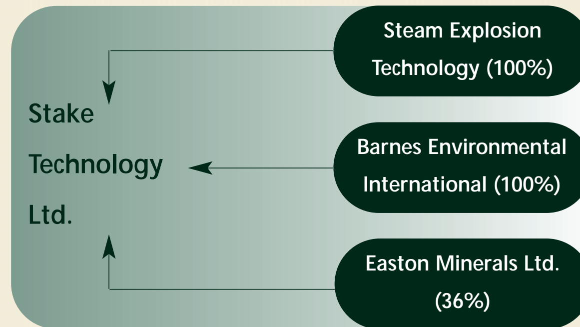
STAKE TECHNOLOGY LTD.

ANNUAL REPORT 1998



Stake Technology Ltd. (StakeTech) is an environmentally based growth Company with a technology division and a recycling division. The Company is listed on NASDAQ as STKL and has approximately 3,300 shareholders.

Stake's vision is to contribute towards the creation of a healthy environment by providing products and services, which improve the quality of life. The Company is focusing on:

- developing cleaner pulping technologies that can use annually regenerative crops for paper production.
- supplying industrial minerals that are safer, cleaner and can be recycled.
- producing and distributing food products made from organic and non genetically altered ingredients

The Steam Explosion Technology division has developed a patented technology and focuses on selling its proprietary equipment to two major markets:

- production of pulp for paper from non-woody materials such as cereal straws, grasses and sugarcane bagasse.
- production of cellulose derivatives used in the manufacture of textiles, cellulose film and pharmaceuticals.

The Company's patented StakeTech System uses high pressure steam to free the cellulose from natural fibres, greatly reducing the use of chemicals currently associated with industrial practices.

Barnes Environmental International, (B.E.I.) a division of StakeTech, is a producer, distributor and recycler of industrial minerals. B.E.I. has established a strong customer base throughout North America by providing exceptional service supported by a high level of technical capability. B.E.I. is focusing on two major growth areas:

- increasing B.E.I.'s market share in the abrasives market through the introduction of its proprietary Barshot™ product, garnet product line and copper slags.
- utilizing its environmental Certificate of Approval to expand its recycling services and provide industry with economic alternatives to landfill.

Easton Minerals Ltd. is a valuable non-strategic investment in mineral exploration held for investment purposes.

Dear Shareholder:

This year's annual report is being released to coincide with the annual and special shareholders meeting which includes the Company's request for the shareholders to consider the approval of the acquisition of Sunrich, Inc. All of the major agreements with Sunrich have been completed. The Sunrich transaction is described in the S-4 which also registers the shares to be issued upon completion of the transaction. The Board of Directors recommends approval of the acquisition of Sunrich, Inc.

1998 in Review

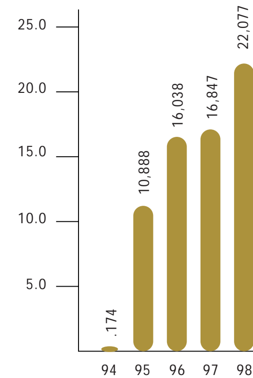
Sales in 1998 rose by 31% to a record level of $22,077,000. While the great majority of the sales came from the Company's wholly owned division, Barnes Environmental International (B.E.I.), encouraging progress was made on a number of potential steam explosion projects.

Profit Magazine, a national business publication, reported that Stake was the 16th fastest growing company in Canada with a 5 year sales growth of 4,237%.

Earnings for the year rose 452% to $822,000 or $0.06 per share compared to $149,000 or $0.01 per share in 1997.

Sales in 1998 rose by 31% to a record level of $22 million.

During 1998 the Company repaid an additional $500,000 of debt, redeemed $170,000 of preferred shares, and at the same time invested $471,000 in capital expenditures, primarily at B.E.I..

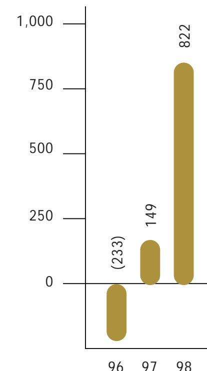


The net worth of the Company rose 11.2% to $10,073,000 and working capital increased by 14.1% to $3,551,000. In summary, the financial strength of the Company continued to improve during the year.

Barnes Environmental International (B.E.I.)

B.E.I. achieved sales of $22 million with division net earnings of $2.6 million or 11.8% on sales, an extremely good year. B.E.I. has experienced monthly sales growth over the previous year for 18 consecutive months.

During the first quarter of 1999, sales were up $600,000 or 15% over the first quarter in 1998, despite difficult weather conditions in January.



Abrasive sales grew rapidly in 1998 with Barshot™, the Company's specular hematite product, increasing in sales by 111% to approximately $4.0 million.

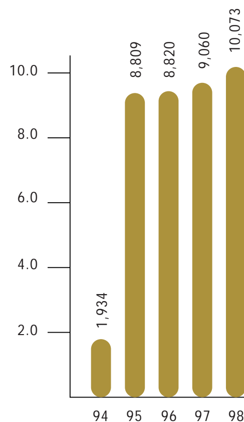
New products developed over the last 3 years, account for 30% of total sales and a new full time product development function has been added this year.

Formal agreements were signed during 1998 giving the Company exclusivity from:

- U.S. Silica for the sale of foundry sands in Ontario and Quebec;
- a company located in India for exclusive North American rights to their garnet product line;
- a company in South Africa for the Canadian rights for the sales of chromite sands;
- a 5 year agreement signed with Falconbridge to supply copper slag processed into an abrasive at the Company's Waterdown site, and
- a customer agreement signed for 5 years, with USE Hickson and B.E.I. continued to be the exclusive supplier of environmental additive products to Essroc Canada. The Company also became the principal supplier of chromite and zircon sands, and bentonite clay to Dominion Casting.

Net worth

(Millions of dollars)



Abrasive sales grew rapidly in 1998 with Barshot™ the Company's specular hematite product, increasing in sales by 111% to approximately $4.0 million. The Company's new facility in Louisiana had an excellent year supplying the ship repair industry. Further investment is planned in 1999 in Louisiana to allow for the receipt of raw materials by boat with screening and drying to be done at the Company's facilities.

Environmental sales were strong in 1998 reflecting a high level of recycling of foundry sands, steel company iron cakes, alumina and slag generated from industrial sources and site remediation projects. These recycled materials are processed, blended and resold for cement manufacturing. Approximately 99.5% of the 86,000 tons received on site under the Company's certificate of approval from the Ministry of the Environment were recycled, avoiding the landfill option.

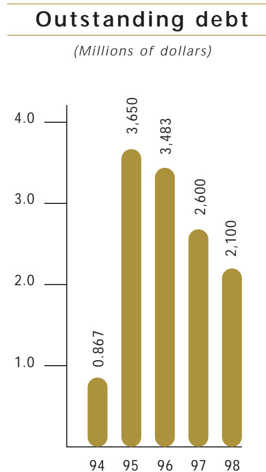
For 1999, management anticipates further growth led by increasing sales of abrasives, North American introduction of garnets, particularly in the waterjet metal cutting market and growing sales of specialty chromite and zircon sands.

B.E.I. is actively considering acquisition opportunities, which would establish a national distribution base for its existing products and broaden its current product lines in both Canada and the USA.

The net worth of the Company rose 11.2% to $10,073,000 and working capital increased by 14.1% to $3,551,000.

Steam Explosion Technology

1998 was a difficult year for the steam explosion technology division with two major projects being put on hold by the clients. Substantial progress was made in application of the technology in certain high value applications and this has enhanced the benefits we can now offer to end-users.



Highlights of Steam Explosion in 1998 were:

- Bagasse testing with Sappi of South Africa expanded our process into higher value bleached pulps. A new process patent was applied for and has strengthened our proprietary position.
- A test reactor was installed and successfully started up in the UK with excellent results. The client is currently using the system to evaluate our technology for commercial application in the production of a high value cellulose product.
- Kenaf pulping for linerboard was optimized at the lab level. This is the first application of our technology to an industrial crop. These raw materials are of increasing interest as an alternative source of fibre for the pulp and paper industry.
- In Q3 and Q4, cost reductions were put in place to substantially reduce expenses pending a recovery in the pulp and paper industry.
- A major market opportunity for the company's technology to make pulp from straw in China was identified and it was decided to seek an alliance with an engineering firm and/or an equipment company to develop this market. These activities included the signing of a letter of intent with Kellogg Brown and Root in the first quarter of 1999. These discussions are ongoing.

On behalf of the Board of Directors we would like to thank our shareholders for their continuing support and to express our appreciation to our employees who are responsible for achieving our improved results in 1998.

Jeremy N. Kendall
Chairman and Chief Executive Officer

John D. Taylor
President and Chief Operating Officer

Management's Responsibility for Reporting

Management is responsible for the preparation and integrity of the consolidated financial statements of Stake Technology Ltd.. The financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada, and reflect estimates based on judgment. Management has determined such amounts on a reasonable basis to ensure that the consolidated financial statements are presented fairly, in all material respects. Reconciliation of these policies to U.S. accounting policies are described in note 16 to the consolidated financial statements. Financial information used throughout the Annual Report is consistent with that in the consolidated financial statements.

The Company's policy is to maintain systems of internal accounting and administrative controls which are high quality, consistent with reasonable cost. These systems are designed to provide reasonable assurance that the financial information is accurate and reliable and that the Company's assets are appropriately accounted for and safeguarded.

The Board of Directors, through the three person Audit Committee, which includes two non-management members, is responsible for assuring that management fulfills its financial reporting responsibilities. The Audit Committee meets periodically with management and the auditors to discuss internal controls over the financial reporting process, audit plans, auditing matters and financial reporting issues, and to review the consolidated financial statements and the Auditors' Report. The Committee reports its findings to the Board of Directors for consideration of the Board when it approves the consolidated financial statements for issuance to the shareholders. The auditors have unrestricted access to the Audit Committee. The Audit Committee recommends the appointment of the Company's auditors who are appointed at the Company's Annual Meeting.

The consolidated financial statements have been audited by PricewaterhouseCoopers LLP, the auditors, in accordance with generally accepted auditing standards.

Leslie N. Markow
Vice President, Finance and Chief Financial Officer

Independent Auditors' Report

TO THE SHAREHOLDERS OF STAKE TECHNOLOGY LTD.

We have audited the consolidated balance sheets of Stake Technology Ltd. as at December 31, 1998 and 1997 and the consolidated statements of operations, 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 generally accepted auditing standards in Canada. 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, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles in Canada.

"PricewaterhouseCoopers LLP"
Chartered Accountants

Mississauga, Ontario
February 19, 1999

Consolidated Balance Sheets

As at December 31, 1998 and 1997
(Expressed in Canadian Dollars)

	1998	1997
	$	$
ASSETS *(note 5)*		
Current assets		
Cash and cash equivalents	181,000	740,000
Cash held as security deposit *(note 5)*	400,000	525,000
Marketable securities – at cost (quoted market value – $nil (1997 – $16,000))	–	16,000
Accounts receivable – trade	3,805,000	2,615,000
Inventories *(note 2)*	2,878,000	1,931,000
Miscellaneous receivables and other assets	161,000	349,000
	7,425,000	6,176,000
Property, plant and equipment *(note 3)*	5,825,000	5,960,000
Investments *(note 4)*	565,000	531,000
Goodwill – at cost, less accumulated amortization of $358,000 (1997 – $245,000)	1,897,000	2,010,000
Patents, trademarks, licenses and other assets – at cost, less accumulated amortization of $900,000 (1997 – $874,000)	384,000	347,000
	16,096,000	15,024,000
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	2,937,000	2,241,000
Current portion of long-term debt *(note 5)*	700,000	590,000
Current portion of preference shares *(note 6)*	237,000	234,000
	3,874,000	3,065,000
Long-term debt *(note 5)*	1,400,000	2,010,000
Preference shares of subsidiary company *(note 6)*	749,000	889,000
	6,023,000	5,964,000
SHAREHOLDERS' EQUITY		
Capital stock *(note 7)*		
Authorized		
Unlimited common shares without par value		
Issued		
14,779,718 (1997 – 14,425,718) common shares	4,467,000	4,276,000
Contributed surplus	4,635,000	4,635,000
Retained earnings *(note 7)*	971,000	149,000
	10,073,000	9,060,000
	16,096,000	15,024,000

SIGNED ON BEHALF OF THE BOARD

Jeremy N. Kendall
Director

John D. Taylor
Director

Contingencies and Commitments *(notes 5 and 10)*

(See accompanying notes to consolidated financial statements)

Consolidated Statements of Operations

For the years ended December 31, 1998 and 1997
(Expressed in Canadian Dollars)

	1998	1997
	$	$
Revenues	22,077,000	16,847,000
Cost of goods sold	17,308,000	13,287,000
Gross profit	4,769,000	3,560,000
Expenses		
Research and development	357,000	349,000
Administration, market development and demonstration	3,419,000	2,973,000
Amortization of patents, trademarks, licenses and goodwill	139,000	149,000
Gain on sale of property, plant and equipment	(60,000)	–
	3,855,000	3,471,000
Earnings from operations	914,000	89,000
Interest on long-term debt	(134,000)	(155,000)
Other interest	–	(28,000)
Interest and other income	57,000	83,000
Foreign exchange gain	67,000	7,000
(Loss) gain on sale of marketable securities	(16,000)	36,000
Gain on dilution of investment interests in equity accounted investees *(note 4)*	26,000	226,000
Share of losses of equity accounted investees *(note 4)*	(29,000)	(35,000)
Dividend on preference shares of subsidiary company	(30,000)	(35,000)
Imputed interest on preference shares of subsidiary company	(33,000)	(39,000)
Earnings before income taxes	822,000	149,000
Provision for income taxes *(note 8)*	–	–
Net earnings for the year	822,000	149,000
Earnings per share *(note 11)*	0.06	0.01

Consolidated Statements of Retained Earnings

For the years ended December 31, 1998 and 1997
(Expressed in Canadian Dollars)

	1998	1997
	$	$
Retained earnings (deficit) – Beginning of year	149,000	(25,026,000)
Reduction of deficit *(note 7)*	–	25,026,000
Net earnings for the year	822,000	149,000
Retained earnings – End of year	971,000	149,000

(See accompanying notes to consolidated financial statements)

Consolidated Statements of Cash Flows

For the years ended December 31, 1998 and 1997
(Expressed in Canadian Dollars)

	1998	1997
	$	$
Cash flows from operating activities		
Net earnings for the year	822,000	149,000
Items not affecting cash		
Amortization	716,000	692,000
Share of losses of investees	29,000	35,000
Loss (gain) on sale of marketable securities	16,000	(36,000)
Gain on sale of property, plant and equipment	(60,000)	–
Gain on dilution of interest in investee	(26,000)	(226,000)
Imputed interest on preference shares	33,000	39,000
	1,530,000	653,000
Change in non-cash working capital balances related to operations		
Accounts receivable – trade	(1,190,000)	(561,000)
Inventories	(947,000)	829,000
Miscellaneous receivables and other assets	188,000	(12,000)
Accounts payable and accrued liabilities	696,000	(552,000)
Deferred revenue	–	(45,000)
Net cash provided by operating activities	277,000	312,000
Cash flows from investing activities		
Acquisition of patents, trademarks, licences and other assets	(63,000)	(67,000)
Cash held as security deposit	125,000	(150,000)
Acquisition of marketable securities	–	(137,000)
Acquisition of property, plant and equipment	(471,000)	(883,000)
Proceeds on sale of property, plant and equipment	89,000	–
Proceeds on sale of marketable securities	–	663,000
Increase in investments and advances	(37,000)	(21,000)
Proceeds on sale of investments	–	25,000
Net cash used in investing activities	(357,000)	(570,000)
Cash flows from financing activities		
Purchase of preference shares in subsidiary company	(100,000)	–
Redemptions of preference shares in subsidiary company	(70,000)	(70,000)
Repayment of long-term debt	(500,000)	(883,000)
Issuance of common shares	191,000	91,000
Net cash used in financing activities	(479,000)	(862,000)
Decrease in cash during the year	(559,000)	(1,120,000)
Cash and cash equivalents – Beginning of year	740,000	1,860,000
Cash and cash equivalents – End of year	181,000	740,000

(See accompanying notes to consolidated financial statements)

Notes to Consolidated Financial Statements

For the years ended December 31, 1998 and 1997
(Expressed in Canadian Dollars)

1 Description of business and significant accounting policies

Stake Technology Ltd. (the “Company”) was incorporated under the laws of Canada on November 13, 1973 and operates in two principal businesses. Through its division, Barnes Environmental International (“B.E.I.”), the Company sells abrasives and industrial materials and recycles inorganic materials. The Company also operates a division developing and commercializing a proprietary steam explosion technology for processing of biomass into higher value products. A substantial majority of the Company’s assets, operations and employees are in Canada.

These financial statements are prepared in accordance with accounting principles generally accepted in Canada. Differences arising from the application of accounting principles generally accepted in the United States are described in note 16. The significant policies are outlined below:

Basis of presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All significant intercompany accounts and transactions have been eliminated on consolidation.

Cash and cash equivalents

Cash and cash equivalents consist of unrestricted cash and short-term deposits with a maturity at acquisition of less than 90 days.

Inventories

Inventories are related to the recycling and industrial minerals business of the Company’s division, B.E.I., and are valued at the lower of cost and estimated net realizable value. Cost is determined on a first in first out basis.

Investments and marketable securities

Investments in companies over which the Company exercises significant influence are accounted for by the equity method whereby the Company includes its proportionate share of earnings and losses of such companies in earnings. Other long-term investments are recorded at cost and are written down to their estimated recoverable amount when there is evidence of a decline in value which is other than temporary.

Short-term marketable securities are carried at the lower of cost and quoted market value.

Amortization of capital assets

Amortization is provided on plant and equipment on the diminishing balance basis at rates of 20% to 33% per annum for office furniture and equipment, machinery and laboratory equipment and vehicles and 4-8% for buildings. Amortization is calculated from the time the asset is put into use.

Costs of acquiring or filing patents, trademarks and licenses are capitalized and amortized on a straight-line basis over their expected lives of 10 to 20 years. Costs of renewing patents and trademarks are expensed as incurred.

Revenue recognition

Revenue from the sale of industrial minerals is recognized upon shipment.

Tipping fee revenue, which consists of a per ton fee paid to the Company for waste recycling materials being received by the Company, is recognized at the time the material is received. Provision is made for the net costs of processing and disposal of the material.

The percentage of completion method is used to account for significant contracts in progress when related costs can be reasonably estimated. The Company uses costs incurred to date as a percentage of total expected costs to measure the extent of progress towards completion.

Revenue from consulting and contract research is recognized when the service is completed.

License fees related to sales of the Company’s technologies are recorded as revenue when earned and collection is reasonably assured.

1 Description of business and significant accounting policies *(continued)*

Foreign currency translation

Revenues and expenses arising from foreign currency transactions are translated into Canadian dollars using the exchange rate in effect at the transaction date. Monetary assets and liabilities are translated using the rate in effect at the balance sheet date. Related exchange gains and losses are included in the determination of earnings.

Goodwill

Goodwill represents the excess of the cost of subsidiaries and businesses over the assigned value of net assets acquired. Goodwill is amortized on a straight-line basis over its estimated life of twenty years. The Company reviews the recoverability of goodwill whenever events or changes in circumstance indicate that the carrying amount may not be recoverable. The measurement of possible impairment is based primarily on the ability to recover the balance of the goodwill from expected future operating cash flows on an undiscounted basis.

Income taxes

During 1998, the Company adopted the asset and liability method of accounting for income taxes whereby deferred income tax assets are recognized for deductible temporary differences and operating loss carryforwards, and deferred income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred income tax assets are recognized only to the extent that management determines that it is more likely than not that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in deferred income tax assets and liabilities during the period. The adoption of the liability method has had no impact on the reported earnings for the years presented.

Earnings per share

The computation of earnings per share is based on the weighted average number of common shares outstanding during the period.

Use of estimates

The preparation of these financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

2 Inventories

	1998	1997
	$	$
Raw materials	**1,696,000**	1,007,000
Finished goods	**1,182,000**	924,000
	2,878,000	1,931,000

3 Property, plant and equipment

	1998			1997		
	Cost	*Accumulated Amortization*	*Net*	*Cost*	*Accumulated Amortization*	*Net*
	$	**$**	**$**	$	$	$
Land and buildings	**4,087,000**	**396,000**	**3,691,000**	4,053,000	321,000	3,732,000
Office furniture and equipment	**566,000**	**275,000**	**291,000**	454,000	212,000	242,000
Vehicles	**60,000**	**59,000**	**1,000**	60,000	55,000	5,000
Machinery and laboratory equipment	**3,563,000**	**1,721,000**	**1,842,000**	3,276,000	1,295,000	1,981,000
	8,276,000	**2,451,000**	**5,825,000**	7,843,000	1,883,000	5,960,000

4 Investments

	1998	1997
	$	$
Easton Minerals Ltd.		
36% (1997 – 37%) common share ownership	**507,000**	510,000
Advances	**58,000**	21,000
	565,000	531,000

Easton Minerals Ltd. ("Easton") is a small mining exploration company listed on the Vancouver Stock Exchange. The quoted market value of the shares held by the Company at December 31, 1998 was $1,258,000 (1997 – $3,538,000), however, this value is based upon limited trading volumes of the common shares of Easton. It is unlikely that these values could be realized upon sale of all or a portion of the Company's holdings in Easton, particularly given the significant number of shares held by the Company.

The Company's share of losses of Easton for 1998 amounted to $29,000 (1997 – $35,000). In 1998, Easton issued 500,000 (1997 – 1,254,348) common shares to third parties for cash consideration of $98,000 (1997 – $741,000). A dilution gain on this transaction of $26,000 (1997 – $226,000) was recognized on the reduction of the Company's percentage ownership of Easton.

5 Long-term debt and bank facilities

Long-term debt consists of the following:

	1998	1997
	$	$
Term bank loan, interest based on banker's acceptance rates, currently 6.6%	**2,100,000**	2,600,000
Less: current portion	**700,000**	590,000
	1,400,000	2,010,000

In the event of default under the long-term debt agreement, a former director of the Company has a right to acquire all of the common shares of a subsidiary company of the Company for $1. The sole asset of the subsidiary is 19.2 acres of land with a book value of $1,312,000. If this occurred, the liability in respect of the first and second preference shares of the subsidiary company reflected in these financial statements *(note 6)* would be extinguished without payment.

The term loan facility bears interest at the rate of prime + 1%, or banker's acceptance rates + 1.25% and requires payments as follows:

	$
1999	700,000
2000	600,000
2001	800,000
	2,100,000

The Company has provided a general collateral agreement representing a first charge on all assets of the Company as collateral for a $3,000,000 operating bank facility and the term loan facility. The Company has also provided first mortgages in the aggregate amount of $2,575,000 on certain land and buildings located in Waterdown, Ontario, and a pledge of certain book debts, inventories and other assets as collateral. The Company is also required to maintain cash deposits of $400,000 (1997 – $525,000) as collateral for the loan facility.

As at December 31, 1998, the Company is contingently liable under letters of credit in the amount of $823,000 which have been drawn on the operating facility.

The fair value of the long-term debt would not be materially different from the carrying amount. The effective interest rate at December 31, 1998 is 6.6% (1997 – 6%).

6 Preference shares of subsidiary company

	1998	1997
	$	$
600,000 (1997 – 700,000) First Preference shares	**600,000**	700,000
525,834 (1997 – 595,834) Second Preference shares	**386,000**	423,000
	986,000	1,123,000
Less: current portion of preference shares	**237,000**	234,000
	749,000	889,000

The Company is required to purchase 100,000 first preference shares issued by 1108176 Ontario Inc., its subsidiary, per annum at $1 per share plus unpaid dividends thereon calculated at 5% per annum, commencing December 31, 1996, until the long-term debt described in note 5 is repaid. Thereafter the Company is required to purchase 200,000 first preference shares per annum under the same terms and conditions.

In January 1998, 100,000 first preference shares were purchased for $100,000, and a dividend of $35,000 was paid. Payment for a further purchase of 100,000, first preference shares and a dividend of $30,000 was delivered in trust to the Company's lawyer in January 1999 pending receipt of the shares purchased.

The second preference shares of the subsidiary company with a stated value of $1 per share are non-dividend bearing and are redeemable monthly at the rate of $5,833 per month until fully paid out. The Company is required to fund the redemption. As a result of the fixed repayment requirements, the second preference shares have been discounted at an imputed rate of 8%. During the year, 70,000 (1997 – 70,000) second preference shares were redeemed. Imputed interest on the second preference shares during the year amounted to $33,000 (1997 – $39,000).

The Company is required to purchase all of the outstanding first preference shares at $1 per share in the event of a change in the current Chairman of the Company or upon the sale of the Company's environmental recycling business, B.E.I.

The fair market values of the first and second preference shares would not be materially different from their carrying amounts and could vary with fluctuations in interest rates.

7 Capital stock

(a) During 1997, the shareholders of the Company agreed to amend the Company's by-laws as follows:

i) the authorized common shares were changed from 25,000,000 to an unlimited number;

ii) the 5,000,000 Class "A" non-dividend bearing, non-voting, redeemable, preference shares authorized that had never been issued were eliminated; and

iii) the stated capital account of the Company in respect of its common shares was reduced by $25,026,000 and applied against the deficit.

(b) During 1998, options to acquire 354,000 common shares were exercised for net proceeds of $191,000.

(c) At December 31, 1998 and 1997, the Company has outstanding 1,182,500 warrants to acquire common shares. Of these warrants, 650,000 are exercisable at U.S. $2.25 per share, and 532,500 are exercisable at U.S. $2.00 per share. As a result of extensions to the original expiry dates approved in 1997 and 1998, as at December 31, 1998, the warrants expire on June 30, 1999. In December 1998, the Company offered to the warrant holders a 4 for 1 exchange of the 1,182,500 warrants for:

i) 295,625 new warrants with an exercise price of U.S. $0.50 per share expiring on January 31, 1999; and

ii) provided the warrants in i) above are exercised prior to January 31, 1999, 295,625 additional warrants with an exercise price of U.S. $1.00 to December 31, 1999, rising to U.S. $2.00 on January 1, 2000 and expiring on December 31, 2000 would be issued.

During January 1999, 283,125 of the 295,625 warrants were exercised to acquire 283,125 common shares for proceeds of $212,000.

As of February 19, 1999, the Company has the following warrants outstanding:

i) 50,000 exercisable at U.S. $2.00, expiring June 30, 1999; and

ii) 283,125 warrants with an exercise price of U.S. $1.00 to December 31, 1999, rising to U.S. $2.00 on January 1, 2000 and expiring on December 31, 2000.

7 Capital stock *(continued)*

(d) Director/employee option plans

The Company grants options to employees and directors from time to time under employee/director stock option plans. Details of the options outstanding and changes during the periods presented are as follows:

Expiry date	Exercise price	Balance as at December 31, 1996	Exercised	Retracted	Granted with immediate vesting	Vested from prior year grants	Balance as at December 31, 1997
February 12, 1998	U.S. $0.25 to U.S. $1.44	188,500	(95,000)	–	–	–	93,500
April 27, 1998	U.S. $0.25	250,000	–	–	–	–	250,000
February 12, 1999	U.S. $1.81	–	–	(17,250)	–	209,750	192,500
March 10, 2001	U.S. $1.03 to U.S. $1.75	230,250	(8,250)	(50,250)	260,000	–	431,750
		668,750	(103,250)	(67,500)	260,000	209,750	967,750

Expiry date	Exercise price	Balance as at December 31, 1997	Exercised	Retracted	Extended	Granted with immediate vesting	Vested from prior year grants	Balance as at December 31, 1998
February 12, 1998	U.S. $0.25 to U.S. $1.44	93,500	(89,500)	(4,000)	–	–	–	–
April 27, 1998	U.S. $0.25	250,000	(250,000)	–	–	–	–	–
February 12, 1999	U.S. $1.81	192,500	–	(10,000)	(182,500)	–	–	–
March 10, 2001	U.S. $1.03 to U.S. $1.75	431,750	(14,500)	(55,250)	–	–	109,250	471,250
December 11, 2003	U.S. $0.75 to U.S. $1.38	–	–	(21,375)	–	4,500	319,750	302,875
December 31, 2004	U.S. $1.81	–	–	–	182,500	–	–	182,500
		967,750	(354,000)	(90,625)	–	4,500	429,000	956,625

The weighted average exercise price of the above outstanding options at December 31, 1998 is U.S. $1.363 per share (1997 – U.S. $1.05 per share).

At December 31, 1998, options to acquire an additional 303,625 common shares at prices ranging from U.S. $0.75 to U.S. $1.25 have been granted but have not yet vested. Options that have not vested are excluded from the above table.

8 Income taxes

The effective income tax rate on consolidated earnings is influenced by items such as available losses carried forward and non-deductible expenses.

	1998	1997
	$	$
Net earnings (loss) before income taxes	**822,000**	149,000
Income taxes at Canadian statutory rates of 44%	**362,000**	66,000
Increase (decrease) by the effects of:		
Application of prior year losses and scientific research expenditures carried forward	**(438,000)**	(68,000)
Non-taxable income/non-deductible expenses	**76,000**	2,000
Provision for income taxes	–	–

8 Income taxes *(continued)*

The tax benefit of research and development costs expensed but available to be claimed for Canadian income tax purposes would be:

	1998	1997
	$	$
Tax benefit of scientific research expenditures	**3,266,000**	3,700,000
Valuation allowance (100%)	**(3,266,000)**	(3,700,000)
Net tax benefit recognized	**–**	–

The Company has approximately $8,000,000 in Canadian scientific research expenditures which can be carried forward indefinitely to reduce future years' taxable income, and approximately $150,000 in scientific research investment tax credits which can be used to reduce future years' income taxes payable. These scientific research investment tax credits expire in varying amounts from 1999 to 2006.

The benefits of these scientific research expenditures and investment tax credits have not been recorded in these financial statements due to the extent of uncertainty over their potential realization.

9 Related party transactions and balances

In addition to transactions disclosed elsewhere in these financial statements, the Company entered into the following related party transactions:

(a) During 1998, the Company charged affiliated companies $66,000 for services rendered (1997 – $60,000).

(b) Included in miscellaneous receivables at December 31, 1998 is $3,000 (1997 – $72,000) due from officers/directors of the Company.

(c) In 1997, employees purchased the right to 125,000 of the U.S. $2.25 warrants and 37,000 of the U.S. $2.00 warrants from third parties.

(d) Certain of the warrants described in note 7(c) are held by directors, officers and employees. Subsequent to year-end, certain employees, officers and directors exercised warrants to acquire 40,500 common shares for U.S. $20,250 and received 40,500 additional warrants (see note 7(c)).

10 Commitments and contingencies

(a) The Company has named as a defendant a former director in a lawsuit relating to certain actions taken when he was the President of the Company's operating division, B.E.I. The former director has counter claimed against the Company and its subsidiaries, the Chairman of the Company and Easton, the Company's 36% equity investment.

It cannot be determined if there will be any recovery by the Company at this time or if there will be any loss to the Company, and no provision has been made in these financial statements in respect of this matter.

(b) The Company believes, with respect to both its operations and real property, that it is in material compliance with current environmental laws. Based on known existing conditions and the Company's experience in complying with emerging environmental issues, the Company is of the view that future costs relating to environmental compliance will not have a material adverse effect on its financial position, but there can be no assurance that unforeseen changes in the laws or enforcement policies of relevant governmental bodies, the discovery of changed conditions on the Company's real property or in its operations, or changes in use of such properties and any related site restoration requirements, will not result in the incurrence of significant costs. No provision has been made in these financial statements for these future costs since such costs, if any, are not determinable at this time.

10 Commitments and contingencies *(continued)*

(c) An irrevocable letter of credit for $685,000 has been placed with the Ontario Ministry of Environment and Energy as a security deposit for the Certificate of Approval granted to the Company for certain recycling activities. Under the terms of the Certificate, this security must be increased to 5% of revenues from environmental recycling up to a maximum of $750,000.

(d) The Company is obligated to March 31, 1999 to pay Chesapeake Resource Company various fees and/or royalties based on future sales and license fees related to the steam explosion of waste paper.

(e) Commitments under operating leases, principally for rental of the Quebec distribution centre and warehouse, are as follows:

	$
1999	121,000
2000	92,000
2001	79,000
2002	73,000
2003	73,000
2004 and thereafter	72,000
	510,000

Rent expense incurred in the year amounted to $89,000 (1997 – $73,000).

11 Earnings per share

The calculation of the earnings per share is based on the weighted average number of shares outstanding of 14,702,000 (1997 – 14,391,000). The dilutive effect on earnings per share of the potential exercise of outstanding warrants and options is not considered material for the years presented.

12 Potential acquisition

On December 19, 1998, the Company signed a letter of intent to purchase a company in Minnesota. The purchase is subject to certain conditions, including final due diligence by both parties, completion of satisfactory documentation, approval of the board of directors of the Company, the submission and approval of an S-4 filing document with the Securities and Exchange Commission and the approval of both companies' shareholders. The purchase price as proposed would consist of 5,519,481 common shares of the Company and warrants to acquire up to an additional 212,000 common shares.

13 Financial instruments

The Company's financial instruments recognized in the consolidated balance sheet and included in working capital consist of cash and cash equivalents, marketable securities, accounts receivable and accounts payable and accrued liabilities. The fair values of these instruments approximate their carrying value due to their short-term maturities.

The Company's financial instruments that are exposed to credit risk include cash and cash equivalents and accounts receivable. The Company places its cash with institutions of high credit worthiness. The Company's trade accounts receivable are not subject to a high concentration of credit risk. The Company routinely assesses the financial strength of its customers and, as a consequence, believes that its accounts receivable credit risk exposure is limited. The Company maintains an allowance for losses based on the expected collectibility of the accounts.

14 Segmented information

The Company operates in two industry segments: (a) the design, engineering, and sale of customized steam explosion technology systems; and (b) the recycling and sale or disposal of certain non-hazardous and hazardous industrial waste and resale of inorganic minerals. Currently, a substantial majority of the Company's operations, assets and employees are located in Canada.

	1998			
	Corporate Offices and Steam Explosion Technology Systems	*Waste Recycling and Resale of Inorganic Minerals*	*Eliminations*	*Consolidated*
	$	$	$	$
External sales by market				
Canada	**78,000**	**13,890,000**	–	**13,968,000**
Export – U.S.A.	**4,000**	**8,105,000**	–	**8,109,000**
Total sales to external customers	**82,000**	**21,995,000**	–	**22,077,000**
Interest expense	–	**134,000**	–	**134,000**
Segment net income (loss)	**(1,791,000)**	**2,613,000**	–	**822,000**
Identifiable assets	**4,353,000**	**11,743,000**	–	**16,096,000**
Amortization	**274,000**	**442,000**	–	**716,000**
Capital expenditures	**8,000**	**463,000**	–	**471,000**
Equity accounted investments	**507,000**	–	–	**507,000**
	1997			
External sales by market				
Canada	73,000	13,027,000	–	13,100,000
Export – U.S.A.	14,000	3,307,000	–	3,321,000
Europe	426,000	–	–	426,000
Total sales to external customers	513,000	16,334,000	–	16,847,000
Interest expense	–	183,000	–	183,000
Segment net income (loss)	(1,357,000)	1,506,000	–	149,000
Identifiable assets	5,000,000	10,024,000	–	15,024,000
Amortization	301,000	391,000	–	692,000
Capital expenditures	195,000	688,000	–	883,000
Equity accounted investments	510,000	–	–	510,000

15 Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

16 United States accounting principles differences

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") which conform in all material respects applicable to the Company with those in the United States ("U.S. GAAP") during the periods presented except with respect to the following:

(a) Under U.S. GAAP, the gain on dilution in the amount of $26,000 in 1998 (1997 – $226,000) resulting from the dilution of the Company's ownership of the common share equity of Easton would have been excluded from income and included as a separate component of shareholders' equity as Easton is a development stage exploration company. Also, under U.S. GAAP, certain development costs of $35,000 (1997 – $62,000) deferred in these financial statements would be expensed.

(b) Under U.S. GAAP, the amounts due from related parties of $33,000 (1997 – $72,000) would be shown separately on the balance sheet. Also, under U.S. GAAP, the allowance for doubtful accounts at December 31, 1998 of $133,000 (1997 – $97,000) must be disclosed. Included in accounts payable and accrued liabilities is an accrual for recycling costs of $393,000 (1997 – $365,000) which also would be disclosed separately under U.S. GAAP.

Accordingly, the following would have been reported under U.S. GAAP:

	1998	1997
	$	$
Net earnings for the year – as reported	**822,000**	149,000
Dilution gain	**(26,000)**	(226,000)
Development costs expensed	**(35,000)**	(62,000)
Net earnings (loss) for the year – U.S. GAAP	**761,000**	(139,000)
Net earnings (loss) per share – U.S. GAAP	**0.05**	(0.01)
Weighted average number of common shares outstanding	**14,702,000**	14,391,000
Shareholders' equity – as reported	**10,073,000**	9,060,000
Cumulative development costs expensed	**(164,000)**	(129,000)
Shareholders' equity – U.S. GAAP	**9,909,000**	8,931,000

Effective January 1, 1996, Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") encourages, but does not require, companies to include in compensation cost the fair-value of stock options granted. The Company has decided not to adopt the fair-value method. A company that does not adopt this new method must disclose pro forma net income and earnings per share giving effect to the method of compensation cost described in SFAS No. 123.

The Company's stock option plan is described in Note 7. Employee stock options granted by the Company in 1997 and 1998 were granted at prices which were at the value of stock on the grant date, vest at various dates ranging from the date of the grants to January 1, 1999 and expire 3 to 6 years subsequent to the grant date.

The fair value of the options granted during 1997 and 1998 was estimated using the Black-Scholes option-pricing model with the assumptions of a dividend yield of 0% (1997 – 0%), an expected volatility of 75% (1997 – 86%), a risk-free interest rate of 4% (1997 – 5.07%), and an expected life of 1 to 6 years.

The total value of 5,000 (1997 – 918,000) stock options that were granted by the Company to employees during 1998 was $3,000 (1997 – $871,000). Of this total amount, under SFAS No. 123, the cost of stock compensation expense for the year ended December 31, 1998 would be $1,000 (1997 – $253,000). The unrecognized value of $2,000 (1997 – $618,000) will be charged to pro forma net earnings in future years according to the vesting terms of the options. Compensation expense of options granted in 1997 and 1996 and vesting in 1998 is $296,000 (1997 – $185,000). The resulting pro forma net earnings (loss) and earnings (loss) per share for the year ended December 31, 1998 under U.S. GAAP are $464,000 (1997 – ($577,000)) and $0.03 (1997 – ($0.04)), respectively.

The effects of applying SFAS 123 in this pro forma disclosure are not indicative of future amounts. The Company's adoption of SFAS 123 for pro forma disclosure purposes does not apply to awards prior to 1995, and additional awards in future years are anticipated.

The Company has not adopted the provisions of SFAS No's 132 ("Employers' Disclosures about Pension and Other Post-retirement Benefits") and 133 ("Accounting for Derivative Instruments and Hedging Activities"). The adoption of these pronouncements would not have had a significant impact for the years ended December 31, 1998 and 1997.

The Company is pleased to report net earnings of $822,000 or $0.06 per share in 1998 (1997 – $149,000 or $0.01 per share), and a 31% increase in revenue for 1998 to $22,077,000 (1997 – $16,847,000).

Long-term debt repayments of $500,000 were made during the year, reducing the outstanding balance to $2,100,000 at the end of 1998 from $2,600,000 at the end of 1997.

Working capital has improved to $3,551,000 compared to $3,111,000 in 1997. The increase in working capital is primarily due to the growth in accounts receivable due to the 31% increase in sales and the corresponding growth in inventory balances to supply this growth.

A change to the Company's capital structure in 1997 was made under rules of the Canadian Business Corporations Act, the Company's incorporating statute that must be disclosed in its financial statements for 10 years to December 31, 2006.

In 1997, the Company's shareholders approved and the Company:

1. eliminated the 5,000,000 Class "A" non dividend bearing, non-voting, redeemable, preference shares that were authorized but never issued;
2. increased the authorized common shares from 25,000,000 to an unlimited number; and
3. reduced the stated capital account of the Company in respect of its common shares by $25,026,000, being the deficit at December 31, 1996.

These changes result in the common share class being the only authorized capital of the Company. This change should eliminate the confusion that existed concerning the purpose of the previously authorized but unissued Class "A" preference shares.

In addition, the reduction of the stated capital account by the deficit provides better presentation in the shareholder's equity section of the balance sheet, as it reflects the Company as the operating Company it is today, rather than the development Company it was before the acquisition of B.E.I. in 1995.

In early 1998, the Company signed a letter of intent to purchase a Michigan operating company and its subsidiary. The purchase was subject to certain conditions. This transaction was not consummated.

On December 19, 1998, the Company signed a letter of intent to purchase a company in Minnesota. The purchase is subject to certain conditions, including final due diligence by both parties, approval of the Boards of Directors of the two companies, the filing and approval by the SEC of a S-4 filing and approval of both Company's shareholders. The purchase price includes 5,519,481 common shares of Stake and warrants to acquire up to 212,000 additional common shares.

1998 Operations Compared with 1997 Operations

Revenues in 1998 increased by 31% to $22,077,000 from $16,847,000 in 1997 and the Company's earnings for 1998 were $822,000 or $0.06 per common share compared to $149,000 or $0.01 per share for the year ended December 31, 1997.

Substantially all revenues in 1998 were derived from the B.E.I. division. Sales of B.E.I. increased by 34.7% to $21,995,000 (1997 – $16,334,000). B.E.I. segment sales represent 99.6% of consolidated sales in 1998. (1997 – 97%).

In 1998, B.E.I. sales consisted of sales of abrasives, foundry sands and other products were $19,006,000 (1997 – $13,504,000) and recycling revenues were of $2,989,000 (1997 – $2,830,000). The sales of abrasive, foundry sands and other products increased by over $5,000,000 in 1998. The increase is principally attributable to a 143% increase in sales of Barshot, the Company's specular hematite product; 10% increases in 1998 over 1997 in sales of three significant existing product lines and sales of new products such as Chromite Zircon, Garnet and others which added over $1 million in new sales to the Company. Aggressive marketing, development of new product lines and the opening of the Louisiana facility, which has broadened the Company's market area, resulted in this significant sales growth.

Steam explosion and general corporate revenues in 1998 were $82,000 (1997 – $513,000). No equipment sales were made in 1998 (1997 – $139,000). Private industry technology projects generated revenue of $16,000 (1997 – $305,000), and other corporate revenues were $66,000 (1997 – $69,000).

Cost of sales increased by 30.3% to $17,308,000 for the year ended December 31, 1998 from $13,287,000 for the year ended December 31, 1997. The increase in cost of sales is primarily related to the 34.7% increase in B.E.I. sales. Cost of sales in 1998 attributable to the B.E.I. segment were $17,195,000 (1997 – $12,953,000). Steam explosion division cost of sales were $113,000 (1997 – $334,000), which primarily relates to standard amortization charges.

B.E.I.'s cost of sales in 1998 from abrasives, foundry and other products was $14,515,000 (1997 – $10,455,000) and recycling of $2,680,000 (1997 – $2,498,000). The margins in products contained in the abrasive, foundry and other category have improved slightly to 23.6% from 22.6% in 1997. Recycling margins have decreased in 1998 over 1997 due to a decrease in the incoming recycling fees and increased freight costs.

The Company's gross margin was 21.6% in 1998 compared to 21.1% in 1997. B.E.I.'s margin increased to 21.8% in 1998 from 20.7% in 1997, however, due to the lack of equipment sales and private industry contracts, steam explosion division margins were negative due to standard depreciation charges compared to 34.8% in 1997 when there was more activity in this business line.

Research and development (R & D) costs increased to $357,000 in 1998 from $349,000 for the year ended December 31, 1997 due to minor increases in research into non-wood applications for steam explosion technology in 1998.

Administration and market development expenditures increased in 1998 to $3,419,000 compared to $2,973,000 for the year ended December 31, 1997. In 1998, B.E.I. operations accounted for $1,902,000 of the administration costs (1997 – $1,935,000). Steam explosion marketing and demonstration and corporate administration expenses were $1,517,000 (1997 – $1,038,000). The principal reason for the increase in these expenses in 1998 over 1997 results from salary increases and over $220,000 related to costs of uncompleted acquisitions that have been written off during 1998.

Other income decreased to $57,000 in 1998 from $83,000 in 1997 due a decrease in interest earned due to lower cash balances being available during 1998 over 1997. Lower cash balances were held during 1998 due to the need to invest in working capital to support the Company's growth in sales.

Interest on long-term debt decreased to $134,000 in 1998 from $155,000 in 1997 due to debt repayments of $500,000 during 1998.

The share of losses of equity accounted investees of ($29,000) (1997 – ($35,000)) and dilution gain of $26,000 (1997 – $226,000) is related to the Company's 36% equity investment in Easton Minerals Ltd. (Easton) a mining exploration company listed on the Vancouver Stock Exchange (EM – VSE). Dilution gains result from the increase in equity value of Easton due to issues of capital above Stake's carrying cost of this investment. US readers should note that dilution gains are not recognized as income for US GAAP purposes due to the development stage nature of Easton, and accordingly, the effects of this gain are reversed in Note 16 of the Company's financial statements.

The Company's investment in Easton is carried at a book value of $507,000 and accumulated advances of $58,000 have also been made. The market value of Easton at February 19, 1999 was $1,258,000. On June 15, 1998, the Company's Board decided to sell its holdings in Easton as mining development and exploration are not related to the Company's primary businesses, and has filed appropriate notification of this intent with Easton's regulators. The market value of Easton is based on limited trading values, and while it is unlikely that these values will be received upon the sale of this investment at this time, sale proceeds could add to the Company's net equity and management plans to use any cash proceeds to reduce debt and increase working capital.

The foreign exchange gain of $67,000 (1997 – $7,000) is attributable to the strengthening of the US $ on the Company's net receivable balance during 1998.

The loss on sales of marketable securities of ($16,000) (1997 – gain on sale of marketable securities of $36,000) is related to the disposal on non-core investments. The gain on sale of property, plant and equipment of $60,000 (1997 – nil) is due to the sale of non-essential land for net proceeds of $89,000 at a location separate from the Company's principal operations.

The dividend on preference shares of a subsidiary company of $30,000 (1997 – $35,000) and the imputed interest of preference shares of a subsidiary company of $33,000 (1997 – $39,000) are related to the preference shares issued for the acquisition of B.E.I.

Liquidity and Capital Resources at December 31, 1998

Cash and short-term deposits decreased by $559,000 to $181,000 at December 31, 1998 from $740,000 at December 31, 1997. The decrease is principally due to $500,000 used to repay long-term debt. Capital additions and the investment in working capital made to expand the Company's business came from internally generated operating cash flow.

Trade accounts receivable increased to $3,805,000 at December 31, 1998 from $2,615,000 at December 31, 1997 due largely to the increase in sales. Trade receivables at December 31, 1998 related to the B.E.I. operations were $3,727,000 (1997 – $2,500,000), general corporate activities and steam explosion $78,000 (1997 – $115,000).

Inventories increased to $2,878,000 at the end of 1998 from $1,931,000 at December 31, 1997. The increase is due to higher levels of materials needed in inventory to handle the increase in sales as well as negotiated orders received in late 1998 to meet spring and summer 1999 demand. The inventory balance at December 31, 1998 and 1997 is entirely related to B.E.I. operations as the steam explosion division is not required to carry inventory.

Investments and advances increased to $565,000 from $531,000 in 1997 due primarily to advances of $37,000 made to Easton (1997 – $21,000) and the dilution gain of $26,000 (1997 – $226,000) offset by the equity loss on Easton of $29,000 (1997 – $35,000).

The Company has formal capital commitments of approximately $50,000 at of December 31, 1998, relating to normal equipment replacement at B.E.I.

In 1998, $467,000 (1997 – $847,000) was spent at B.E.I. for machinery and equipment improvements in Waterdown, establishment of the facilities is Louisiana, general upgrading of computers and the acquisition of accounting software that will be year 2000 compliant. In 1998, $4,000 (1997 – $36,000) was spent at corporate office on computer equipment. The improvements made in 1997 of $36,000 were directed at improving the pilot plant, which has improved Stake's ability to demonstrate its steam explosion technology to interested parties.

B.E.I.'s capital budget for 1999 is $500,000 and is to improve and replace production equipment primarily in Waterdown and Louisiana. There are no plans to make significant capital expenditures during 1999 at Stake's steam explosion pilot plant. Corporate office has a capital budget of $25,000 to make certain Year 2000 computer upgrades.

Accounts payable and accrued liabilities increased to $2,937,000 in 1998 from $2,241,000 in 1997. The increase is due to the increase in inventory held due to the growth in business. The accrued recycling reserve of $393,000 (1997 – $365,000) included in accounts payable relates to B.E.I.'s business and represents the future costs to process and dispose of the reclaimed materials that B.E.I. has accepted for recycling, and were on site at December 31, 1998. The increase in the accrual in 1998 is due to more tons being on site at the end of 1998 compared to 1997.

The Company's term loan has a 5 year amortization period and will be paid over the next 3 years to December, 2001 subject to the Company's compliance to certain financial covenants. The Company does not anticipate a breach of these covenants.

This debt is financed by short-term instruments to take advantage of low short-term Canadian interest rates and the ability to repay the debt ahead of schedule. The Company can elect to fix the rate and term of this debt at the maturity date of underlying debt instruments,

which is generally every 90 days. During 1998, $500,000 was repaid. At December 31, 1998, the loan outstanding was $2,100,000.

The term loan bears interest at Canadian prime + 1 % or banker's acceptances + 1.25%; the Canadian prime interest rate is currently 6.5%. Principal payments of $700,000 in 1999, $600,000 in 2000 and $800,000 in 2001 are required, to be made per annum, with a minimum of $300,000 to be paid in the second quarter of 1999 and a minimum of $100,000 to be made each subsequent quarter. Interest is paid in advance with the banker's acceptances. Full or partial repayment of the term loan is permitted based on the maturity of the underlying debt instruments.

In addition to the term loan, the Company has bank lines of credit of $3,000,000 available based on margining of trade accounts receivable and a ratio of finished goods inventory. At December 31, 1998, $823,000 was drawn on this facility for letters of credit to the MOEE, two key suppliers, and for security on the Louisiana lease.

Substantially all of the Company's assets are pledged as collateral under this lending agreement, with the exception of the real property at Stake's corporate offices in Norval, and the lease and physical assets in Louisiana.

The Company considers its relationship with its principal bankers to be very satisfactory.

The Company believes that its cash to be generated from operations, its current cash and short term deposits and its available lines of credit at February 19, 1999 are sufficient for the Company's operations during 1999.

Cash flow provided by operations for the year ended December 31, 1998 was $277,000 (1997 – $312,000). Though earnings increased by $673,000 from 1997, the additional cash flow provided by these earnings was offset by a substantial increase of non-cash working capital assets of $1,253,000 in 1998 (1997 – $341,000) due to the increase in sales in 1998.

Cash used in investment activities decreased to ($357,000) (1997 – ($570,000)). In 1998, cash used for investing activities was principally used for the acquisition of capital assets of $471,000 (1997 – $883,000) offset by the $125,000 (1997 – $150,000) reduction in cash held as a security deposit by the Company's bankers.

Cash used for financing activities was ($479,000) (1997 – ($862,000)). The reduction of cash used for financing is principally due to lower debt repayments of $500,000 in 1998 compared to payments of $883,000 in 1997.

Corporate Governance

The governance of the Corporation is the responsibility of the Board of Directors of Stake Technology Ltd., the majority of whom are independent of management.

The Board approves the annual Business Plan of the Corporation and its divisions, and reviews actual results compared to budget at quarterly Board meetings and through monthly management reports. The plan includes an assessment of the principle risks and opportunities facing the Company.

The Board also approves all major capital expenditures, debt obligations, share issues and corporate acquisitions.

The Board has established an independent Audit Committee, which reviews the audit plan, meets with the auditors and assesses the Corporation's internal control and management information systems.

The Board has also established an independent Compensation Committee, which reviews the compensation of senior officers, suggests appropriate compensation for directors and recommends to the Board, employee/director stock option plans.

CORPORATE INFORMATION

OFFICERS AND SENIOR MANAGEMENT

Jeremy N. Kendall * (1)
Chairman and Chief Executive Officer

John D. Taylor *
President and Chief Operating Officer

Cyril A. Ing * (2)
Corporate Secretary

Murray J. Burke
Vice President, Engineering

Leslie N. Markow, C.A.
Vice President, Finance and Chief Financial Officer

J. Andrew Richard
Vice President, Technology

Donald K. Shaw
Vice President and General Manager, B.E.I.

Robert J. Hunt
Vice President, Sales, B.E.I.

Sergio H. Casali
Quebec Sales Manager, B.E.I.

David J. Kruse
Financial Manager, B.E.I.

Gary M. Duschl
Manager, Operations, B.E.I.

DIRECTORS

Phillip D.E. Bergqvist (2)
Past Chairman – Eucalyptus Pulp Mills PLC

Joseph Riz (1)
Managing Director – Tricapital Management Limited

James K. Rifenbergh
Chairman Emeritus – Brown Printing Company

Michael M. Boyd (1)
Vice President – HSBC Capital Canada Inc.

(*) Directors
(1) Members of Audit Committee
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