cash in 2003 was for capital expenditures, which totalled $3.8 million for the twelve-month period ended December 31, 2003, compared to the $1.4 million spent in 2002. The largest expenditure was an environmental investment of $2.9 million at our Delson (Quebec) plant to improve and augment the air and wastewater treatment capacities. This expenditure exceeded last year's estimate included in the MD&A, as the project was expanded to include enhancements to our steam generating capabilities to reduce heating costs. During 2003, we also completed the conversion to ACQ treating systems at our Sorel-Tracy and Delson plants in Quebec, as well as our Guelph plant in Ontario. Capital projects required to comply with Environment Canada's Technical Recommendations Documents (TRDs) were undertaken at our Truro (Nova Scotia) and Sorel-Tracy (Quebec) plants. As at December 31, 2003, the Truro and Sorel-Tracy facilities were approaching full TRD compliance. All our other plants are on track to meet the TRD compliance deadline of December 31, 2005. The major environmental project at Delson was financed through a new mortgage loan, maturing November 2008.

Our contractual obligations for future payments are outlined in the table below:

Contractual obligations

(thousands of dollars)	Payments due by period				
	Total $	Less than 1 year $	1 – 3 years $	4 – 5 years $	After 5 years $
Long-term debt	12,345	2,235	3,784	6,326	–
Capital lease obligations	481	264	169	48	–
Operating leases	2,734	595	419	240	1,480
Total contractual obligations	15,560	3,094	4,372	6,614	1,480

Year 2002 compared to 2001
The sales increase of $8.8 million in 2002 compared with 2001 was the result of a strong railway tie and domestic utility pole market. Treating services for consumer lumber also posted a 31.5% year-over-year increase in the period.

The net earnings improvement of $3.2 million in 2002 compared with 2001 reflects the results of the strategic operations review undertaken in the latter part of 2001 and the continuation of the cost-reduction program begun in 2000. The Company's focus on core product lines and cost containment produced improved gross margins and reduced overhead costs.

In the period from December 31, 2001 to December 31, 2002, the Company reduced its inventory levels by $10.3 million, which accounted for the majority of the total asset reduction of $11.4 million in 2002. This reduction was a result of the Company's strategic operations review which saw the Company exit certain product sectors and optimize inventory stocking levels at each plant.

The funds generated by improved net earnings in 2002 were used to reduce long-term debt, which declined by $4.8 million from December 31, 2001 to December 31, 2002.

Share and stock option information
As at March 12, 2004, the capital stock issued and outstanding consisted of 10,018,011 common shares (9,053,100 as at December 31, 2002 and 10,012,961 as at December 31, 2003).

As at March 12, 2004, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 494,760 (December 31, 2003 – 499,810), of which 356,476 (December 31, 2003 – 355,526) were exercisable. Effective May 6, 2003 and subject to future regulatory and shareholder approval, the Company granted to its President and Chief Executive Officer, under a Stock Option Agreement, 300,000 options to acquire an equivalent number of common shares at an exercise price of $2.99 per share. The Stock Option Agreement also provides the President with the option of receiving cash in lieu of shares. None of these options are currently exercisable.

Dividends
The Company decided in March 2002 that, in light of the reduced profitability in 2001 and the liquidity requirements of 2002, there would be no cash dividend paid in 2002.

On March 18, 2003, with the return to higher profitability in 2002 and solid expectations for 2003, the Company announced a modification to its dividend policy whereby, going forward, the Board of Directors would consider a dividend on a semi-annual rather than on an annual basis. Immediately following the adoption of this policy amendment, the Company declared its first semi-annual dividend of $0.04 per common share. On August 22, 2003 and March 16, 2004, the Board of Directors again declared semi-annual dividends of $0.04 per common share.

The declaration, amount and date of any future dividends will continue to be considered by the Board of Directors of the Company based upon and subject to the Company's earnings and financial requirements, any covenants in its loan documentation and other conditions prevailing at the time. There can be no assurance as to the amount or timing of such dividends in the future.

Risks and uncertainties
Management considers that the Company may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. Nevertheless, the Company's 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 significant investments toward that end, will allow the Company to continue to meet the applicable regulatory requirements.

The Company is exposed to currency risks due to its export of goods manufactured in Canada. These risks are partially covered by purchases of goods and services denominated in U.S. dollars. The Company also uses foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars.

Critical accounting policies and estimates
The Company's significant accounting policies are described in note 1 to the December 31, 2003 audited consolidated financial statements.

The Company prepares its consolidated financial statements in conformity with Canadian generally accepted accounting principles, which require 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 reported 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.

The Company's inventory valuation involves an important degree of complexity and estimates are required with respect to the provision for slow-moving stock. A change in the estimation of the adequacy of this provision, or important declines in the value of inventory, could therefore have an impact on the financial statements.

The Company's operations are subject to Federal and provincial environmental laws and regulations, governing, among other matters, our emissions, waste management and wastewater effluent discharges. The Company takes measures and provides in its accounts the estimated costs to comply with such laws and regulations. However, the estimated costs and measures taken are subject to the uncertainties of changing legal requirements, enforcement practices and developing technological processes.

Changes in accounting policies
During 2002, the Company adopted, on a prospective basis, the new recommendations of the Canadian Institute of Chartered Accountants (CICA) related to the accounting for stock-based compensation and other stock-based payments. In accordance with the transitional provisions, the Company adopted the new recommendations for awards granted after January 1, 2002.

Impact of accounting pronouncements not yet implemented

In 2003, there were no new accounting recommendations from the CICA to be applied by the Company. However, certain recommendations will affect the 2004 fiscal year and accordingly, management has chosen to disclose the known effects of accounting pronouncements not yet implemented in the consolidated financial statements. These changes are described in note 2 to the December 31, 2003 audited consolidated financial statements.

Related party transactions

In 2003, the Company had transactions with related parties totalling $376,500 (2002 - $376,500) as detailed in note 13 to the December 31, 2003 audited consolidated financial statements.

These transactions were with the majority shareholder, Stella Jones International S.A. (marketing services), and the ultimate shareholders, Stella S.p.A and James Jones and Sons Ltd. (technical services and interest on loans). The majority shareholder and ultimate shareholders have extensive international experience in the forest products and wood treating industries, and management considers the amounts paid with respect to the various transactions to be reasonable and competitive.

Outlook

We begin the year 2004 with a strong order book for railway ties and a larger customer base for our domestic utility pole business. We have made the necessary investment in plant and equipment to ensure that we can efficiently supply our growing consumer lumber markets in Eastern Canada with the latest generation in preservation technologies, without jeopardizing our ability to treat for and service our industrial customers. The acquisition of three additional treating facilities in 2003 has enabled us to specialize and streamline our production capabilities. We believe we are at optimum inventory levels to service forecasted demand and our wood supply is secure for the medium to long-term. Our balance sheet and cash situation is healthy and with a long-term debt to equity ratio of 0.30:1, our current financing arrangements are more than adequate to handle our internal requirements as well as any investment opportunities.

In 2004, we should reap the benefits of the cost reduction program now firmly entrenched in all our plants, as well as the full annual impact of acquisition-related synergies. Our goal remains to be the lowest cost operator in our industry, for the long-term benefit of our employees, our customers and our shareholders.

March 16, 2004

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 Canadian generally accepted accounting principles. 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 three unrelated non-management 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, which recommended their approval by the Board of Directors.

(Signed)

Brian McManus
President and Chief Executive Officer

(Signed)

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

Westmount, Quebec
March 16, 2004

Auditors' Report

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheets of Stella-Jones Inc. as at December 31, 2003 and 2002 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, 2003 and 2002 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
March 16, 2004

Consolidated Financial Statements

Consolidated Balance Sheets

As at December 31, 2003 and 2002	**2003** $	2002 $
Assets		
Current assets		
Accounts receivable (notes 4 and 7(d))	**11,973,823**	11,865,391
Inventories (notes 5 and 7(d))	**48,578,915**	34,999,891
Prepaid expenses	**532,925**	416,815
Future income taxes (note 9(a))	**610,000**	798,000
	61,695,663	48,080,097
Property, plant and equipment (notes 6 and 7(c))	**31,383,850**	21,150,575
Future income taxes (note 9(a))	**271,000**	205,000
	93,350,513	69,435,672
Liabilities		
Current liabilities		
Bank indebtedness (note 7(a))	**19,527,592**	11,183,913
Accounts payable and accrued liabilities	**13,683,318**	9,852,010
Income taxes	**136,478**	1,731,829
Current portion of long-term debt (note 7)	**2,474,636**	3,894,104
	35,822,024	26,661,856
Long-term debt (note 7)	**10,308,220**	3,133,821
Future income taxes (note 9(a))	**4,149,000**	3,678,000
Employee future benefits (note 10)	**785,517**	607,099
	51,064,761	34,080,776
Shareholders' Equity		
Capital stock (note 8)	**20,439,188**	16,499,561
Retained earnings	**21,846,564**	18,855,335
	42,285,752	35,354,896
	93,350,513	69,435,672

Approved by the Board of Directors

(Signed)

Tom A. Bruce Jones, CBE
Director

(Signed)

Richard Bélanger, FCA
Director

Consolidated Financial Statements

Consolidated Statements of Earnings

For the years ended December 31, 2003 and 2002	**2003** $	2002 $
Net sales	**92,032,713**	96,652,333
Expenses		
Cost of sales	**77,100,871**	81,798,301
Selling and administrative	**4,982,196**	5,156,050
Foreign exchange loss	**385,358**	77,664
Amortization of property, plant and equipment	**2,634,918**	2,472,592
	85,103,343	89,504,607
Operating earnings	**6,929,370**	7,147,726
Financial expenses (note 7(h))	**1,329,590**	1,332,150
Earnings before income taxes	**5,599,780**	5,815,576
Provision for (recovery of) income taxes (note 9(b))		
Current	**1,486,839**	2,381,000
Future	**359,161**	(286,000)
	1,846,000	2,095,000
Net earnings for the year	**3,753,780**	3,720,576
Net earnings per common share (note 8(b))	**0.40**	0.41
Diluted net earnings per common share (note 8(b))	**0.39**	0.41

Consolidated Statements of Retained Earnings

For the years ended December 31, 2003 and 2002	**2003** $	2002 $
Balance – beginning of year	**18,855,335**	15,134,759
Net earnings for the year	**3,753,780**	3,720,576
	22,609,115	18,855,335
Dividends on common shares	**762,551**	–
Balance – end of year	**21,846,564**	18,855,335

Consolidated Financial Statements

Consolidated Statements of Cash Flows

For the years ended December 31, 2003 and 2002	**2003** **$**	2002 $
Cash flows from		
Operating activities		
Net earnings for the year	**3,753,780**	3,720,576
Adjustments for		
Amortization of property, plant and equipment	**2,634,918**	2,472,592
Gain on disposal of property, plant and equipment	**(21,977)**	(163,700)
Employee future benefits	**81,823**	74,056
Stock-based compensation	**17,300**	–
Future income taxes	**359,161**	(286,000)
	6,825,005	5,817,524
Change in non-cash working capital components		
Decrease (increase) in		
Accounts receivable	**5,216,110**	(1,487,613)
Inventories	**(3,317,937)**	10,315,891
Prepaid expenses	**34,206**	1,507,269
Income taxes	**–**	459,097
Increase (decrease) in		
Accounts payable and accrued liabilities (note 6(b))	**(2,297,416)**	(7,227,945)
Income taxes	**(1,576,013)**	1,731,829
	(1,941,050)	5,298,528
	4,883,955	11,116,052
Financing activities		
Increase (decrease) in bank indebtedness	**8,343,679**	(5,046,836)
Increase in long-term debt	**9,980,032**	6,436,023
Repayment of long-term debt	**(7,294,190)**	(11,251,457)
Proceeds from issuance of common shares	**3,922,327**	19,361
Dividends	**(762,551)**	–
	14,189,297	(9,842,909)
Investing activities		
Business acquisition (note 3)	**(15,306,235)**	–
Purchase of property, plant and equipment (note 6(b))	**(3,788,994)**	(1,436,843)
Proceeds from disposal of property, plant and equipment	**21,977**	163,700
	(19,073,252)	(1,273,143)
Net change in cash and cash equivalents during the year	**–**	–
Cash and cash equivalents – beginning and end of year	**–**	–
Supplemental disclosure		
Interest paid	**1,313,337**	1,314,977
Income taxes paid	**3,308,932**	215,748

Notes to Consolidated Financial Statements

December 31, 2003 and 2002

1 Significant accounting policies

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries, Guelph Utility Pole Company Ltd. and, since July 31, 2003 (note 3), I.P.B. – W.P.I. International Inc., using the purchase method.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian 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 equipment	10 to 20 years
Rolling stock	5 to 10 years
Anti-pollution equipment	10 to 20 years
Office equipment	2 to 5 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.

Notes to Consolidated Financial Statements

1 Significant accounting policies (continued)

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.

Stock-based compensation and other stock-based payments
The Company uses the fair value based approach for stock-based payments to non-employees and has chosen to record an expense for the stock options granted to its employees using the fair value method. Any consideration paid by the plan participants on the exercise of stock options or the purchase of shares will be credited to stated capital together with any related stock-based compensation expense.

Stock-based compensation expense is recognized over the vesting period for the options. The contributed surplus component of the stock-based compensation is transferred to capital stock upon the issuance of common shares.

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.

Financial instruments
The Company enters into foreign exchange forward contracts to limit its exposure under contracted net cash inflows and outflows of U.S. dollars. These contracts are treated as hedges. The exchange gains or losses related to these contracts, together with related hedging costs, are included in sales or cost of sales, as appropriate, when the underlying hedged transaction is completed.

2 Changes in accounting policies

During 2002, the Company adopted, on a prospective basis, the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") related to the accounting for stock-based compensation and other stock-based payments. In accordance with the transitional provisions, the Company adopted the new recommendations for awards granted after January 1, 2002 (note 8(e)).

Impact of accounting pronouncements not yet implemented

Generally accepted accounting principles and financial statement presentation
In July 2003, the CICA issued new Handbook sections 1100, "Generally Accepted Accounting Principles", and 1400, "General Standards of Financial Statement Presentation". Section 1100 describes what constitutes Canadian Generally Accepted Accounting Principles ("Canadian GAAP") and its sources and provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures when a matter is not dealt with explicitly in the primary sources of Generally Accepted Accounting Principles. Section 1400 provides general guidance on financial statement presentation and further clarifies what constitutes fair presentation in accordance with Canadian GAAP. These recommendations are effective for years beginning on or after October 1, 2003.

The Company records delivery costs as a reduction of gross sales to determine net sales in accordance with industry practice. In 2003, delivery costs amounted to $4,511,290 (2002 – $8,975,136). Effective January 1, 2004, these costs will be recorded under cost of sales, as industry practices are no longer permitted under the new Canadian GAAP hierarchy. Upon adoption, the Company does not expect these recommendations to have any other significant impact on its consolidated financial statements.

2 Changes in accounting policies (continued)

Impact of accounting pronouncements not yet implemented (continued)

Hedging relationships
The new CICA accounting guideline relating to hedging relationships must be applied to hedging relationships in effect in fiscal years beginning on or after July 1, 2003. This accounting guideline addresses the identification, designation, documentation and effectiveness of the hedging relationships for the purpose of applying hedge accounting. In addition, it deals with the discontinuance of hedge accounting and establishes conditions for applying hedge accounting. Under this guideline, documentation of the information related to hedging relationships is required and the effectiveness of the hedges must be demonstrated and documented. Effective January 1, 2004, the Company had in place all necessary hedge documentation to be able to apply hedge accounting for its foreign exchange forward contracts.

3 Business acquisition

On July 31, 2003, the Company acquired most of the assets of Cambium Group Inc., a privately held producer and marketer of pressure treated wood products, primarily in the industrial market. Assets acquired included production plants in Gatineau, Quebec, and Sorel–Tracy, Quebec, a pole-peeling plant in Senneterre, Quebec, as well as all related inventories, accounts receivable and timber cutting rights. The acquisition also included all of the shares of Cambium Group Inc.'s wholly owned subsidiary, I.P.B. – W.P.I. International Inc., which operates a pressure treated wood plant in Clarenville, Newfoundland. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on their estimated fair value as of the acquisition date. The results of operations of all these acquired plants have been included in the consolidated financial statements from the acquisition date. The following is a summary of the net assets acquired at fair values:

	$
Assets acquired	
Current assets	15,755,283
Property, plant and equipment	8,493,800
	24,249,083
Liabilities assumed	
Current liabilities	5,625,393
Long-term debt	2,987,021
Future income taxes	233,839
Employee future benefits	96,595
	8,942,848
	15,306,235
Consideration	
Cash, including transaction costs of $670,351	15,306,235

Financing for the transaction was provided by the issuance of 950,000 common shares of the Company at a price of $4.10 per share, as well as warrants permitting the subscription to 190,000 additional common shares at an exercise price of $4.10 per share on or before July 31, 2008, under a separate agreement with a shareholder of Cambium Group Inc. A nil value was attributed to the warrants using the Black-Scholes option pricing model. The Company also issued to the same shareholder a non-convertible and unsecured five-year debenture in the amount of $2,500,000, bearing interest at a rate of 8% a year and repayable in one instalment of $2,500,000 on July 31, 2008. The balance of the purchase price was financed through the Company's existing bank operating line and a new $4,000,000 term loan.

Notes to Consolidated Financial Statements

4 Accounts receivable

	2003 $	2002 $
Trade	**10,966,638**	11,632,608
Other	**1,007,185**	232,783
	11,973,823	11,865,391

5 Inventories

	2003 $	2002 $
Raw materials	**35,109,824**	23,740,652
Finished goods	**13,469,091**	11,259,239
	48,578,915	34,999,891

6 Property, plant and equipment

		2003	
	Cost $	**Accumulated amortization** $	**Net** $
Land	**978,872**	**–**	**978,872**
Buildings	**6,301,414**	**1,473,534**	**4,827,880**
Production equipment	**28,811,819**	**11,156,403**	**17,655,416**
Rolling stock	**1,534,173**	**1,205,473**	**328,700**
Anti-pollution equipment	**10,173,997**	**2,675,812**	**7,498,185**
Office equipment	**668,718**	**573,921**	**94,797**
	48,468,993	**17,085,143**	**31,383,850**

		2002	
	Cost $	Accumulated amortization $	Net $
Land	810,572	–	810,572
Buildings	3,909,659	1,202,413	2,707,246
Production equipment	22,415,111	9,330,662	13,084,449
Rolling stock	1,095,862	1,037,080	58,782
Anti-pollution equipment	6,778,131	2,345,726	4,432,405
Office equipment	591,468	534,347	57,121
	35,600,803	14,450,228	21,150,575

a) Property, plant and equipment include assets under capital leases with a cost of $607,390 and accumulated amortization of $313,537 (2002 – $1,449,665 and $958,734 respectively).

b) During the year, property, plant and equipment were acquired at an aggregate cost of $4,374,393 (2002 – $1,610,437), of which $859,533 (2002 – $356,202) was acquired by assuming directly related accounts payable and accrued liabilities and $82,068 (2002 – nil) by means of capital leases. Cash payments of $3,788,994 (2002 – $1,436,843) were made for property, plant and equipment purchases.

c) As at December 31, 2002, the net carrying value of property, plant and equipment not yet in service was $2,912,899 (2002 – $1,022,022).

Notes to Consolidated Financial Statements

7 Long-term debt

	2003 $	2002 $
Non-revolving term loans (note 7(a))	**4,000,000**	2,500,000
Unsecured and non-convertible debenture, bearing interest at 8%, repayable on July 31, 2008	**2,500,000**	–
Loans from ultimate shareholders, unsecured and subordinated, bearing interest at 8.5%, repayable on demand after the repayment of the debenture and term loans	**900,000**	900,000
Promissory note (note 7(b))	**681,250**	1,226,250
Mortgage loans (note 7(c))	**3,791,422**	2,026,042
Obligations under capital leases (note 7(g))	**437,688**	375,633
Term note, bearing interest at 4.75%, payable in monthly instalments of $8,333 and maturing in March 2008	**424,017**	–
Loan, non-interest bearing, payable in monthly instalments of $4,040 and and maturing in December 2004	**48,479**	–
	12,782,856	7,027,925
Less: current portion	**2,474,636**	3,894,104
	10,308,220	3,133,821

a) The Company has available two bank credit facilities, one comprising a demand operating loan of $30,000,000, which includes a bid and performance bond guarantee facility of up to a maximum of $5,000,000, a demand revolving line of credit of $9,726,000 for the purchase of forward exchange contracts with an aggregate nominal amount of $25,000,000 and a non-revolving term loan of $1,250,000. The second facility comprises a non-revolving term loan of $4,000,000 that was borrowed in connection with the business acquisition (note 3) and a term loan facility of $1,000,000 to finance future purchases of property, plant and equipment.

   The demand operating loan bears interest at the bank's prime rate plus 0.50%. The non-revolving term loan of $1,250,000 was repaid in December 2003 and bore interest at the bank's prime rate plus 1%.

   The non-revolving term loan of $4,000,000 bears interest at prime rate plus 1.25%, is repayable in eighteen quarterly instalments of $222,222 beginning May 1, 2004, and matures August 1, 2008.

   The term loan facility of $1,000,000, once disbursed, will be repayable in 60 monthly payments of $16,667.

   As security for the demand operating loan, the bank holds a first ranking moveable hypothec over the universality of the Company's property, subject to the priority interest under the second facility on certain property, plant and equipment acquired in the business acquisition (note 3), and a first ranking security under Section 427 of the Bank Act. The security for the $4,000,000 non-revolving term loan consists of a first ranking immovable hypothec on the immovable property acquired in the business acquisition (note 3) and a second ranking moveable hypothec on all other assets of the Company, excluding accounts receivable and inventories. The Company must also respect certain covenants relating to its two bank credit facilities.

   On January 15, 2004, the Company entered into a new bank credit facility for a non-revolving capital loan of $4,000,000, which was disbursed on January 21, 2004. This loan will bear interest at the bank's prime rate plus 1%. The loan is repayable in quarterly instalments of $444,333 beginning January 31, 2005 and matures January 31, 2007.

b) Pursuant to the acquisition of Guelph Utility Pole Company Ltd. in 2000, 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%, repayable in quarterly instalments of $136,250 and maturing in March 2005.

7 LONG-TERM DEBT (CONTINUED)

c) The mortgage loans bear interest at a weighted average rate of 5.8% as at December 31, 2003 (December 31, 2002 – 6.7%) and certain specific property, plant and equipment with a net book value of $7,180,890 (December 31, 2002 – $3,524,588) have been pledged as collateral. The loans are repayable in monthly instalments and mature at various dates to November 2008.

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 $12,481,355 as at December 31, 2003 (December 31, 2002 – $6,928,433) 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 five years to meet retirement provisions is as follows:

		$
Years ending December 31,	2004	2,235,351
	2005	2,005,008
	2006	1,778,880
	2007	1,551,436
	2008	4,774,493
		12,345,168

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

		$
Years ending December 31,	2004	263,402
	2005	105,125
	2006	63,987
	2007	20,496
	2008	27,737
Total future minimum lease payments		480,747
Less: interest (weighted average rate of 7.4%)		43,059
Balance of obligation		437,688
Less: current portion		239,136
		198,552

h) Financial expenses are detailed as follows:

	2003 **$**	2002 $
Interest on long-term debt	**495,383**	313,165
Other interest	**834,207**	1,018,985
	1,329,590	1,332,150

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

	2003		2002	
	Shares	**$**	Shares	$
Balance – Beginning of year	**9,053,100**	**16,499,561**	9,043,462	16,480,200
Private placement (note 3)	**950,000**	**3,895,000**	–	–
Share purchase plan	**9,861**	**27,327**	9,638	19,361
	10,012,961	**20,421,888**	9,053,100	16,499,561
Stock-based compensation (note 8(e))	**–**	**17,300**	–	–
Balance – End of year	**10,012,961**	**20,439,188**	9,053,100	16,499,561

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, warrants and other dilutive securities.

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

	2003	2002
Net earnings applicable to common shares	**$3,753,780**	$3,720,576
Weighted average number of common shares outstanding	**9,455,658**	9,047,741
Effect of dilutive stock options	**172,062**	30,032
Weighted average number of diluted common shares outstanding	**9,627,720**	9,077,773
Net earnings per common share	**$0.40**	$0.41
Diluted net earnings per common share	**$0.39**	$0.41

The warrants issued in 2003 have not been included in the calculation above as they do not have a dilutive effect on earnings per share.

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 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, 180 days following the date on which such optionee ceases to be a director of the Company.

8 Capital stock (continued)

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

	2003		2002	
	Number of options	**Weighted average exercise price $**	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	**499,810**	**2.19**	499,095	2.19
Granted	**–**	**–**	30,000	2.00
Cancelled	**–**	**–**	(29,285)	2.04
Outstanding – End of year	**499,810**	**2.19**	499,810	2.19
Options exercisable – End of year	**355,526**	**2.21**	284,884	2.23

The following options were outstanding under the Stock Option Plan as at December 31, 2003:

	Options outstanding			**Options exercisable**	
Year granted	**Number of options**	**Weighted average exercice price $**	**Number of options**	**Weighted average exercice 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**	**15,000**	**1.93**	**2008**
2000	**15,000**	**2.20**	**12,000**	**2.20**	**2010**
2001	**308,210**	**2.16**	**184,926**	**2.16**	**2011**
2002	**30,000**	**2.00**	**12,000**	**2.00**	**2012**
	499,810		**355,526**		

d) Stock Option Agreement
On May 6, 2003, with the objective of assisting the Company in recognizing the significant contributions that the Company's President and Chief Executive Officer ("President") has made to the Company, and in order to provide incentives for him to continue to make significant contributions to the Company, 300,000 options were granted to the President under a Stock Option Agreement. These options are subject to the approval of the Toronto Stock Exchange and are conditional upon shareholder approval.

The Stock Option Agreement provides that the options are exercisable at a price of $2.99 in whole or in part, commencing on May 6, 2008, or earlier in the event of a loss or change in control of the Company, the closing of a going private transaction, or the occurrence of termination without cause (each one being a "Triggering Event"). The Stock Option Agreement also provides the President with the option of receiving cash in lieu of shares. The right to exercise these options terminates on May 6, 2013 or, in the case of a Triggering Event, within thirty days of the event.

8 Capital stock (continued)

e) Stock-based compensation
The Company records expenses for the fair value of the stock options granted under the Stock Option Plan and the Stock Option Agreement using the Black-Scholes option pricing model. This model determines the fair value of stock options granted and amortizes it to earnings over the vesting period.

In 2003, the fair value of options granted was $80,500 (2002 – $5,700) and the expense amortized to earnings was $17,300 (2002 – nil). The fair value was estimated with the following weighted average assumptions:

	2003	2002
Risk-free interest rate	**4.5%**	4.5%
Dividend yield	**2.5%**	2.5%
Expected lives (years)	**8**	7
Volatility	**5.1%**	5.1%
Weighted average of fair value of options granted during the year	**$0.27**	$0.19

f) 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 2003, 9,861 shares (2002 – 9,638) were issued under this plan at an average price of $2.77 per share (2002 – $2.01). As at December 31, 2003, the total number of shares issued under this plan is 104,190 (December 31, 2002 – 94,329).

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. 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:

	2003	2002
	%	%
Basic Federal rate less provincial deduction	**29.12**	29.12
Combined provincial tax rates	**11.99**	11.43
	41.11	40.55
Manufacturing and processing profit deduction	**(7.58)**	(6.98)
Other	**(0.56)**	2.45
Effective income tax rate	**32.97**	36.02

Notes to Consolidated Financial Statements

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:

	2003	2002
	$	$
Change in accrued benefit obligation		
Balance – Beginning of year	**789,792**	611,373
Current year service costs	**46,629**	36,421
Interest on obligation	**44,678**	41,048
Benefit payments	**(13,881)**	(4,307)
Acquisitions	**96,595**	–
Amendments	**20,619**	–
Actuarial loss (gain)	**(138,069)**	105,257
Balance – End of year	**846,363**	789,792
Net obligation – End of year	**846,363**	789,792
Less: Unamortized net actuarial loss	**41,454**	182,693
Unamortized past service costs	**19,392**	–
Accumulated benefit obligation	**785,517**	607,099
Component of net benefit cost for the year		
Current year service cost	**46,629**	36,421
Interest on obligation	**44,678**	41,048
Amortization of net actuarial loss	**3,170**	894
Amortization of past service costs	**1,227**	–
Net benefit cost	**95,704**	78,363

b) The significant actuarial assumptions are the following:

	2003	2002
	%	%
Discount rate	**6.00**	6.50
Salary escalation rate	**4.00**	4.50

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2003. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%.

Notes to Consolidated Financial Statements

11 Contingencies and commitments

a) The Company has issued guarantees amounting to $1,386,715 (December 31, 2002 – $2,738,034) under various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on and, as such, no provisions have been recorded in the financial statements.

b) Future minimum payments under operating leases related to land, equipment and rolling stock are as follows:

		$
Years ending December 31,	2004	595,315
	2005	235,360
	2006	183,387
	2007	148,020
	2008	92,287
	Thereafter	1,480,000
		2,734,369

c) 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. The Company also uses foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars. Sale prices on export contracts are generally established well in advance of shipment dates and, in order to protect margins from currency fluctuations, the Company sells forward the U.S. dollars to be received. Purchase prices for goods sourced from American suppliers are usually established at the order date and are also subject to currency fluctuations in the period from the date ordered to the date received. To manage this risk, the Company purchases forward the U.S. dollars required to pay these suppliers. As at December 31, 2003, the forward exchange sales contracts aggregate a nominal amount of US$9,000,000 (December 31, 2002 – US$13,000,000), with expiry dates ranging from April 2004 to December 2007, and contracted rates ranging from 1.4820 to 1.6125. As at December 31, 2003, the forward exchange purchase contracts aggregate a nominal amount of US$2,200,000 (December 31, 2002 – nil), with expiry dates ranging from January 2004 to April 2004, and contracted rates ranging from 1.3090 to 1.3140. As at December 31, 2003, the net unrealized foreign exchange gain on these contracts was $1,699,595 (December 31, 2002 – net unrealized loss of $269,000).

Interest rate risks

As at December 31, 2003, the Company is exposed to an interest rate risk on long-term debt because 37% (December 31, 2002 – 53%) 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 telecommunication companies and other major corporations.

Notes to Consolidated Financial Statements

13 Related party transactions

The Company had the following transactions with related parties:

	2003 **$**	2002 $
Parent company		
Marketing and technical service fees paid	**200,000**	200,000
Ultimate shareholders		
Marketing and technical service fees paid	**100,000**	100,000
Interest on loans	**76,500**	76,500

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:

	2003 **$**	2002 $
Accounts payable to parent company	**50,000**	50,000
Accounts payable to ultimate shareholders	**63,774**	63,774

14 Segment information

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

In 2003, export sales amounted to $18,541,000 (2002 – $28,004,000), including $16,084,000 (2002 – $17,855,000) to the United States. Other export sales are to various foreign countries located in Central America, South America, the Middle East and Africa.

In 2003, the Company had one customer representing 11% of its sales (2002 – 11% of sales).

15 Comparative figures

Certain comparative figures have been reclassified in order to comply with the basis of presentation adopted in the current year.

Directors and Officers

Board of Directors

Richard Bélanger, FCA [1]
Senior Vice-President,
Eastern Operations and
Corporate Development,
Canfor Corporation
(Forest products company)
President and
Chief Executive Officer,
Bois Daaquam Inc.
(Forest products company)
Sainte-Foy, Quebec
Director since 1997

Tom A. Bruce Jones, CBE
Chairman of the Board,
Stella-Jones Inc.
Chairman of the Board,
James Jones & Sons Limited
(Forest products company)
Larbert, Scotland
Director since July 1993

George J. Bunze [1][2]
Vice-Chairman,
Kruger Inc.
(Manufacturer of specialty wood and paper products)
Montreal, Quebec
Director since May 2001

Gianni Chiarva [2]
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)
Milan, Italy
Director since July 1993

Arthur P. Earle, C.M., F.E.I.C. [1] [3]
Corporate Director,
Beaconsfield, Quebec
Director since October 1992

Brian McManus
President and
Chief Executive Officer,
Stella-Jones Inc.
Westmount, Quebec
Director since June 2001

Nycol Pageau-Goyette [2][3]
President and
Chief Executive Officer,
Pageau Goyette et
associés limitée
(Management services firm)
Chairperson,
Sorinco inc.
(Recycling facility)
Montreal, Quebec
Director since July 1993

Daniel Picotte [3]
Partner,
Fasken Martineau DuMoulin LLP
(Law firm)
Montreal, Quebec
Director since July 1993

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[1] Member of the Audit Committee
[2] Member of the Remuneration Committee
[3] Member of the Environmental Committee

A full report of Stella-Jones' corporate governance practices is set out in the Management Proxy Circular for the Annual and Special Meeting of Shareholders.

Officers

Tom A. Bruce Jones, CBE
Chairman of the Board

Gianni Chiarva
Vice-Chairman of the Board

Brian McManus
President and
Chief Executive Officer

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

Marla Eichenbaum
General Counsel and Secretary

Bernard Lucas
Vice-President and General
Manager, Western Region

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

Martin Poirier
Vice-President and General
Manager, Central Region

Rémi Godin, C.G.A.
Comptroller

Subsidiaries

Rick Thompson
General Manager,
Guelph Utility Pole Company Ltd.

Robert Tilley
General Manager,
I.P.B. – W.P.I. International Inc.
d.b.a. Newfoundland Hardwoods

Transfer Agent and Registrar

Computershare Trust Company
of Canada

Auditors

PricewaterhouseCoopers LLP

Legal Counsel

Fasken Martineau DuMoulin LLP

Corporate Information

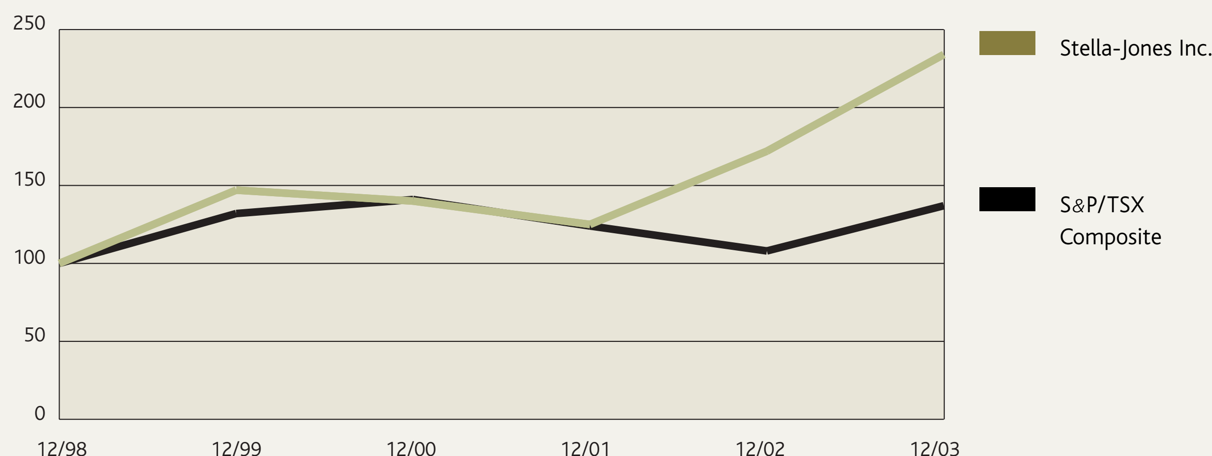
Annual and Special Meeting of Shareholders
May 6, 2004
9:30 a.m.
Hotel Inter-Continental Montreal
Salon Saint-Jacques
360 Saint Antoine Street West
Montreal, Quebec

Stock Information
Shares listed: Toronto Stock Exchange
Ticker symbol: SJ
Initial public offering: 1994
Majority shareholder: Stella Jones International S.A. (62%)
52-week high/low (Jan. 1 – Dec. 31, 2003): $3.65/$2.57
Share price at March 16, 2004: $4.10
Common shares outstanding as at December 31, 2003: 10.01 million

Dividend policy
On March 18, 2003, the Board of Directors adopted a new dividend policy whereby a dividend would be considered on a semi-annual rather than an annual basis, conditional upon the Company's financial performance and cash requirements. In light of the Company's performance in fiscal 2003 and solid expectations for 2004, the Board of Directors declared semi-annual dividends of $0.04 per common share on both March 18, 2003 and August 22, 2003. On March 16, 2004, the Board once again declared a semi-annual dividend of $0.04 per common share.

Comparison of 5-Year Cumulative Total Return*

Between Stella-Jones Inc. and the S&P/TSX Composite Index



* *$100 invested on December 31, 1998 in stock or index – including reinvestment of dividends. Fiscal year ending December 31.*

Cumulative Total Return

	1999	2000	2001	2002	**2003**
Close	$2.50	$2.30	$2.00	$2.75	**$3.65**
Price/earnings ratio	6.4	6.6	40.0	6.7	**9.1**
Price/book value	0.77	0.65	0.57	0.70	**0.86**

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