Stella-Jones Inc.

Condensed Interim Consolidated Financial Statements (Unaudited) June 30, 2023 and 2022

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Financial Position
(Unaudited)

(expressed in millions of Canadian dollars)

	Note	As at June 30, 2023	As at December 31, 2022
Assets			
Current assets			
Accounts receivable		403	287
Inventories		1,335	1,238
Income taxes receivable		4	—
Other current assets		66	58
		1,808	1,583
Non-current assets			
Property, plant and equipment		804	755
Right-of-use assets		169	160
Intangible assets		165	171
Goodwill		375	369
Derivative financial instruments	7	28	29
Other non-current assets		6	6
		3,355	3,073
Liabilities and Shareholders' Equity			
Current liabilities			
Accounts payable and accrued liabilities		232	201
Income taxes payable		4	7
Current portion of long-term debt	4	101	1
Current portion of lease liabilities		44	41
Current portion of provisions and other long-term liabilities	5	13	9
		394	259
Non-current liabilities			
Long-term debt	4	1,038	940
Lease liabilities		133	126
Deferred income taxes		154	158
Provisions and other long-term liabilities	5	27	26
Employee future benefits		9	7
		1,755	1,516
Shareholders' equity			
Capital stock	6	191	194
Retained earnings		1,268	1,192
Accumulated other comprehensive income		141	171
		1,600	1,557
		3,355	3,073
Subsequent events	10		

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

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Change in Shareholders' Equity
(Unaudited)

For the six-month periods ended June 30, 2023 and 2022

(expressed in millions of Canadian dollars)

			Accumulated other comprehensive income				
	Capital stock	**Retained earnings**	**Foreign currency translation adjustment**	**Translation of long-term debts designated as net investment hedges**	**Unrealized gains (losses) on cash flow hedges**	**Total**	**Total shareholders' equity**
Balance – January 1, 2023	194	1,192	261	(111)	21	171	1,557
Comprehensive income (loss)							
Net income	—	160	—	—	—	—	160
Other comprehensive (loss) income	—	(1)	(34)	5	(1)	(30)	(31)
Comprehensive income (loss)	—	159	(34)	5	(1)	(30)	129
Dividends on common shares	—	(27)	—	—	—	—	(27)
Employee share purchase plans	1	—	—	—	—	—	1
Repurchase of common shares (note 6)	(4)	(56)	—	—	—	—	(60)
	(3)	(83)	—	—	—	—	(86)
Balance – June 30, 2023	191	1,268	227	(106)	20	141	1,600

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

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Change in Shareholders' Equity...*Continued*

(Unaudited)

For the six-month periods ended June 30, 2023 and 2022

(expressed in millions of Canadian dollars)

			Accumulated other comprehensive income				
	Capital stock	**Retained earnings**	**Foreign currency translation adjustment**	**Translation of long-term debts designated as net investment hedges**	**Unrealized gains on cash flow hedges**	**Total**	**Total shareholders' equity**
Balance – January 1, 2022	208	1,161	175	(98)	2	79	1,448
Comprehensive income (loss)							
Net income for the period	—	140	—	—	—	—	140
Other comprehensive income (loss)	—	7	19	(3)	13	29	36
Comprehensive income (loss) for the period	—	147	19	(3)	13	29	176
Dividends on common shares	—	(25)	—	—	—	—	(25)
Employee share purchase plans	1	—	—	—	—	—	1
Repurchase of common shares (note 6)	(8)	(77)	—	—	—	—	(85)
	(7)	(102)	—	—	—	—	(109)
Balance – June 30, 2022	201	1,206	194	(101)	15	108	1,515

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

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Income

(Unaudited)

(expressed in millions of Canadian dollars, except earnings per common share)

	Note	For the three-month periods ended June 30, 2023	2022	For the six-month periods ended June 30, 2023	2022
Sales		972	907	1,682	1,558
Expenses					
Cost of sales (including depreciation and amortization (3 months - $22 (2022 - $18) and 6 months - $43 (2022 - $35))		772	734	1,346	1,285
Selling and administrative (including depreciation and amortization (3 months - $4 (2022 - $3) and 6 months - $8 (2022 - $7))		48	39	89	72
Other losses, net		3	1	3	1
		823	774	1,438	1,358
Operating income		149	133	244	200
Financial expenses		16	6	30	12
Income before income taxes		133	127	214	188
Income tax expense					
Current		31	29	55	42
Deferred		2	4	(1)	6
		33	33	54	48
Net income		100	94	160	140
Basic and diluted earnings per common share	6	1.72	1.51	2.73	2.23

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

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Comprehensive Income

(Unaudited)

(expressed in millions of Canadian dollars)

	For the three-month periods ended June 30,		For the six-month periods ended June 30,	
	2023	**2022**	**2023**	**2022**
Net income	100	94	160	140
Other comprehensive income (loss)				
Items that may subsequently be reclassified to net income				
Gains (losses) on translation of financial statements of foreign operations	(33)	37	(34)	19
Gains (losses) on translation of long-term debt designated as hedges of net investment in foreign operations	5	(7)	5	(3)
Change in fair value of derivatives designated as cash flow hedges	4	5	(1)	18
Income tax on change in fair value of derivatives designated as cash flow hedges	(1)	(1)	—	(5)
Items that will not subsequently be reclassified to net income				
Remeasurements of post-retirement benefit obligations	—	4	(1)	9
Income taxes on remeasurements of post-retirement benefit obligations	—	(1)	—	(2)
	(25)	37	(31)	36
Comprehensive income	75	131	129	176

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

Stella-Jones Inc.

Condensed Interim Consolidated Statements of Cash Flows

(Unaudited)

(expressed in millions of Canadian dollars)

	Note	For the three-month periods ended June 30, 2023	2022	For the six-month periods ended June 30, 2023	2022
Cash flows from (used in)					
Operating activities					
Net income		100	94	160	140
Adjustments for					
Depreciation of property, plant and equipment		10	8	19	15
Depreciation of right-of-use assets		12	10	24	20
Amortization of intangible assets		4	3	8	7
Financial expenses		16	6	30	12
Income tax expense		33	33	54	48
Other		3	—	5	—
		178	154	300	242
Changes in non-cash working capital components					
Accounts receivable		(20)	8	(123)	(144)
Inventories		23	65	(115)	5
Other current assets		(8)	(9)	(10)	(16)
Accounts payable and accrued liabilities		22	34	33	46
		17	98	(215)	(109)
Interest paid		(14)	(5)	(29)	(13)
Income taxes paid		(54)	(19)	(61)	(28)
		127	228	(5)	92
Financing activities					
Net change in revolving credit facilities		(2)	(192)	215	47
Proceeds from long-term debt		—	63	—	63
Repayment of long-term debt		(1)	(1)	(1)	(33)
Repayment of lease liabilities		(12)	(9)	(23)	(19)
Dividends on common shares		(27)	(25)	(27)	(25)
Repurchase of common shares	6	(30)	(44)	(60)	(83)
Other		1	—	—	—
		(71)	(208)	104	(50)
Investing activities					
Business combinations	3	(20)	—	(33)	—
Purchase of property, plant and equipment		(33)	(17)	(61)	(37)
Additions of intangible assets		(3)	(3)	(5)	(5)
		(56)	(20)	(99)	(42)
Net change in cash and cash equivalents during the period		—	—	—	—
Cash and cash equivalents – Beginning of period		—	—	—	—
Cash and cash equivalents – End of period		—	—	—	—

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

1 Description of the business

Stella-Jones Inc. (with its subsidiaries, either individually or collectively, referred to as the "Company") is North America's leading producer of pressure-treated wood products. It supplies the continent's major electrical utilities and telecommunication companies with wood utility poles and North America's Class 1, short line and commercial railroad operators with railway ties and timbers. The Company also provides industrial products, which include wood for railway bridges and crossings, marine and foundation pilings, construction timbers and coal tar-based products. Additionally, the Company manufactures and distributes premium treated residential lumber and accessories to Canadian and American retailers for outdoor applications, with a significant portion of the business devoted to servicing Canadian customers through its national manufacturing and distribution network. The Company has treating and pole peeling facilities across Canada and the United States and sells its products primarily in these two countries. The Company's headquarters are located at 3100 de la Côte-Vertu Blvd., in Saint-Laurent, Quebec, Canada. The Company is incorporated under the Canada Business Corporations Act, and its common shares are listed on the Toronto Stock Exchange ("TSX") under the stock symbol SJ.

2 Significant accounting policies

Basis of presentation

The Company's condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") and Chartered Professional Accountants Canada Handbook Accounting - Part I, applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting.

These condensed interim consolidated financial statements were approved by the Board of Directors on August 8, 2023.

The same accounting policies, methods of computation and presentation have been followed in the preparation of these condensed interim consolidated financial statements as were applied in the annual consolidated financial statements for the year ended December 31, 2022.

These condensed interim consolidated financial statements should be read in conjunction with the Company's annual consolidated financial statements for the year ended December 31, 2022, which have been prepared in accordance with IFRS.

Principles of consolidation

The condensed interim consolidated financial statements include the accounts of Stella-Jones Inc. and its controlled subsidiaries. Intercompany transactions and balances between these companies have been eliminated. All consolidated subsidiaries are wholly owned. The significant subsidiaries within the legal structure of the Company are as follows:

Subsidiary	Parent	Country of incorporation
Stella-Jones U.S. Holding Corporation	Stella-Jones Inc.	United States
Stella-Jones Corporation	Stella-Jones U.S. Holding Corporation	United States

3 Business combination

On February 14, 2023, the Company acquired substantially all the operating assets of IndusTREE Pole & Piling, LLC ("IndusTREE"), a business specialized in pole peeling and drying Southern Yellow Pine poles in Goodwater, Alabama. On June 16, 2023, the Company acquired substantially all the operating assets of Balfour Pole Co., LLC ("Balfour"), a business specialized in pole peeling and drying Southern Yellow Pine poles in Baconton, Georgia.

IndusTREE and Balfour were acquired for synergistic reasons and financed through the Company's existing credit facilities. Total acquisition-related costs of less than one million dollars were recognized in the consolidated statement of income under selling and administrative expenses.

These acquisitions were not individually material, therefore the Company has chosen to disclose the required information in aggregate. The below table presents a final summary of the aggregate assets acquired and consideration transferred at fair value as at the acquisition dates. The original transactions were made in U.S. dollars and converted into Canadian dollars as at the acquisition dates.

(Amounts in millions of Canadian dollars)	
Assets acquired	
Inventories	1
Property, plant and equipment	21
Goodwill	14
	36
Cash	33
Deferred consideration	1
Settlement of an advance payable by IndusTREE	2
Consideration transferred	**36**

Goodwill is deductible for U.S. tax purposes and represents the future economic value associated with the acquired workforce and synergies with the Company's operations. For impairment test purposes, goodwill is allocated to a cash-generating unit defined as plants specialized in the treatment of utility poles and residential lumber.

The acquired businesses of IndusTREE and Balfour were vertically integrated within the Company's operations and no third-party revenue was recognized from the acquisition dates.

4 Long-term debt

(Amounts in millions of Canadian dollars)	Year of maturity	As at June 30, 2023	As at December 31, 2022
Unsecured:			
Revolving credit facilities [(a)]	2026-2028	605	394
Term loan facilities			
US$125, variable rate based on SOFR plus 1.725% [(a)]	2028	166	169
US$100, fixed rates ranging from 3.27% to 4.47%, with quarterly amortization payments starting in 2026	2029-2030	132	135
US$25, fixed rate of 4.52%	2029	33	34
Senior notes			
US$75, fixed rate of 3.54% US$75, fixed rate of 3.81%	2024 2027	199	204
Other		4	5
		1,139	941
Less: Current portion of long-term debt		101	1
		1,038	940

a) Unsecured Senior U.S. Farm Credit Facilities

On March 3, 2023, the Company amended and restated the U.S. Farm Credit Agreement in order to, among other things, (i) increase the amount available under the credit facilities from US$350 million to US$550 million, ii) extend the term of U.S. Farm Revolving Credit Facility in the amount of US$150 million from April 29, 2026 to March 3, 2028, and iii) transition from London Interbank Offered Rate (“LIBOR”) references to Secured Overnight Financing Rate (“SOFR”). Revolving credit facility advances made prior to this amendment continued to apply LIBOR until the end of their term.

In order to maintain the credit facilities and senior notes in place, the Company needs to comply with customary affirmative covenants, negative covenants, reporting requirements and financial ratios. The Company is required to maintain a net funded debt-to-EBITDA ratio of no more than 3.50:1, an interest coverage ratio equal to or greater than 3.00:1 and a priority debt to equity ratio not more than 15%, which are measured on a quarterly basis. As at June 30, 2023, the Company was in full compliance with these covenants, requirements and ratios.

5 Provisions and other long-term liabilities

(Amounts in millions of Canadian dollars)	**As at June 30, 2023**	**As at December 31, 2022**
Site remediation	20	18
Share-based payment plans	13	9
Others	7	8
	40	35
Less: Current portion of provisions and long-term liabilities	13	9
	27	26

The Company's share-based payment plans consist of cash-settled restricted stock unit, performance stock unit and deferred share unit plans.

Restricted stock units (RSUs) and Performance stock units (PSUs)

Under the Stock Unit Plan, RSUs and PSUs are granted to certain executives and key employees of the Company. RSUs and PSUs entitle the holders to receive a cash payment equal to the average closing price on the TSX of the Company's common shares for the five trading days preceding the vesting date multiplied by a factor which ranges from 0% to 200% based on the attainment of performance criteria and/or market conditions set out pursuant to the plan, provided the individual is still employed by the Company at time of vesting. RSUs vest ratably over a period of three years and PSUs are paid three years after the grant date.

Changes in outstanding RSUs for the six-month periods ended June 30, are as follows:

	2023	**2022**
RSUs outstanding - Beginning of period	122,315	103,963
Granted	65,479	88,763
Vested	(47,966)	(63,527)
Forfeited	(7,634)	(2,395)
RSUs outstanding - End of period	132,194	126,804

Changes in outstanding PSUs for the six-month periods ended June 30, are as follows:

	2023	**2022**
PSUs outstanding - Beginning of period	69,337	29,398
Granted	38,517	44,382
Forfeited	(8,532)	(697)
PSUs outstanding - End of period	99,322	73,083

Deferred share units (DSUs)

DSUs entitle non-executive directors of the Company to receive a minimum participation amount in the form of DSUs and they may elect to participate in the DSU plan for a portion of their Board fees. Such deferred remuneration is converted to DSUs based on the average closing price of the Company's common shares on the TSX of the five trading days immediately preceding the date such awards are granted to the non-employee director. DSUs are settled for cash only after a non-employee director ceases to act as a director.

hanges in outstanding DSUs for the six-month periods ended June 30, are as follows:

	2023	**2022**
DSUs outstanding - Beginning of period	44,333	20,131
Granted	13,144	24,202
Settled	(1,760)	—
DSUs outstanding - End of period	55,717	44,333

6 Capital stock and earnings per share

The following table provides the number of common shares outstanding for the six-month periods ended June 30:

	2023	**2022**
Number of common shares outstanding – Beginning of period	59,115,959	63,773,252
Common shares repurchased	(1,110,457)	(2,286,186)
Stock option exercised	5,000	—
Employee share purchase plans	15,046	21,715
Number of common shares outstanding – End of period	58,025,548	61,508,781

a) Capital stock

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares, issuable in series.

All issued shares are fully paid. The common shares provide for the right to receive notice of, attend and vote at all meetings of shareholders and receive dividends, subject to the prior rights of the preferred shares and any other shares ranking senior to the common shares. To date, the Company has not issued any preferred shares.

On June 7, 2023, 5,000 ordinary shares were issued as a result of the exercise of options arising from the share options granted in 2015. Options were exercised at the option value price of 49.01$ per share.

b) Normal Course Issuer Bid

On November 8, 2022, the TSX accepted the Company's Notice of Intention to Make a Normal Course Issuer Bid ("NCIB") to purchase for cancellation up to 5,000,000 common shares during the 12-month period commencing November 14, 2022 and ending November 13, 2023, representing approximately 9.6% of the public float of its common shares.

During the six-month period ended June 30, 2023, the Company repurchased for cancellation 1,110,457 common shares under its NCIB (June 30, 2022 - 2,286,186 common shares under the NCIB then in effect) for a total consideration of $60 million (June 30, 2022 - $85 million), representing an average price of $53.86 per common share (June 30, 2022 - $37.17). For the six-month period ended June 30, 2023, the Company's capital stock was reduced by four million dollars (June 30, 2022 – eight million dollars) and the remaining $56 million (June 30, 2022 – $77 million) was accounted for as a decrease in retained earnings.

c) Earnings per share

The following table provides the reconciliation, as at June 30, between basic earnings per common share and diluted earnings per common share:

(Amounts in millions of Canadian dollars, except per share amounts)	**For the three-month periods ended June 30,**		**For the six-month periods ended June 30,**	
	2023	**2022**	**2023**	**2022**
Net income applicable to common shares	$100	$94	$160	$140
Weighted average number of common shares outstanding*	58,292	62,321	58,543	62,794
Effect of dilutive stock options*	5	—	3	—
Weighted average number of diluted common shares outstanding*	58,297	62,321	58,546	62,794
Basic and diluted earnings per common share	$1.72	$1.51	$2.73	$2.23

* Number of shares is presented in thousands.

7 Fair value measurement and financial instruments

The following table summarizes the Company's interest rate swap agreements:

(Amounts in millions of Canadian dollars)					**As at June 30, 2023**	**As at December 31, 2022**
Notional amount	**Related debt instrument**	**Fixed rate**	**Effective date**	**Maturity date**	**Notional equivalent**	**Notional equivalent**
		%			**CA$**	**CA$**
US$50	Revolving credit facilities	0.796*	Dec. 2021	Dec. 2026	66	68
US$125	Term loan facility	1.0769**	July 2021	June 2028	166	169

* Plus applicable margin based on pricing grid included in the revolving credit agreements.
** Plus set margin of 1.725%.

In March 2023, the Company amended its interest rate swap agreements and replaced its LIBOR interest derivatives used in cash flow hedging relationships with economically equivalent interest derivatives referencing SOFR. Prior to the transition from LIBOR to SOFR, the fixed swap rate was 0.872% and 1.125% plus applicable margin for the revolving credit facilities and the term loan facility, respectively.

The Company designates its interest rate swap agreements as cash flow hedges of the underlying debt. The cash flow hedge documentation allows the Company to substitute the underlying debt as long as the hedge effectiveness is demonstrated. As at June 30, 2023, all cash flow hedges were effective.

As at June 30, 2023, the fair value of interest swap agreements was $28 million, recognized as non-current assets in the condensed interim consolidated statement of financial position (December 31, 2022 - $29 million in the consolidated statement of financial position).

The fair value of these financial instruments has been estimated using the discounted future cash flow method and has been classified as Level 2 in the fair value hierarchy as per IFRS 7, *Financial Instruments: Disclosures*, as it is based mainly on observable market data, namely government bond yields and interest rates. A description of each level of the hierarchy is as follows:

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

Financial instruments which are not measured at fair value on the statement of financial position are represented by accounts receivable, accounts payable and accrued liabilities and long-term debt. The fair values of accounts receivable and accounts payable and accrued liabilities approximate their carrying values due to their short-term nature. The long-term debt has a carrying value of $1,139 million (December 31, 2022 – $941 million) and a fair value of $1,111 million (December 31, 2022 – $908 million).

8 Seasonality

The Company's operations follow a seasonal pattern, with utility poles, railway ties and industrial products shipments strongest in the second and third quarters to provide industrial end-users with product for their summer maintenance projects. Residential lumber sales follow the same seasonal pattern. Inventory levels of utility poles, railway ties and residential lumber are typically highest in the first quarter in advance of the summer shipping season.

9 Segment information

The Company operates within two business segments which are the production and sale of pressure-treated wood and the procurement and sales of logs and lumber.

The pressure-treated wood segment includes utility poles, railway ties, residential lumber and industrial products.

The logs and lumber segment comprises of the sales of logs harvested in the course of the Company's procurement process that are determined to be unsuitable for use as utility poles. Also included in this segment is the sale of excess lumber to local home-building markets. Assets and net income related to the logs and lumber segment are nominal.

Operating plants are located in six Canadian provinces and 18 American states. The Company also operates a large distribution network across North America.

Sales attributed to countries based on location of customer for the six-month periods ended June 30, are as follows:

(Amounts in millions of Canadian dollars)	**2023**	**2022**
Canada	457	517
U.S.	1,225	1,041
	1,682	1,558

Sales by product for the six-month periods ended June 30, are as follows:

(Amounts in millions of Canadian dollars)	**2023**	**2022**
Utility poles	750	570
Railway ties	433	390
Residential lumber	361	418
Industrial products	79	71
Pressure-treated wood	1,623	1,449
Logs and lumber	59	109
	1,682	1,558

Property, plant and equipment, right-of-use assets, intangible assets and goodwill attributed to the countries based on location are as follows:

(Amounts in millions of Canadian dollars)	**As at June 30, 2023**	**As at December 31, 2022**
Property, plant and equipment		
Canada	216	204
U.S.	588	551
	804	755
Right-of-use assets		
Canada	24	22
U.S.	145	138
	169	160
Intangible assets		
Canada	55	54
U.S.	110	117
	165	171
Goodwill		
Canada	21	21
U.S.	354	348
	375	369

10 Subsequent events

a) On July 14, 2023, the Company acquired substantially all of the assets of the wood utility pole manufacturing business of Baldwin Pole and Piling Company, Inc., Baldwin Pole Mississippi, LLC and Baldwin Pole & Piling, Iowa Corporation (collectively, “Baldwin”) for a total consideration of approximately $64 million (US$48 million). Baldwin is a Southern Yellow Pine pole treating company with facilities in Bay Minette, Alabama and Wiggins, Mississippi.

b) On August 8, 2023, the Board of Directors declared a quarterly dividend of $0.23 per common share payable on September 25, 2023 to shareholders of record at the close of business on September 5, 2023.