stella-jones

annual report 2004

Profile

Stella-Jones Inc., a leading manufacturer and supplier of pressure treated wood products for North America's infrastructure requirements, was incorporated in 1992. Since then, it has grown to become the leading Canadian manufacturer of industrial pressure treated wood products and a major supplier of custom pressure treating services to the residential lumber market. The Company's focus on low cost production and customer service has fuelled its significant organic growth, and a number of strategic acquisitions have further strengthened its position as the only national operator of pressure treating facilities. The Company operates seven treating facilities and employs approximately 225 people in five provinces.

Stella-Jones specializes in four major product categories: treated wood poles for utility and telecommunication companies; railway ties for rail transportation companies; industrial treated wood products for construction and maritime applications; and consumer treated lumber products for the residential market.

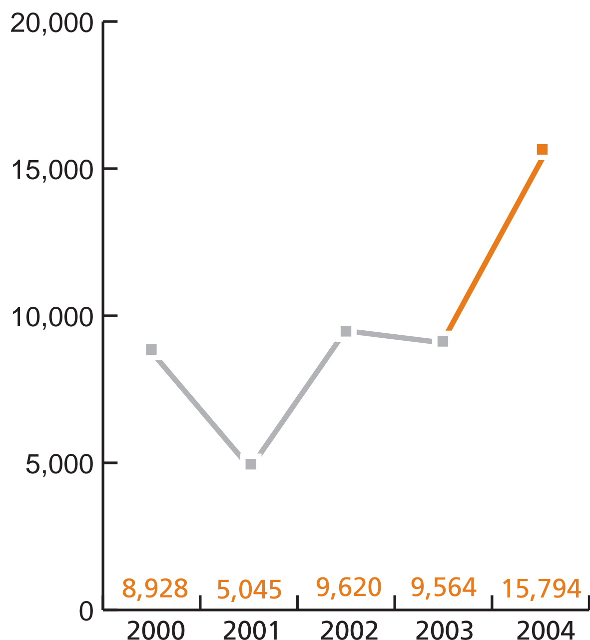
The treatment of lumber and timbers with wood preservatives to increase their resistance to bio-deterioration is almost exclusively done through pressure processes and mature technologies that have been around for more than 100 years. Stella-Jones' strategy for creating shareholder value within this mature market is two-fold: to make strategic acquisitions that are driven by product and operational synergies; and, through the resulting economies of scale, to reduce internal operating costs. Moreover, Stella-Jones focuses on markets where it can grow the domestic business organically through its national distribution network rather than increase market share through predatory pricing.

With its increased scale and national coverage, Stella-Jones is uniquely suited to cater to the specific needs of customers in the transportation, telecommunications and utilities industries. Stella-Jones has rationalized capacity and developed specialized centres that can respond quickly and efficiently to customer demands for products anywhere in the country.

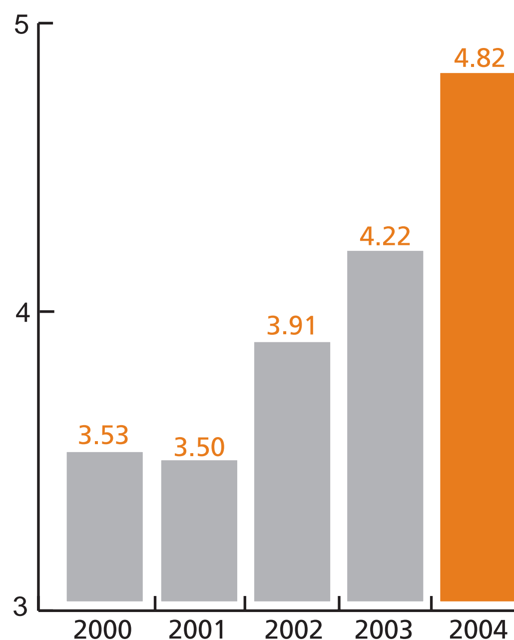
The maintenance of infrastructure is a significant market opportunity with long-term value — from the replacement of utility poles and railway ties to the supply of highway guide rail posts and bridge and wharf timbers. Treated wood products are less costly to produce, more environmentally friendly, and can outperform steel or concrete alternatives, thus ensuring their role for the long term in the national infrastructure.

Stella-Jones intends to maintain its leadership position in this industry by growing through acquisition, securing sources of sustainable wood supply, maintaining low operating costs and respecting its employees and the environment.

Financial Highlights



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



Book Value per Common Share
(dollars)

Achievements for 2004

- Surpassed the $125 million mark in revenues
- Increased net earnings by 94.2% to $7.3 million
- Improved gross margin from 15.5% to 18%

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Chairman's Message

Tom
A. Bruce Jones, CBE

I expressed the belief in my message to shareholders with the 2003 accounts that 2004 "should show a significant improvement in profitability as we reap the full benefit of the synergies from the Cambium acquisition". Even allowing for the fact that the assets bought from Cambium Group Inc. impacted only five months of Stella-Jones' 2003 results compared with the full year results in 2004, profitability in 2004 was exceptionally good. This proves, I believe, that our overall business strategy and our operating systems are robust and sound, and that we have skilled and pro-active management well able to cope both with the day-to-day demands of a continuing business and with new developments.

In 2004, Stella-Jones also completed the acquisition of certain wood treating assets of *Les Industries Légaré (1998) Ltée* (Légaré), based in St. Raymond, Québec. All treatment was switched to Stella-Jones' sites and one of the Légaré treating cylinders has been re-installed at our Truro, Nova Scotia plant. This is further evidence of our objectives of both consolidating what was a fragmented industry and offering comprehensive and cost-effective products and services to our customers.

It was particularly encouraging that in 2004 all sectors of Stella-Jones' business were strong. Pole sales in the previous year were very slow but improved substantially, especially in the second half of 2004. Demand for railway ties continued to be good and industry analysts

anticipate strength in this sector both in Canada and the USA in the next years. Our treated residential lumber sales also grew through our fruitful partnership in Ontario, Québec and the Maritimes. Despite the weakness of the U.S. dollar, exports to the U.S. market were substantially the same as in 2003, and the Company's currency exposure to the U.S. dollar is largely hedged by purchases of raw material from south of the border.

In December, Rick Thompson was promoted from General Manager to Vice-President of Guelph Utility Pole Company Ltd., based in Ontario. At the same time, Wayne Hingley was appointed General Manager of the New Westminster and Prince George plants in British Columbia, following the retirement in September of Ben Lucas, Vice-President Western Region, after 34 years of service in the business.

Shareholders will be pleased that Stella-Jones' share price has at last started to properly reflect the strengths of the Company and its unique position as the major player in a genuine niche market in the forest products sector. Sales have been brisk in the early months of 2005, and prospects look to be encouraging for the year as a whole. The Board is therefore recommending an increase in the Corporation's next semi-annual dividend to $0.05 per share, payable on May 16, 2005 to shareholders of record on April 4, 2005.

Brian McManus, our President and CEO, and his whole team have done a fine job in bringing solid organic growth to Stella-Jones and in smoothly absorbing two acquisitions. On behalf of the Board, I thank all our employees for their contributions in 2004.

(Signed)

Tom A. Bruce Jones, CBE
Chairman of the Board

President's Message

When I assumed the presidency of Stella-Jones in June of 2001, we set in motion a series of strategic plans that would ultimately change Stella-Jones in fundamental ways and generate increased shareholder value in the Company. I am pleased to report that those plans have helped us to achieve what we consider to be a significant milestone in the history of Stella-Jones.

For the first time ever, Stella-Jones has surpassed the $125.0 million mark in revenues. Sales grew 33.6% during the year ended December 31, 2004, to $129.0 million compared with $96.5 million in 2003.

That would be noteworthy in itself were it not for the fact that net earnings also increased by more than 94% compared to last year. Net earnings increased to $7.3 million or $0.72 per share compared with $3.8 million or $0.40 per share in the previous year. As a result of this performance, our Board of Directors has resolved to increase our May 16, 2005 semi-annual dividend to $0.05 per common share.

Stella-Jones' achievement must be appreciated in the context of the current state of the industry. Demand remains soft in our key utility pole market as some of our larger customers continue to defer portions of their expenditures on infrastructure maintenance and upgrade. Despite this, we have been able to increase our top line performance through synergistic acquisitions, and improve our bottom line performance by strategic management of capacity and reduced operating costs.

Clearly our strategy of reducing costs through economies of scale is working. It also means that we are on track to solidify our competitive position as the leading low cost producer of high quality treated wood products in our industry.

In 2004 we remained true to our strategy. During the year, we managed to consolidate our capacity to an optimal level. Ours is a seasonal industry with the added challenge of relatively long lead times (six to nine months) to allow our products to air-dry and be ready for market. Therefore, our production scheduling must be finely tuned in order to achieve profitable operating levels. In that regard, we have shifted production to specialty centres that better meet the demand requirements of our customers.

In April 2004, Stella-Jones acquired certain wood treating assets of *Les Industries Légaré (1998) Ltée*, including inventories and all the production equipment related to pressure treated wood operations. In addition to increasing our traditional customer base, this $2.0 million acquisition also gave us access to a new product line, borate treatment for the interior wood framing market.

Mergers and acquisitions are an important growth strategy for Stella-Jones. We will continue to act as a market consolidator. However, there are a number of additional growth opportunities that, if properly exploited, can bring increased revenues and earnings to the Company. A few of these include:

- The pent-up demand in our key market, utility poles. The average age of installed utility poles is continually rising and there will come a point when major upgrades will be required.
- The growth potential in our other key market, railway ties. The congestion of North America's railway grid will likely require a return to increased double tracking and new railway sidings to allow passing traffic.
- The potential for growth in our consumer lumber business. Our reputation as a quality treater, evidenced by our dominance in the exacting industrial market, our ACQ production capacity and our national presence will allow us to exploit this potential.

Stella-Jones can also increase the value of its products by focusing on creating value within the organization. Increased scale brings continuing opportunities to lower costs and increase efficiencies. As we grow, we will seek out these opportunities as we continue to foster an operational culture of superior client service at the lowest possible cost.

Indeed, Stella-Jones is becoming a different company with each acquisition. I believe we have an exciting future in our new role as a larger, more efficient supplier of treated wood products. We look forward to 2005 with optimism and the awareness that our recent successes should not lead us to complacency. We are confident in the knowledge that over the past few years, Stella-Jones has emerged as a market leader.

I want to thank our employees, customers, Board members and stakeholders who have contributed to the outstanding success of 2004.

(Signed)

Brian McManus
President and Chief Executive Officer

4 Product Categories

Preservatives Used in Treated Wood

Wood preservation relies on the introduction of chemicals into the wood to render it impervious to natural degradation processes. Wood preservatives consist of two components: one part is the preservative, that repels the living organisms that use wood as their food source; the other part, typically water or oil, carries the preservative into the wood cells.

Creosote: This oil-based preservative is unique because it is both carrier and preservative. The oldest industrial wood treating preservative, it is produced from the high temperature carbonization of bituminous coal.

Pentachlorophenol: Pentachlorophenol is an oil-borne solution that is created by reacting phenol with chlorine. Pentachlorophenol is widely used in utility poles because of its effectiveness in repelling organisms.

CCA: Chromated copper arsenate, a waterborne solution, is a highly effective preservative based on chemical elements that occur naturally throughout the earth's crust and atmosphere. Proper fixation of CCA to wood products virtually eliminates the potential for leaching into the environment during its lifetime of use.

ACZA: Ammoniacal copper zinc arsenate is a waterborne preservative that, because of its superior penetration properties, is highly effective in the treatment of Douglas fir.

ACQ: Amine copper quaternary is a recently introduced waterborne preservative used for the treatment of lumber destined for the consumer market.

1 Wood Poles

Treated wood poles are the preferred choice for use in transmission and distribution lines by both utility and telecommunication companies. Treated wood poles are more economical to manufacture, transport and maintain than alternative products such as steel, concrete and composites. Linemen generally prefer wood poles because of climbability, manoeuvrability, as well as low conductivity.

Wood Species
Red pine
Jack pine
Lodgepole pine
Southern yellow pine
Douglas fir
Western red cedar

Preservatives
Chromated copper arsenate (CCA)
Pentachlorophenol
Creosote
Ammoniacal copper zinc arsenate (ACZA)

Railway Ties 2

The creosote pressure treated wood crosstie has been the very foundation of the North American railroad for more than 175 years. Of the approximately 19 million railway ties sold each year in North America, 90% are treated wood. Demand for ties has strengthened in recent years as a result of the increased maintenance required by higher traffic loads and a return to the use of double tracking in the more congested rail corridors.

Wood Species
Maple
Oak
Birch
Red pine
Jack pine
Lodgepole pine
Hemlock

Preservatives
Creosote
Creosote/oil

3 Consumer Lumber

The current boom in new housing starts and home renovations has created significant demand for Stella-Jones' treated wood products. Typically, exterior finishing projects such as wood decks and fencing follow 18-24 months after new house construction. Sales of existing homes are also a strong indicator of renovation spending, since households generally undertake renovations within the first three years of buying a house. Stella-Jones supplies wood board, lattice, fence board, plywood and dimensional lumber for use in patios, decks, fences and other outdoor applications to major lumber retail chains.

Wood Species
White pine
Red pine
Jack pine
Fir

Preservatives
Amine copper quaternary (ACQ)
Borates

Industrial Treated Wood 4

Industrial treated wood products include marine pilings and timbers, foundation pilings, construction timbers, highway guide rail posts and bridge timbers. Wood used in and over freshwater and marine environments is subject to the harshest of conditions, and unless treated, constant wetting and dampness can result in rot, decay, marine borer attack or corrosion.

Wood Species
Hemlock
Douglas fir
Red pine
Jack pine
Lodgepole pine
Western red cedar

Preservatives
Chromated copper arsenate (CCA)
Pentachlorophenol
Creosote
Ammoniacal copper zinc arsenate (ACZA)
Borates

5-year Review

(thousands of dollars, except per share data and ratios) For the years ended December 31	**2004** **$**	2003 $	2002 $	2001 $	2000 $
Operating results					
Sales [1]	**128,972**	96,544	105,627	96,065	94,002
EBITDA [2]	**15,794**	9,564	9,620	5,045	8,928
Net earnings	**7,291**	3,754	3,721	488	3,156
Cash flow from operations [3]	**10,919**	6,825	5,818	3,064	5,287
Financial position					
Working capital	**36,582**	25,874	21,418	20,669	21,086
Total assets	**98,200**	93,351	69,436	80,854	74,494
Long-term debt [4]	**16,184**	12,783	7,028	11,843	10,618
Shareholders' equity	**49,285**	42,286	35,355	31,615	31,570
Per share data					
Net earnings per common share	**0.72**	0.40	0.41	0.05	0.35
Diluted net earnings per common share	**0.70**	0.39	0.41	0.05	0.35
Cash flow from operations [2,3]	**1.07**	0.68	0.64	0.34	0.59
Book value	**4.82**	4.22	3.91	3.50	3.53
Working capital	**3.57**	2.58	2.37	2.29	2.36
Average number of shares outstanding (000s)	**10,082**	9,456	9,048	9,002	9,028
Shares outstanding at year end (000s)	**10,235**	10,013	9,053	9,043	8,947
Average number of diluted shares outstanding (000s)	**10,355**	9,628	9,078	9,015	9,087
Dividend per share	**0.08**	0.08	–	0.07	0.07
Financial ratios					
Return on average equity	**15.9%**	9.7%	11.1%	1.5%	10.3%
Long-term debt [4] to equity	**0.33:1**	0.30:1	0.20:1	0.37:1	0.34:1

1 Since 2004, freight costs are no longer included as a reduction from sales; accordingly, sales for 2000 to 2003 have been restated to reflect this change.
2 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 ("GAAP") 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.
3 Before change in non-cash working capital balances.
4 Including current portion.

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") dated March 16, 2005 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2004 compared with the fiscal year ended December 31, 2003. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2004 and the notes thereto. The audited consolidated financial statements and MD&A have been reviewed by the Company's Audit Committee and, upon its recommendation, have been approved by the Board of Directors.

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. Additional information, including the Company's annual information form, quarterly and annual reports, and supplementary information is available on SEDAR at **www.sedar.com.** Press releases and other information are also available in the Financial Information section of the Company's Web site at **www.stella-jones.com.**

Our business

Stella-Jones is the leading Canadian producer of industrial pressure treated wood products and a major supplier of custom pressure treating services to the residential lumber market.

The Company specializes in four major product categories: treated wood poles for utility and telecommunication companies; railway ties for rail transportation companies; industrial treated wood products for construction and maritime applications; and treated consumer lumber products for the residential market.

The Company operates seven wood treating plants and two distribution centres. These nine facilities are located in British Columbia, Ontario, Québec, Nova Scotia and Newfoundland. The Company's workforce currently numbers approximately 225 employees.

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.

2004 overview

The year ended December 31, 2004 compared to the prior year was marked by unprecedented sales growth of 33.6% and, more importantly, a 94.2% improvement in net earnings. All four major product categories posted sales and gross margin increases in 2004 compared to 2003. For the second year in a row, the Company also grew by acquisition. In April 2004, the Company purchased for cash of approximately $2.0 million, certain wood treating assets of Québec-based *Les Industries Légaré (1998) Ltée* ("Légaré") (See Business acquisition section below). This further demonstrates our commitment to the wood preserving industry and our stated objective of being an industry consolidator. We significantly improved our cash flows from operating activities during the year, increasing from $6.8 million in 2003 to $10.9 million in 2004. Our balance sheet as at December 31, 2004 remains strong, with an enviable long-term debt to equity ratio of 0.33:1. We believe our prospects for additional sales and margin growth from our core businesses in 2005 are excellent. We also possess the financial capacity and resources to allow us to take advantage of any external opportunities for growth.

Selected annual information

For the years ended December 31	**2004**	2003	2002
(thousands of dollars, except per share data)	**$**	$	$
Sales	**128,972**	96,544	105,627
Net earnings	**7,291**	3,754	3,721
Net earnings per common share	**0.72**	0.40	0.41
Diluted net earnings per common share	**0.70**	0.39	0.41
Total assets	**98,200**	93,351	69,436
Total long-term debt*	**16,184**	12,783	7,028
Dividend per share	**0.08**	0.08	-

*Including current portion

Sales by product group

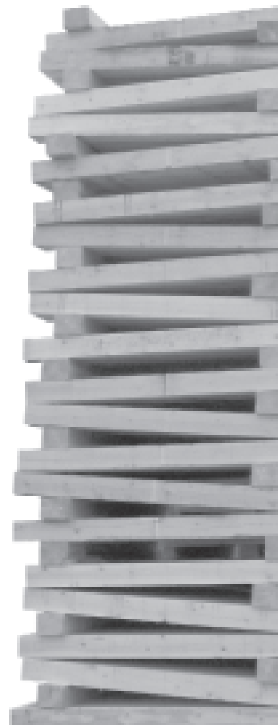
Utility poles

Domestic utility pole sales reached $57.0 million in 2004, an increase of $9.3 million or 19.5% over the 2003 sales of $47.7 million. The major Canadian utilities, as has been the case over the last decade, have continued a policy of purchasing replacement poles only when inspection determines that a pole's reliability has been compromised, either by extreme age or visual decay. There has been a trend away from preventive maintenance programs, most likely due to budget restrictions. There are 12 to 14 million treated wood utility poles in service in Canada. Stella-Jones currently sells about 125,000 poles each year in Canada, representing approximately 44% of our total revenues. The average age of an installed treated wood pole continues to climb, now between 35 and 40 years in a typical system. The total life expectancy of a treated wood pole can be as high as 60 years, depending on usage (stress) and conditions (weather), but this is unusual and 40 to 50 years is the consensus average. In suburban and urban locations, a growing number of poles are either overloaded or near their capacity. We believe the current purchasing levels, particularly in the face of the highly publicized infrastructure failures following last year's severe weather conditions, is not sustainable and that a return to a preventive maintenance model will eventually result in higher annual demands for utility poles.

Export utility pole sales, which exclude sales to the United States discussed separately below, totalled $2.8 million in 2004, compared to $3.3 million in the prior year. As reported in previous MD&A's, going forward, overseas export sales will not be a target core market, although we will continue to monitor export trends through our international contacts and affiliations. On the West Coast, we do have a small but growing market for large transmission poles destined for the overseas export market, but they are sold through local contractors and agents. These sales are included in domestic operations.

Railway ties

Railway tie sales totalled $38.6 million in 2004, an increase of $14.4 million over 2003 sales of $24.2 million. Our sales results in this product group mirror the strong performances in the rail transport sector, which has recently seen record growth in its traffic loads. Maintenance requirements, installation of double tracking and new siding construction have all contributed to the increase in demand. This growth is not just confined to Class 1 (major) railroads, as we have also been successful in increasing our sales to short line customers and to operators of dedicated lines in the mining sector. Our ability to service clients from several plants, a financial base that allows us to stockpile and air-season green wood for major long-term contracts and a long-standing stable source of wood supply are the key growth drivers in this product category. On the cost side, plant specialization and increased volumes through dedicated production facilities have enabled us to maintain competitive pricing.



Industrial treated wood

Industrial treated wood sales increased to $19.0 million in 2004, up from $11.9 million in 2003, an increase of 59.7%. We significantly increased our customer base in the Maritimes with the acquisition of Cambium Group Inc. ("Cambium"), which enjoyed a strong presence in the Newfoundland marine market, and in 2004 we benefited from a complete year's sales to these new customers, versus only five months in 2003. The West Coast piling and marine markets, which includes a significant U.S. client base, also performed well for us this year despite the negative impact on revenues when converting U.S. dollar sales to the relatively stronger Canadian dollar in 2004 compared to 2003. We continue to actively participate in industry initiatives to demonstrate the environmental safety and effectiveness of wood pilings for ocean marine projects, and the

economic advantage of wood versus steel in the foundation piling market. We also picked up additional industrial treated wood sales with the acquisition of Légaré in April 2004. Légaré had developed a small but growing niche market for the Borate treatment of dimensional lumber used in the interior wood framing market. Borates are particularly effective against termites and many prefab housing manufacturers export their product to areas susceptible to such damage. We have installed the Borate treating system purchased from Légaré at our plant in Sorel-Tracy, Québec.

Consumer lumber

Consumer lumber custom treating sales continued as a growth market in 2004 as we added to the network of retail outlets that carry our products. Total sales climbed from $9.5 million in 2003 to $11.5 million in 2004. Our strategic alliance with a major lumber wholesaler that supplies the wood and manages the retail distribution channels has been a driving force behind this expansion. We service the Québec, Ontario and Maritime markets with Amine Copper Quaternary ("ACQ") treating services. ACQ is the new waterborne preservative that has captured the major market share of the preservatives approved for residential lumber treating. Its introduction followed the December 2003 Canadian and U.S. wood treating industry's voluntary phase-out of the use of Chromated Copper Arsenate ("CCA") as a preservative for treating lumber used in consumer applications. In the Maritimes and Newfoundland, we provide full service programs, including supplying dimensional lumber as well as ACQ treatment for the residential housing market. However, the vast majority of our sales in this product category are for treating services only. With the installation at our Truro plant in late 2004 of one of the cylinders acquired from Légaré, we now have three plants—Delson, Québec, Guelph, Ontario and Truro, Nova Scotia—that have at least two cylinders for treating with waterborne preservatives, one of which can be dedicated to ACQ treatment for our residential lumber customers.

United States sales

In 2004, sales to the United States totalled $19.1 million, an increase of $1.6 million or 9.1% over the $17.5 million of revenues recorded in 2003. However, in terms of volume, sales were up approximately 17% and the more modest revenue increase is totally related to conversion rate, which reflects the relatively stronger Canadian currency in 2004. We believe the market represents opportunities for additional growth, particularly for our West Coast operations where our access to Douglas fir, a preferred large pole species, is a competitive advantage when bidding on transmission projects. However, in other product sectors such as distribution poles and piling, a strong Canadian dollar does put us at a competitive disadvantage versus U.S. producers. Our low cost structure can compensate for some revenue erosion and still provide us with satisfactory margins, but further weakness in the U.S. dollar may affect our ability to grow this market.

Operating results

Sales for the year ended December 31, 2004 totalled $129.0 million, an increase of $32.5 million, or 33.6%, over last year's sales of $96.5 million for the same period. This significant increase is a result of a full year's sales contribution from the operations of the three treating plants acquired from Cambium on July 31, 2003, compared to the five-month contribution included in last year's sales. In addition, in our core business categories of railway ties, where Cambium had limited activity, and consumer lumber, a product line we did not acquire from Cambium, we achieved solid sales growth in 2004 compared to 2003 of 59.5% and 21.1% respectively. Finally, this year's sales include eight months of revenues generated from the former clients of Légaré, following the Company's acquisition of its wood treating assets on April 26, 2004 (See Business acquisition section below).

The sales increase was tempered by a decline in overseas utility pole export sales, which were down $500,000 in 2004 versus 2003, in line with our policy of selling only to those markets that can provide adequate returns for the risks assumed. Accordingly, export margins, in dollars, were actually higher in 2004 compared to 2003. This strategy will continue in 2005.

Gross margins improved significantly in fiscal 2004 compared to fiscal 2003, as the full year effect of Cambium acquisition synergies, coupled with the replacement of higher cost acquired inventories with less costly purchases from traditional suppliers, took hold. In 2004, gross margins rose to $23.2 million, or 18% of sales, compared to $14.9 million, or 15.5% of sales in 2003.

Selling and administrative expenses for the year ended December 31, 2004 were $7.3 million, an increase of $2.3 million over the $5.0 million incurred the prior year. The increase in part reflects the additional expenses for bonuses under the Company's employee profit sharing plan, a major portion of which is directly related to the Company's superior results in 2004 compared to 2003. Also in 2004, the Company incurred a number of restructuring charges in connection with its Clarenville, Newfoundland and New Westminster, British Columbia plants, in addition to writing-down certain redundant assets at the Port of Becancour, Québec and at the Company's pole peeling plant at Hérouxville, Québec. These latter charges were offset by gains on disposal of our pole peeling operations at Albanel and Senneterre, both in Québec.

The foreign exchange loss for the year totalled $360,000, slightly lower than last year's foreign exchange loss of $385,000. Our exposure to foreign exchange gains or losses from currency fluctuations is related to our sales and purchases in U.S. dollars. In 2004, we were partially shielded from the effects of a stronger Canadian dollar due to the natural hedge afforded by our U.S. dollar purchases. 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, 2004, the Company had on hand foreign exchange contracts for the future sale of U.S. dollars totalling $6,000,000, at rates ranging from C$1.5940 to C$1.6125/US$1.00 (average – C$1.6040/US$1.00) and expiry dates ranging from July 2005 to December 2007. The unrecognized net foreign exchange gain on these contracts totalled approximately $1.9 million as at December 31, 2004.

Financial expenses for the year ended December 31, 2004 totalled $1.7 million, an increase of $400,000 over the financial expenses of $1.3 million incurred in 2003. In the first half of fiscal 2004, total indebtedness levels, both short and long-term, were substantially higher than the corresponding periods in 2003. This reflected the increases in borrowings against our short-term operating line to support higher levels of working capital and the new long-term debt incurred to finance the Cambium acquisition in July 2003. During this period, we also drew down a further amount under the mortgage loan arranged to finance the purchase of the thermal oxidizer installed at our Delson, Québec plant in early 2004. In the second half of 2004, the combination of our improved operating results, which allowed us to sharply reduce our operating line, and lower interest rates, generated financial expenses comparable to the same period in 2003.

Amortization of property, plant and equipment totalled $3.1 million for the year ended December 31, 2004, an increase of $500,000 over the same period in 2003. The increase is primarily due to the additional amortization on the thermal oxidizer installed at our Delson, Québec, plant, a $3.1 million environmental investment, as well as the amortization on the property, plant and equipment purchased from Cambium and Légaré.

Income tax expense totalled $3.8 million in 2004 versus $1.8 million in 2003, an increase of $2.0 million, reflecting the vastly improved earnings before tax. The effective tax rate was 34%.

Net earnings for the year ended December 31, 2004 totalled $7.3 million, or $0.72 per share, compared to $3.8 million, or $0.40 per share, in 2003. This represents a year-over-year net earnings increase of $3.5 million, or 94.2%.

Restructuring

The Company decided to cease treating operations at its Clarenville, Newfoundland plant in the last quarter of 2004. The Clarenville plant was facing major capital investment requirements in 2005. During the year 2000, baseline assessments, known as Technical Recommendations Documents (TRD's), were carried out on the Clarenville plant as well as on all other wood preserving plants in Canada by environmental consultants on behalf of Environment Canada. All plants were obliged to submit a plan of action to effectively remedy all items for correction noted in the assessments. The compliance deadline is December 31, 2005. The Company estimated that the cost of compliance for Clarenville could not be justified and the decision to close the treating operations was made. Severance costs for the employees who worked in this area were expensed in 2004. Henceforth, this plant will operate as a distribution centre and continue to service the Newfoundland market. Treating on the East Coast has been centralized at our Truro, Nova Scotia plant, which has sufficient capacity to meet the total local market demand.

In New Westminster, British Columbia a combination of the early retirement of two long-term employees and two staff reductions, both in the last quarter of the year, resulted in the expensing of severance and retirement allowances in 2004. The non-cash write-downs of the Québec based assets at Becancour and Hérouxville is related to our strategic withdrawal from the overseas export market. A storage pad installed at the Port of Becancour to hold treated poles prior to ocean shipment is no longer required and we have written-off the net book value of this asset. We have also

Sales by product
(% of revenues)

Wood Poles	46%
Railway Ties	30%
Industrial Treated Wood	15%
Consumer Lumber	9%

Sales by geographic region
(% of revenues)

Canada	83%
United States	15%
Overseas	2%

taken a provision for the removal of the storage pad and the remediation of the site. Our pole peeling yard at Hérouxville, Québec, was the primary producer of smaller sized export poles that could only be marketed off-shore. It produced very few poles that met the dimensional specifications for a domestic pole. We do not foresee resuming pole peeling operations on this site and it was therefore decided to write-down the net book value of the property and equipment to its current market value. The total amount of the asset write-downs and provision was approximately $400,000.

The Company also disposed of two additional pole peeling operations in Québec in 2004, which resulted in capital gains of approximately $400,000. In March 2004, the Company sold its pole peeler at Albanel, Québec. The sale was conditional upon the agreement by the Québec Minister of Natural Resources ("MNR") to transfer a portion of the Company's timber cutting rights, known in Québec as *contrats d'approvisionnement et d'aménagement forestier* ("CAAF"), amounting to 14,600 cubic metres of Jack pine, to the purchaser. In October 2004, the Company also sold its pole peeling operation at Senneterre, Québec. Again, the sale was conditional upon the MNR's agreement to transfer a portion of the Company's CAAF, amounting to 18,550 cubic metres of Jack pine, to the purchaser. These pole peeling assets became available for sale, and the related CAAFs available for transfer, as a result of a strategic review in early 2004 of our forestry operations in Québec and in particular, the carrying costs of our timber cutting rights. As part of the Cambium transaction in July 2003, we received an additional 72,300 cubic metres of cutting rights in the Outaouais and Abitibi regions of Québec, more than doubling the volume of our then existing Québec timber cutting rights of 51,550 cubic metres. The poles sourced from these new cutting rights were peeled either at our Gatineau, Québec, treating plant, which is equipped with a modern and efficient pole peeler, or at the pole peeling plant at Senneterre, Québec. Our prior cutting rights were situated in the Lac St. Jean and Shawinigan regions of Québec and were the primary source of raw material for our pole peeling plant in Hérouxville, Québec, and a smaller pole peeling operation in Albanel, Québec.

The poles from the Lac St. Jean and Shawinigan CAAFs consist primarily of Jack pine, which in this Northern area produce poles that rarely exceed 35 feet in length, the minimum size for a domestic utility pole. However, shorter poles meet the standards for overseas utility companies and in the past, the Company has sourced virtually all of its export poles from its own forestry operations. However, the Cambium CAAFs consist primarily of Red pine, a species that will produce domestic sized poles in the 35 to 50 foot range. Our decision in 2002 to pull back from the overseas export market has substantially reduced our requirement for export sized poles and put in question the need for maintaining the forestry operations associated with Hérouxville and Albanel. The annual cost for maintaining our right to these forest licenses was approximately $350,000, and a similar amount for the previous Cambium rights.

The net result of these transactions is to consolidate our Québec forest licenses in the Outaouais region, a geographic area close to our Gatineau plant. Our cutting rights in Québec will now consist primarily of areas that produce Red pine poles that can be economically sourced in our own forestry operations for the domestic pole market.

Business acquisition

On April 26, 2004, the Company acquired certain wood treating assets of Légaré, a privately held producer and marketer of pressure treated wood products primarily serving the industrial market. Assets acquired consisted of inventories of green and treated wood poles and certain production equipment related to the pressure treated wood operations. All wood treating production equipment purchased was removed and transferred to several of the Company's other treating facilities. No other assets were purchased and Légaré retained ownership of its previous operating site. The total purchase price was approximately $2.0 million, with $1.4 million allocated to inventories, and $600,000 to property, plant and equipment. The consideration was cash, except for a balance of sale of $150,000

payable one year from the date of acquisition, and was financed through the Company's existing bank operating line. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired based on their estimated fair values as of the acquisition date.

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

2004

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
Sales	**24,947**	**41,894**	**35,677**	**26,454**	**128,972**
Operating earnings before amortization of property, plant and equipment[1]	**2,764**	**5,964**	**4,204**	**2,862**	**15,794**
Operating earnings[1]	**2,016**	**5,203**	**3,478**	**2,020**	**12,717**
Net earnings	**1,008**	**3,038**	**1,966**	**1,279**	**7,291**
Net earnings per common share	**0.10**	**0.30**	**0.20**	**0.12**	**0.72**
Diluted net earnings per common share	**0.10**	**0.29**	**0.19**	**0.12**	**0.70**

2003

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept.30 $	Dec. 31 $	Total $
Sales	20,516	28,450	25,396	22,182	96,544
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

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 structure. 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.

Fourth quarter results

Sales for the fourth quarter of 2004 increased to $26.5 million, up 19.4% from the $22.2 million of sales in the fourth quarter of 2003. All product sector sales were ahead of last year, with railway ties and domestic utility poles accounting for over 67% of the $4.3 million quarterly sales increase. Increases in export pole sales to Mexico, a 35% improvement in residential lumber sales, and a modest increase in industrial treated wood sales provided the balance of the positive sales growth.

Gross margins as a percentage of sales increased by approximately 3.6% in the fourth quarter of 2004 compared to the fourth quarter of the prior year, primarily the result of significantly higher margins on domestic utility pole sales. This improvement reflects the progressively lower average white wood costs in our inventories as we sold off higher

priced poles acquired from Cambium, as well as price increases implemented in the last half of the year.

The net earnings for the fourth quarter of 2004 were $1.3 million, or $0.12 per share, compared to net earnings of $658,000, or $0.06 per share in the fourth quarter of 2003.

Liquidity and capital resources

The Company's current assets as at December 31, 2004 were $67.4 million, an increase of $5.7 million over the $61.7 million of current assets as at the prior year end. Inventory growth accounts for $4.2 million of this increase. This level of inventory is required to service the new customers acquired from Légaré, our tie and pole contract demands for 2005 and 2006, and anticipated new demand. Our ability to finance the working capital to allow our stocks of green wood for poles, ties and industrial lumber to air dry through the nine to twelve months required prior to treating is a critical success factor and marketing asset in our industrial markets. With the exception of a small supply of lumber purchased for a few customers in the Maritimes, we do not carry an inventory of dimensional lumber for our consumer treating business, preferring to provide treatment services only to our wholesale lumber partner; they assume the risk of lumber price fluctuations. The increase in trade accounts receivable is consistent with our increased sales volume and our days sales in receivables have declined slightly.

Our current bank indebtedness is down significantly since last year-end, from $19.5 million as at December 31, 2003 to $11.4 million as at December 31, 2004. This decrease of $8.1 million is partly due to restructuring as we borrowed $5.0 million under new capital and term loan facilities in 2004. This was done in two separate bank financings, a capital loan of $4.0 million in January 2004 and a term loan of $1.0 million in December 2004. Trade accounts payable at the current year-end were $13.9 million, up less than 2.0% over last year's levels at the same date, despite the increased operating activities.

Our total long-term debt, which stood at $12.8 million as at December 31, 2003, was $16.2 million as at December 31, 2004, an increase of $3.4 million. In addition to the new term loans, we also drew down a further $760,000 under the capital lease facility arranged to finance the purchase and installation of the thermal oxidizer at our Delson, Québec plant.

Cash flow from operating activities was $10.9 million for the year ended December 31, 2004, an increase of $4.1 million over the $6.8 million generated in the same period in 2003. After taking into account the changes in non-cash working capital components, total cash generated by operations for the year ended December 31, 2004 was $8.9 million versus $4.9 million a year earlier. This cash, together with the funds generated from the new long-term debt financings, the proceeds of the issuance of common shares under the Company's stock option and employee share purchase plans, and the proceeds of disposal of our Senneterre and Albanel peeling operations, were used to pay the two $0.04 semi-annual dividends, to repay the capital repayments on the Company's long-term debt, to acquire the assets of Légaré, to purchase new property, plant and equipment, and to decrease the Company's operating line.

In June 2004, the Company's principal banker extended its credit facility, an operating line of $30.0 million and a capital loan of $4.0 million, for an indefinite period. The loans continue to be repayable on demand and are subject to periodic reviews. The terms and conditions remain unchanged from the previous credit facility, except that in the event the Company maintains a ratio of total liabilities to tangible net worth, as defined in the agreement, below 1.00:1 for two consecutive quarters, the margins applicable to prime rate advances shall be reduced by 0.25% per annum. In the event that this ratio subsequently exceeds 1.00:1, the margins immediately revert to the original rate. The Company's ratio was below 1.00:1 as at December 31, 2004 for the second consecutive quarter and we will benefit from the lowered rate beginning at the end of January 2005.

Additionally, in June 2004, the Company's secondary banker extended its credit facility covering two term loans of $4.0 million and $1.0 million, respectively, for a further period subject to an annual review on or around April 1, 2005.

The Company has no further plans at this time to modify its current banking arrangements, which are sufficient to satisfy all its planned operating activities. We were in compliance with all of our bank covenants throughout the year.

Working capital as at December 31, 2004 increased to $36.6 million, up sharply from the working capital of $25.9 million as at December 31, 2003. The Company's current ratio improved to 2.19:1 at year-end from 1.72:1 one year earlier. Our long-term debt to equity ratio was 0.33:1 at year-end, compared to 0.30:1 as at December 31, 2003, reflecting the new term debt incurred to reduce short-term borrowings.

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

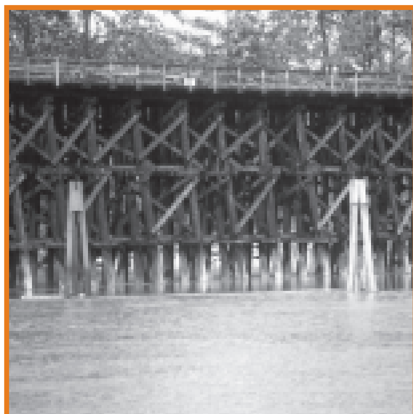
Contractual obligations

(thousands of dollars)

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
	$	$	$	$	$
Long-term debt	15,987	3,605	6,649	4,783	950
Capital lease obligations	216	104	84	28	-
Operating leases	3,386	619	728	279	1,760
Total contractual obligations	19,589	4,328	7,461	5,090	2,710

Year 2003 compared to 2002

Sales declined by $9.1 million in 2003 compared to 2002, primarily the result of the Company's strategic withdrawal from the overseas export market and softness in domestic utility pole and railway tie sales. This decline was partially offset by the five-month sales contribution of the operations of the three treating plants acquired from Cambium. 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 and Sorel-Tracy, both in Québec, a pole peeling plant in Senneterre, Québec, as well as all related inventories accounts receivable and timber cutting rights. 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 that operated 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.



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

The increase in current assets of $13.6 million as at December 31, 2003 versus December 31, 2002 was 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.

Share and stock option information

As at March 14, 2005, the capital stock issued and outstanding consisted of 10,240,339 common shares (10,012,961 as at December 31, 2003 and 10,234,639 as at December 31, 2004).

As at March 14, 2005, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 279,975 (December 31, 2004 – 285,675) of which 215,190 (December 31, 2004 – 214,890) were exercisable. Effective May 6, 2003, 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. These options become exercisable on May 6, 2008, or earlier, upon the occurence of certain triggering events.

Dividends

On March 18, 2003, the Board of Directors adopted a modification to the Company's dividend policy whereby a dividend would be considered on a semi-annual rather than on an annual basis. On March 16, 2004, and August 10, 2004, the Board of Directors declared semi-annual dividends of $0.04 per common share. In light of the Company's strong financial performance in fiscal 2004 and solid expectations for 2005, on March 16, 2005, the Board of Directors resolved to increase the next semi-annual dividend to $0.05 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 it long-standing relationships with private woodland owners and other suppliers.

The Company is subject to a variety of environmental laws and regulations, including those relating to emission to the air, discharges into water, releases of hazardous and toxic substances, and remediation of contaminated sites.

The enforcement of these laws by regulatory agencies will continue to affect the Company's operations by imposing operating and maintenance costs and capital expenditures required for compliance. Failure to comply with environmental statutes, regulations or orders could result in civil or criminal enforcement actions. The Company makes financial expenditures in order to comply with regulations governing environmental issues adopted by federal, provincial and local regulatory agencies.

Under various federal, provincial and local laws and regulations, the Company could, as the owner, lessor or operator, be liable for the costs of removal or remediation of contamination at its sites. The remediation costs and other costs

required to clean up or treat contaminated sites could be substantial. However, in many cases, the Company benefits from indemnities from the former owners of its sites.

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, 2004 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, 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

Generally accepted accounting principles and financial statement presentation

Effective January 1, 2004, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") 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 GAAP. Section 1400 provides general guidance on financial statement presentation and further clarifies what constitutes fair presentation in accordance with Canadian GAAP.

The impact on the results of the Company is that delivery costs are no longer recorded as a reduction of gross sales but recorded under cost of sales. For the year ended December 31, 2004, delivery costs amounted to $5.3 million compared to $4.5 million in 2003. The adoption of these recommendations has no other significant impact on the consolidated financial statements.

Hedging relationships

Effective January 1, 2004, the Company adopted, on a prospective basis, the new recommendations of the CICA relating to hedging relationships. 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 the conditions for applying hedge accounting. Under this guidance, 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 the necessary hedge documentation to be able to apply hedge accounting for its foreign exchange forward contracts.

Employee future benefits

In 2004, the CICA amended Handbook section 3461, "Employee Future Benefits". Section 3461 requires additional disclosures about the periodic benefit cost of employee future benefit plans. The new annual disclosures are effective for years ending on or after June 30, 2004. The Company adopted the amendments of Section 3461 and provided the additional disclosure in note 10 to the Company's audited consolidated financial statements for the year ended December 31, 2004.

Impact of accounting pronouncements not yet implemented

Financial instruments

In January 2005, the CICA issued three new accounting proposed standards in relation with financial instruments: Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", and Section 1530, "Comprehensive Income". Proposed standards 3855, 3865 and 1530 apply to fiscal years beginning on or after October 1, 2006. These proposals are more fully described in note 2 to the December 31, 2004 audited consolidated financial statements. The application of the new accounting standards for financial instruments is not expected to have a significant effect on the Company's financial position or result of operations but will require the Company to present a new financial statement entitled "Comprehensive Income".

Related party transactions

In 2004, the Company had transactions with related parties totalling $376,500 (2003 – $376,500) as detailed in note 13 to the December 31, 2004 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 & 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

The present indications for continued internal growth in 2005 are positive. In our core industrial market groups of domestic utility poles and railway ties, we have a strong base of contracted sales to blue chip customers that allows us to dedicate production capacity in several plants. This specialization both enhances customer service and promotes efficiency, allowing us to maintain our leadership position as a reliable low cost producer.

We also have the treating capacity, sources of supply and the purchasing power to respond to increased demands in all our product sectors. Our residential lumber custom treating sales also appear to be heading towards another year of significant growth. In conjunction with our wholesale lumber partner, we anticipate increased shipments to our existing

network of retail outlets, as well as adding new point of sale locations. With the installation of the new cylinder at our Truro, Nova Scotia plant, we can dedicate our two waterborne preservative treating cylinders to either CCA (industrial) or ACQ (residential) production. We already have this capability at our Delson, Québec and Guelph, Ontario plants.

Industrial treated wood sales will benefit from two restructuring initiatives instituted in late 2004. These markets are strongest on the East and West Coasts, where marine applications predominate. There have been a number of personnel changes in our British Columbia operations to better allocate management resources and to accelerate and enforce the cost cutting measures that have been successful in our Eastern plants. Our strategic review is ongoing but we expect it will have a positive effect on the future profitability of our West Coast operations. We have also rationalized our East Coast operations by shutting down our treating cylinder in Clarenville, Newfoundland and transferring all production in the region to Truro, Nova Scotia. Clarenville will remain a major distribution centre and continue to service our Newfoundland customers. All restructuring costs associated with these two initiatives were expensed in 2004.

We also believe that there are potential acquisition opportunities that meet our stringent investment criteria. We have the necessary financial capability to continue our strategy of industry consolidation.

March 16, 2005

Consolidated Financial Statements

December 31, 2004 and 2003

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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, who recommended their approval by the Board of Directors.

(Signed)

Brian McManus
President and Chief Executive Officer

(Signed)

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

Westmount, Quebec
March 16, 2005

Auditors' Report

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheets of Stella-Jones Inc. as at December 31, 2004 and 2003 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, 2004 and 2003 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
Montréal, Quebec
March 16, 2005

Consolidated Balance Sheets

As at December 31, 2004 and 2003	2004 $	2003 $
Assets		
Current Assets		
Accounts receivable (notes 4 and 7(d))	**13,205,649**	11,973,823
Inventories (notes 5 and 7(d))	**52,769,898**	48,578,915
Prepaid expenses	**857,582**	532,925
Future income taxes (note 9(a))	**522,000**	610,000
	67,355,129	61,695,663
Property, plant and equipment (notes 6 and 7(c))	**30,543,495**	31,383,850
Future income taxes (note 9(a))	**301,000**	271,000
	98,199,624	93,350,513
Liabilities		
Current liabilities		
Bank indebtedness (note 7(a))	**11,420,760**	19,527,592
Accounts payable and accrued liabilities	**13,878,043**	13,683,318
Income taxes	**1,774,917**	136,478
Current portion of long-term debt (note 7)	**3,699,048**	2,474,636
	30,772,768	35,822,024
Long-term debt (note 7)	**12,485,436**	10,308,220
Future income taxes (note 9(a))	**4,784,000**	4,149,000
Employee future benefits (note 10)	**872,380**	785,517
	48,914,584	51,064,761
Shareholders' Equity		
Capital stock (note 8)	**20,954,892**	20,439,188
Retained earnings	**28,330,148**	21,846,564
	49,285,040	42,285,752
	98,199,624	93,350,513

Approved by the Board of Directors

(Signed)

Tom A. Bruce Jones, CBE
Director

(Signed)

Richard Bélanger, FCA
Director

Consolidated Statements of Retained Earnings

For the years ended December 31, 2004 and 2003	2004 $	2003 $
Balance - Beginning of year	**21,846,564**	18,855,335
Net earnings for the year	**7,291,109**	3,753,780
	29,137,673	22,609,115
Dividends on common shares	**807,525**	762,551
Balance - End of year	**28,330,148**	21,846,564

Consolidated Statements of Earnings

For the years ended December 31, 2004 and 2003	2004 $	2003 $
Sales	**128,972,067**	96,544,003
Expenses (income)		
Cost of sales	**105,745,054**	81,612,161
Selling and administrative	**7,319,579**	5,004,173
Foreign exchange loss	**360,008**	385,358
Amortization of property, plant and equipment	**3,076,849**	2,634,918
Write-down of property, plant and equipment	**273,956**	-
Gain on disposal of property, plant and equipment	**(520,320)**	(21,977)
	116,255,126	89,614,633
Operating earnings	**12,716,941**	6,929,370
Financial expenses (note 7(h))	**1,668,832**	1,329,590
Earnings before income taxes	**11,048,109**	5,599,780
Provision for income taxes (note 9(b))		
Current	**3,064,000**	1,486,839
Future	**693,000**	359,161
	3,757,000	1,846,000
Net earnings for the year	**7,291,109**	3,753,780
Net earnings per common share (note 8(b))	**0.72**	0.40
Diluted net earnings per common share (note 8(b))	**0.70**	0.39

Consolidated Statements of Cash Flows

For the years ended December 31, 2004 and 2003	2004 $	2003 $
Cash flows from		
Operating activities		
Net earnings for the year	**7,291,109**	3,753,780
Adjustments for		
Amortization of property, plant and equipment	**3,076,849**	2,634,918
Write-down of property, plant and equipment	**273,956**	-
Gain on disposal of property, plant and equipment	**(520,320)**	(21,977)
Employee future benefits	**86,863**	81,823
Stock-based compensation	**17,244**	17,300
Future income taxes	**693,000**	359,161
	10,918,701	6,825,005
Changes in non-cash working capital components		
Decrease (increase) in		
Accounts receivable	**(1,231,826)**	5,216,110
Inventories (note 3)	**(2,734,331)**	(3,317,937)
Prepaid expenses	**(324,657)**	34,206
Increase (decrease) in		
Accounts payable and accrued liabilities (notes 3 and 6(b))	**631,023**	(2,297,416)
Income taxes	**1,638,439**	(1,576,013)
	(2,021,352)	(1,941,050)
	8,897,349	4,883,955
Financing activities		
Increase (decrease) in bank indebtedness	**(8,106,832)**	8,343,679
Increase in long-term debt	**5,759,829**	9,980,032
Repayment of long-term debt	**(2,358,201)**	(7,294,190)
Proceeds from issuance of common shares	**498,460**	3,922,327
Dividends	**(807,525)**	(762,551)
	(5,014,269)	14,189,297
Investing activities		
Business acquisitions (note 3)	**(1,883,704)**	(15,306,235)
Purchase of property, plant and equipment (notes 3 and 6(b))	**(2,914,542)**	(3,788,994)
Proceeds from disposal of property, plant and equipment	**915,166**	21,977
	(3,883,080)	(19,073,252)
Net change in cash and cash equivalents during the year	**-**	-
Cash and cash equivalents – Beginning and end of year	**-**	-
Supplemental disclosures		
Interest paid	**1,668,924**	1,313,337
Income taxes paid	**1,433,060**	3,308,932

Notes to Consolidated Financial Statements

December 31, 2004 and 2003

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(b)), 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 date of the financial statements and the reported amounts of revenues and expenses during the reporting period. 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 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.

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 of 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

a) Generally accepted accounting principles and financial statement presentation
Effective January 1, 2004, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") 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 GAAP. Section 1400 provides general guidance on financial statement presentation and further clarifies what constitutes fair presentation in accordance with Canadian GAAP.

The impact on the results of the Company is that delivery costs are no longer recorded as a reduction of gross sales but recorded under cost of sales. For the year ended December 31, 2004, delivery costs amounted to $5,282,074 (2003 – $4,511,290). The adoption of these recommendations has no other significant impact on the consolidated financial statements.

b) Hedging relationships
Effective January 1, 2004, the Company adopted, on a prospective basis, the new recommendations of the CICA relating to hedging relationships. 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.

c) Employee future benefits
In 2004, the CICA amended Handbook Section 3461, "Employee Future Benefits". Section 3461 requires additional disclosures about the periodic benefit cost of employee future benefit plans. The new annual disclosures are effective for years ending on or after June 30, 2004. The Company adopted the amendments of Section 3461 and has provided the additional disclosures in note 10.

Impact of accounting pronouncements not yet implemented

Financial instruments
In January 2005, the CICA issued three new accounting proposed standards in relation with financial instruments: Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", and Section 1530, "Comprehensive Income". Proposed standards 3855, 3865 and 1530 apply to fiscal years beginning on or after October 1, 2006.

Proposed Standard 3855 expands on Section 3860, "Financial Instruments – Disclosure and Presentation", by prescribing when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented.

Proposed Standard 3865 provides alternative accounting treatments to Proposed Standard 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline AcG-13, "Hedging Relationships", and the hedging guidance in Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

Proposed Standard 1530 introduces a new requirement to present certain revenues, expenses, gains and losses that otherwise would not be immediately recorded in income, in a comprehensive income financial statement with same prominence as other financial statements that constitute

a complete set of financial statements. The application of the new accounting standards for financial instruments is not expected to have a significant effect on the Company's financial position or result of operations but will require the Company to present a new financial statement entitled "Comprehensive Income".

3 Business acquisitions

a) On April 26, 2004, the Company acquired certain wood-treating assets of *Les Industries Légaré (1998) Ltée,* a privately held producer and marketer of pressure-treated wood products, primarily serving the industrial market. Assets acquired consisted of inventories and certain production equipment related to the pressure-treated wood operations. The total purchase price was $2,033,704. The consideration was cash, except for a balance of sale of $150,000 payable in one year from the date of acquisition, and was financed through the Company's existing bank operating line. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired based on their estimated fair values as of the acquisition date, as follows:

	$
Assets acquired	
Inventory	**1,456,652**
Equipment	**577,052**
	2,033,704
Consideration	
Cash, including transaction costs of $40,000	**1,883,704**
Debt assumed included in liabilities	**150,000**
	2,033,704

b) 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 operated 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.

4 Accounts receivable

	2004 $	2003 $
Trade	**12,548,708**	10,966,638
Other	**656,941**	1,007,185
	13,205,649	11,973,823

5 Inventories

	2004 $	2003 $
Raw materials	**38,763,858**	35,109,824
Finished goods	**14,006,040**	13,469,091
	52,769,898	48,578,915

6 Property, plant and equipment

			2004
	Cost $	**Accumulated Amortization** $	**Net** $
Land	**959,472**	**-**	**959,472**
Buildings	**6,534,795**	**1,814,111**	**4,720,684**
Production equipment	**29,989,708**	**12,452,318**	**17,537,390**
Rolling stock	**1,517,482**	**1,416,787**	**100,695**
Anti-pollution equipment	**10,297,520**	**3,102,264**	**7,195,256**
Office equipment	**668,718**	**638,720**	**29,998**
	49,967,695	**19,424,200**	**30,543,495**

			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

a) Property, plant and equipment include assets under capital leases with a cost of $689,460 and accumulated amortization of $414,997 (2003 – $689,460 and $313,537 respectively).
b) During the year, property, plant and equipment were acquired at an aggregate cost of $2,905,296 (2003 – $4,374,393), of which $273,235 (2003 – $859,533) was acquired by assuming directly related accounts payable and accrued liabilities and nil (2003 – $82,068) by means of capital leases. Cash payments of $2,914,542 (2003 – $3,788,994) were made for property, plant and equipment purchases.
c) As at December 31, 2004, the net carrying value of property, plant and equipment not yet in service was nil (December 31, 2003 – $2,912,899).

7 Long-term debt

	2004 **$**	2003 $
Capital loan (note 7(a))	**4,000,000**	-
Term loans (note 7(a))	**4,555,556**	4,000,000
Unsecured and non-convertible debenture, bearing interest at 8%, repayable on July 31, 2008	**2,500,000**	2,500,000
Loans from ultimate shareholders, unsecured and subordinated, bearing interest at 8.5%, repayable on demand after the repayment of the debenture, the capital loan and the term loans	**900,000**	900,000
Promissory note (note 7(b))	**136,250**	681,250
Mortgage loans (note 7(c))	**3,570,836**	3,791,422
Obligations under capital leases (note 7(g))	**197,825**	437,688
Term note, bearing interest at 4.75%, payable in monthly instalments of $8,333 and maturing in March 2008	**324,017**	424,017
Loan, non-interest bearing, payable in monthly instalments of $4,040 and which matured in December 2004	**-**	48,479
	16,184,484	12,782,856
Less: Current portion	**3,699,048**	2,474,636
	12,485,436	10,308,220

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 capital loan of $4,000,000; the second facility comprising a term loan of $4,000,000 that was borrowed in connection with a business acquisition (note 3(b)) and a term loan of $1,000,000 to finance purchases of property, plant and equipment.

   The demand operating loan of $30,000,000 bears interest at the bank's prime rate plus 0.50% or less, if certain bank ratios are met. The capital loan of $4,000,000, which was disbursed on January 21, 2004, bears interest at the bank's prime rate plus 1%. The capital loan is repayable in quarterly instalments of $333,333 beginning January 31, 2005 and matures October 31, 2007.

   Both term loans bear interest at the bank's prime rate plus 1.25%. The term loan of $4,000,000 is repayable in 18 quarterly instalments of $222,222 beginning August 29, 2004, and matures November 29, 2008. The term loan of $1,000,000, which was disbursed on December 30, 2004, is repayable in 20 quarterly instalments of $50,000 beginning April 30, 2005 and matures January 31, 2010.

   As collateral for the demand operating loan and the capital loan, the bank holds a first ranking movable 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(b)), and a first ranking security under Section 427 of the Bank Act. The collateral for the term loans consists of a first ranking immovable hypothec on the immovable property acquired in the business acquisition (note 3(b)) and a second ranking movable 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.
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.
c) The mortgage loans bear interest at a weighted average rate of 5.6% as at December 31, 2004 (December 31, 2003 – 5.8%) and certain specific property, plant and equipment with a net book value of $6,769,023 (December 31, 2003 – $7,180,890) 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 $16,363,838 as at December 31, 2004 (December 31, 2003 – $12,481,355) 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,	2005	3,605,050
	2006	3,434,862
	2007	3,213,661
	2008	4,432,166
	2009	350,920
		15,036,659

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

		$
Years ending December 31,	2005	104,315
	2006	63,987
	2007	20,496
	2008	27,737
Total future minimum lease payments		216,535
Less : Interest (weighted average rate of 7.2%)		18,710
Balance of obligation		197,825
Less: Current portion		93,998
		103,827

h) Financial expenses are detailed as follows:

	2004 **$**	2003 $
Interest on long-term debt	**943,631**	495,383
Other interest	**725,201**	834,207
	1,668,832	1,329,590

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

	2004		2003	
	Shares	**$**	Shares	$
Balance – Beginning of year	**10,012,961**	**20,421,888**	9,053,100	16,499,561
Private placement (note 3(b))	**-**	**-**	950,000	3,895,000
Stock option plan	**211,278**	**457,388**	-	-
Share purchase plan	**10,400**	**41,072**	9,861	27,327
	10,234,639	**20,920,348**	10,012,961	20,421,888
Stock-based compensation (note 8(e))	**-**	**34,544**	-	17,300
Balance – End of year	**10,234,639**	**20,954,892**	10,012,961	20,439,188

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:

	2004	2003
Net earnings applicable to common shares	**$ 7,291,109**	$3,753,780
Weighted average number of common shares outstanding	**10,082,082**	9,455,658
Effect of dilutive stock options	**273,367**	172,062
Weighted average number of diluted common shares outstanding	**10,355,449**	9,627,720
Net earnings per common share	**$0.72**	$0.40
Diluted net earnings per common share	**$0.70**	$0.39

The warrants issued in 2003 were only included in the 2004 calculation above as they did not have a dilutive effect on earnings per share in 2003.

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.

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

	2004 Number of options	**2004 Weighted average exercise price $**	2003 Number of options	2003 Weighted average exercise price $
Outstanding – Beginning of year	**499,810**	**2.19**	499,810	2.19
Exercised	**211,278**	**2.16**	-	-
Cancelled	**2,857**	**2.15**	-	-
Outstanding – End of year	**285,675**	**2.21**	499,810	2.19
Options exercisable – End of year	**214,890**	**2.23**	355,526	2.21

The following options were outstanding under the Stock Option Plan as at December 31, 2004:

	Options outstanding		Options exercisable		
Year granted	**Number of options**	**Weighted average exercise price $**	**Number of options**	**Weighted average exercise price $**	**Expiration date**
1995	**18,300**	**3.49**	**18,300**	**3.49**	**2005**
1996	**37,500**	**2.10**	**37,500**	**2.10**	**2006**
1997	**10,000**	**1.80**	**10,000**	**1.80**	**2007**
1998	**4,950**	**1.93**	**4,950**	**1.93**	**2008**
2001	**193,925**	**2.16**	**135,140**	**2.16**	**2011**
2002	**21,000**	**2.00**	**9,000**	**2.00**	**2012**
	285,675		**214,890**		

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.

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.

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 2004, no options (2003 – 300,000) were granted, their fair value was nil (2003 – $80,500) and the expense amortized to earnings was $17,244 (2003 – $17,300). The fair value was estimated with the following weighted average assumptions:

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

f) Employee Share Purchase Plan
The aggregate number of common shares reserved for issuance under the Employee Share Purchase Plan is 180,000. Under this plan, employees are eligible to purchase common shares from the Company at a price of 90% of the market value. In 2004, 10,400 shares (2003 – 9,861) were issued under this plan at an average price of $3.95 per share (2003 – $2.77). As at December 31, 2004, the total number of shares issued under this plan is 114,590 (December 31, 2003 – 104,190).

9 Income taxes

a) Current future income tax assets relate mainly to accrued liabilities, whereas 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:

	2004 %	2003 %
Basic Federal rate less provincial deduction	**22.12**	24.12
Combined provincial tax rates	**12.55**	11.99
	34.67	36.11
Manufacturing and processing profit deduction	**(0.40)**	(2.58)
Other	**(0.26)**	(0.56)
Effective income tax rate	**34.01**	32.97

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:

	2004 $	2003 $
Change in accrued benefit obligation		
Balance – Beginning of year	**846,363**	789,792
Current year service costs	**59,139**	46,629
Interest on obligation	**52,154**	44,678
Benefit payments	**(14,806)**	(13,881)
Acquisitions	**-**	96,595
Amendments	**-**	20,619
Curtailment loss	**(28,872)**	-
Actuarial gain	**-**	(138,069)
Balance – End of year	**913,978**	846,363
Net obligation – End of year	**913,978**	846,363
Less: Unamortized net actuarial loss	**23,433**	41,454
Unamortized past service costs	**18,165**	19,392
Accumulated benefit obligation	**872,380**	785,517
Component of net benefit cost for the year		
Current year service cost	**59,139**	46,629
Interest on obligation	**52,154**	44,678
Curtailment gain	**(10,860)**	-
Elements of employee future benefits cost before adjustments to recognize the long-term nature of employee future cost	**100,433**	91,307
Adjustments to recognize the long-term nature of employee future benefits cost:		
Difference between net actuarial loss (gain) and actuarial loss (gain)	**9**	3,170
Amortization of past service costs	**1,227**	1,227
Benefit cost recognized	**101,669**	95,704

Cash payments for employee future benefits for the year ended December 31, 2004, amounted to $14,806 (2003 – $13,881).

b) The significant actuarial assumptions for the accrued benefit obligation and the benefit cost are the following:

	2004 %	2003 %
Discount rate	**6.00**	6.00
Salary escalation rate	**4.00**	4.00

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%.

An increase or decrease of 1% in this rate would have the following impact:

	Increase of 1% $	Decrease of 1% $
Impact on accrued benefit obligation	**186,597**	**154,972**
Impact on benefit cost	**27,976**	**22,535**

11 Contingencies and commitments

a) The Company has issued guarantees amounting to $956,771 (December 31, 2003 – $1,386,715) 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,	2005	619,066
	2006	435,875
	2007	291,684
	2008	172,530
	2009	106,399
	Thereafter	1,760,000
		3,385,554

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, 2004, the forward exchange sales contracts aggregate a nominal amount of US$6,000,000 (December 31, 2003 – US$9,000,000), with expiry dates ranging from July 2005 to December 2007, and contracted rates ranging from 1.5940 to 1.6125. As at December 31, 2004, there were no forward exchange purchase contracts (December 31, 2003 – US$2,200,000). As at December 31, 2004, the net unrealized gain on these contracts was $1,916,023 (December 31, 2003 – net unrealized gain of $1,699,595).

Interest rate risks

As at December 31, 2004, the Company is exposed to an interest rate risk on long-term debt because 54% (December 31, 2003 – 37%) 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.

13 Related party transactions

The Company had the following transactions with related parties:

	2004 **$**	2003 $
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:

	2004 **$**	2003 $
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 Nova Scotia, Québec, Ontario and British Columbia, and a distribution center is located in Newfoundland.

In 2004, export sales amounted to $21,920,947 (2003 – $20,808,527), including $19,081,141 (2003 – $17,474,948) to the United States. Other export sales are primarily to Mexico.

In 2004, the Company had one customer representing 13% of its sales (2003 – 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]
President,
Toryvel Group Inc.
(Holding company)
Québec, Québec
Director since March 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)
Montréal, Québec
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, Québec
Director since October 1992

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

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

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

(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 Proxy Circular for the 2004 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, CA
Senior Vice-President
and Chief Financial Officer

Marla Eichenbaum
General Counsel and Secretary

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

Martin Poirier
Vice-President and General Manager,
Central Region

Rémi Godin, CGA
Comptroller

Subsidiaries

Rick Thompson
Vice-President,
Guelph Utility Pole Company Ltd.

Robert Tilley
General Manager,
I.P.B. – W.P.I. International Inc.
dba 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

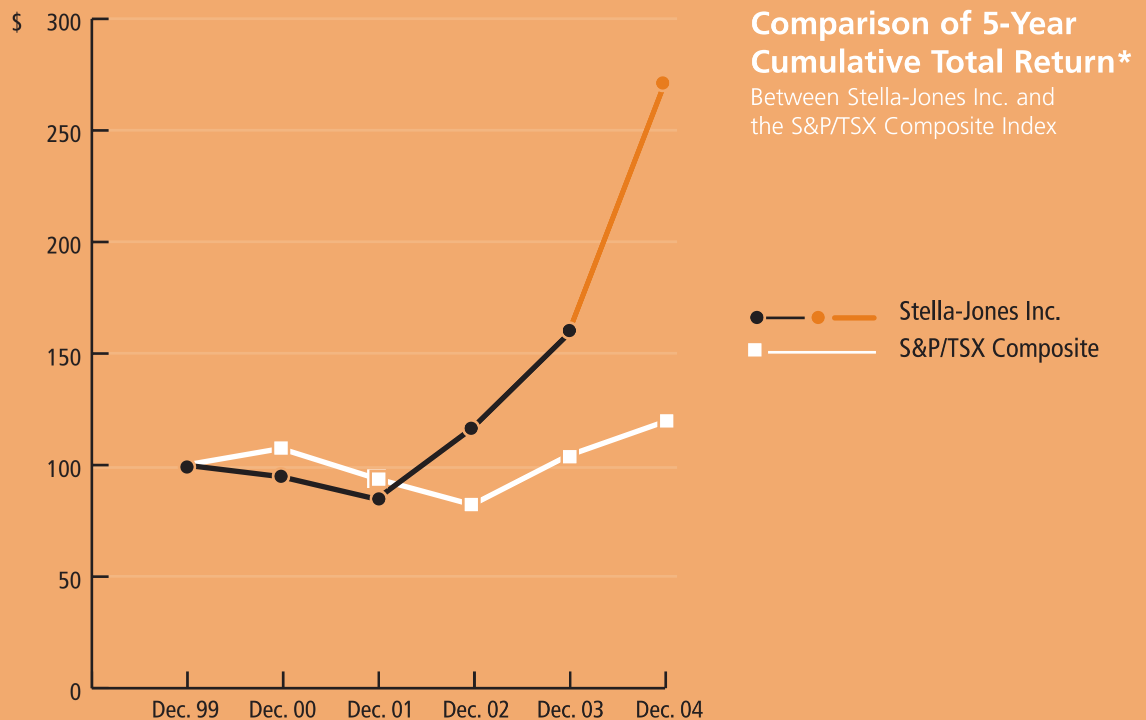
May 4, 2005
9:00 A.M.
Hotel InterContinental Montréal
Salon Saint-Jacques
360 Saint-Antoine Street West
Montréal, Québec

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, 2004): $6.90/ $3.70
Share price at March 16, 2005: $6.75
Common shares outstanding as at December 31, 2004: 10.23 million

Dividend policy:

The Board of Directors considers a dividend on a semi-annual basis, conditional upon the Company's financial performance and cash requirements. On March 16, 2005, in light of the Company's strong financial performance in fiscal 2004 and solid expectations for 2005, the Board of Directors resolved to increase the next semi-annual dividend to $0.05 per common share.



*$100 invested on December 31, 1999 in stock or index – including reinvestment of dividends. Fiscal years ending December 31.

Cumulative Total Return

	2000	2001	2002	2003	2004
Close	$2.30	$2.00	$2.75	$3.65	$6.10
Price / earnings	6.6	40.0	6.7	9.1	8.5
Price / book value	0.65	0.57	0.70	0.86	1.27

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www.stella-jones.com