



TREE ISLAND STEEL LTD.

Annual Report 2012



**Report to Shareholders
for the year ended
December 31, 2012**



TREE ISLAND STEEL LTD.

PROFILE

Tree Island Steel Ltd. ("Tree Island Steel" or the "Company") owns 100% of Tree Island Industries Ltd. ("TIIL"). The common shares of Tree Island Steel are listed on the Toronto Stock Exchange (listing symbol TSL).

Tree Island Steel has Convertible Debentures listed on the Toronto Stock Exchange (listing symbol TSL.DB).

Tree Island Profile

Headquartered in Richmond, British Columbia, since 1964, Tree Island produces wire products for a diverse range of industrial, residential construction, commercial construction, agricultural, and specialty applications. Its products include bright wire; a broad array of fasteners, including packaged, collated and bulk nails; stucco reinforcing products; concrete reinforcing mesh; fencing; and other fabricated wire products. The Company markets these products under the Tree Island, Halsteel, K-Lath, Industrial Alloys, TI Wire, Tough Strand, and Select Brand names. Tree Island also owns and operates a China-based company that assists the international sourcing of products to Tree Island and its customers.

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TREE ISLAND STEEL LTD.

TO OUR SHAREHOLDERS

Chairman's Letter



2012 was a year of continuing to build a fundamentally strong foundation for the future growth of Tree Island. While weaknesses in some of our markets continued to create challenges for managing our cost structure and profitability, our "Return to Profitability" strategy laid the groundwork for improved financial performance and growth

once stability returns.

During the second quarter of 2012 we announced the successful renewal of our senior banking facility with Wells Fargo Capital Finance Corporation Canada and amendments to the terms of our long-term debts. The impact of this announcement was a significant reduction in our contractual obligations over the remainder of 2012 and into future years which will position us to take advantage of market opportunities as the uncertainty in the markets eases.

As a result, we now have more flexibility and strength on our balance sheet. Our focus in the near term is to continue to grow revenues, sales volumes and profitability, while maintaining tight controls over expenses and inventories. Tree Island is well positioned for the future with a capable and energetic management team, and a strong and experienced Board of Directors.

Sincerely,

Amar S. Doman
Chairman of the Board of Directors

President's Letter

Profitable growth remained the theme and primary focus in 2012, after a challenging 2011 which included weakness in some markets, and volatility in input costs and overall product pricing. Despite certain continued external pressures in 2012, we managed to further strengthen the Company's growth prospects and profitability metrics, resulting in a material year-over-year improvement across all of Tree Island's key operating and financial metrics. As we worked through the year, we also started to take note of signs of recovery in some of our key end markets, which we expect to bode well as we look into the future for Tree Island.

For the year ended December 31, 2012, we reported revenue of \$146.2 million, compared to \$150.0 million during the same period in 2011 and sales volumes of 102,408 tons, compared to 110,314 tons in 2011. During this period, gross profit improved from \$10.5 million to \$13.0 million. Gross profit per ton also increased from \$95 per ton to \$127 per ton. The improvement in gross profit, together with our ongoing focus on cost management, resulted in an improvement in EBITDA for FY2012 of \$2.3 million to an EBITDA of \$3.6 million versus an EBITDA of \$1.3 million during the same period last year.

More recently, Tree Island's fourth quarter 2012 results showed an improvement on a year-over-year basis. Despite revenues decreasing to \$28.7 million from \$35.1 million during the fourth quarter of 2011 we reported a \$0.2 million improvement in gross profit amounting to \$1.3 million versus \$1.1 million in the fourth quarter of 2011. EBITDA remained unchanged at a loss of \$1.1 million due largely to costs associated with the conversion from an income trust to a corporate structure.

We remain on track and extremely focused on operating the business profitably with tight controls on costs, managing working capital and maximizing capacity utilization in an effort to drive profitable growth in an improved economic environment. In closing, I would like to thank our employees for continuing to build Tree Island's reputation for product quality and service leadership, to our customers, suppliers and investors, I extend my sincere appreciation for working with us.

Sincerely,

Dale R. MacLean
Director, President and Chief Executive Officer
Tree Island Steel Ltd.



The Management's Discussion and Analysis includes the following sections:

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The following is a discussion of the financial condition and results of operations of Tree Island Steel Ltd. ("Tree Island Steel" or the "Company") and its wholly owned operating subsidiary Tree Island Industries Limited ("TIIL") (together with Tree Island Steel, referred to as "Tree Island"). This discussion is current to March 14, 2012 and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2012. Tree Island Steel's consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of financial statements and are reported in Canadian dollars. Additional information relating to Tree Island Steel, including the audited consolidated financial statements and Annual Information Form ("AIF") for the year ended December 31, 2012, can be found at www.sedar.com or on Tree Island Steel's website at www.treeisland.com.

1. FORWARD-LOOKING STATEMENTS AND RISK

This management's discussion and analysis ("MD&A") includes forward-looking information with respect to Tree Island, including our business, operations and strategies, as well as financial performance and conditions. The use of forward-looking words such as, "may," "will," "expect" or similar variations generally identify such statements. Any statements that are contained herein that are not statements of historical fact may be deemed to be forward-looking statements. Although we believe that expectations reflected in forward-looking statements are reasonable, such statements involve risks and uncertainties, including the risks and uncertainties discussed under the heading "Risks Relating to the Company's Business" in Tree Island's AIF for the year ended December 31, 2012 as well as Section 14 of this MD&A.

The forward looking statements contained herein reflect management's current beliefs and are based upon certain assumptions that management believes to be reasonable based on the information currently available to management. By their very nature, forward looking statements involve inherent risks and uncertainties, both general and specific, and a number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including the risks outlined herein under the heading "Risk Factors" which may cause actual results to differ materially from any forward looking statement. Such risks and uncertainties include, but are not limited to: general economic, market and business conditions, the cyclical nature of our business and demand for our products, financial condition of our customers, competition, volume and price pressure from import competition, deterioration in the Company's liquidity, disruption in the supply of raw materials, volatility in the costs of raw materials, significant exposure to the Western United States due to lack of geographic diversity, dependence on the construction industry, transportation costs, foreign exchange fluctuations, leverage and restrictive covenants, labour relations, trade actions, dependence on key personnel and skilled workers, reliance on key customers, intellectual property risks, energy costs, un-insured loss, credit risk, operating risk, management of growth, changes in tax, environmental and other legislation, and other risks and uncertainties set forth in our publicly filed materials.

This MD&A has been reviewed by the Board of Directors of Tree Island and its Audit Committee, and contains information that is current as of the date of this MD&A, unless otherwise noted. Events occurring after that date could render the information contained herein inaccurate or misleading in a material respect. Readers are cautioned not to place undue reliance on this forward-looking information and management of Tree Island undertakes no obligation to update publicly or revise any forward-looking information, whether as a result of new information, future events or otherwise except as required by applicable securities laws.

2. NON-IFRS MEASURES

References in this MD&A to "EBITDA" are to operating income plus depreciation and references to "Adjusted Net Income (Loss)" are to net income (loss) per IFRS adjusted for certain non-cash items including non-cash financing expenses, changes in fair value of convertible instruments, gain (loss) on renegotiated debt, and deferred income expense (recovery). EBITDA is a measure used by many investors to compare issuers on the basis of ability to generate cash flows from operations. Adjusted Net Income (Loss) is a measure for investors to understand the impact of significant non-cash items that affect our results from operations. Neither EBITDA nor Adjusted Net Income (Loss) are earnings measures recognized by IFRS and do not have a standardized meaning prescribed by IFRS. We believe that EBITDA and Adjusted Net Income (Loss) are important supplemental measure for evaluating our performance. You are cautioned that EBITDA and Adjusted Net Income (Loss) should not be construed as alternatives to net income or loss, determined in accordance with IFRS, as indicators of performance or to cash flows from operating, investing and financing activities as measures of liquidity and cash flows. Our method of calculating EBITDA and Adjusted Net Income (Loss) may differ from methods used by other issuers and, accordingly, our EBITDA or Adjusted Net Income (Loss) may not be comparable to similar measures presented by other issuers.

3. TREE ISLAND

3.1. About Tree Island

Tree Island Steel is a corporation established under the laws of Canada on August 2, 2012. Prior to October 1, 2012, TIIL was wholly owned by Tree Island Wire Income Fund (the "Fund"). On October 1, 2012, pursuant to an information circular dated August 15, 2012, the Fund was converted, on a tax deferred basis, from an open-ended limited purpose trust to an incorporated corporation (the "Corporate Conversion") pursuant to a plan of arrangement (the "Arrangement") under the Canada Business Corporations Act. Under the Arrangement, unitholders of the Fund received common shares of Tree Island, on a one-for-one basis. The business of the Fund continues to be conducted by Tree Island, through TIIL, and all obligations of the Fund have been assumed by Tree Island.

In connection with the Arrangement, Tree Island assumed all of the covenants and obligations of the Fund relating to the outstanding Convertible Debentures ("Debentures") and Warrants. The Debentures have become convertible subordinated

debentures of Tree Island Steel and holders are entitled to receive Tree Island Steel common shares, rather than Units, at the same conversion price at which the Units were previously issuable upon conversion thereof, subject to adjustment in certain events as provided for in the Debenture Indenture. The Warrants will continue to be convertible, but into common shares of Tree Island Steel at the same price at which the Warrants were convertible into units of the Fund, subject to adjustment as provided for in the Warrant Certificates governing the Warrants.

The trustees of the Fund have become the directors of Tree Island Steel and the officers and management of the Fund have become officers and management of Tree Island Steel.

There were 22,155,150 shares of outstanding as of December 31, 2012 and 23,651,150 shares outstanding as of March 14, 2013.

As at December 31, 2012, the total number of Debentures remaining outstanding was 191,896. As at March 14, 2013, the total number of Debentures remaining outstanding is 185,916.

As at December 31, 2012 the total number of Warrants remaining outstanding was 4,875,000. As at March 14, 2013, the total number of Warrants remaining outstanding is 4,575,000.

3.2. About TIIL

Organizational Structure

Our corporate structure has the following primary entities: TIIL which is our Canadian operating company as well as the ultimate parent company to our operations in the United States managed through our US operating subsidiary, Tree Island Wire (USA) Inc. In addition, we have a China based sourcing operation.

Markets

TIIL supplies to customers in five key product markets: industrial and original equipment manufacturers (“OEM”), residential construction, commercial construction, agricultural, and specialty applications.

Products

TIIL is a manufacturer and supplier of premium quality wire products for a broad range of applications. Our goal is to match the appropriate wire product, level of quality and price point for our customers needs. We achieve this by manufacturing most of our products at our own manufacturing facilities (Premium), while outsourcing others from qualified manufacturers (Select Brand). We market these products to customers in Canada, the United States and internationally.

Premium Brands

We manufacture our premium brand products internally in our North American facilities, targeting them to customers that seek value, reliability, and high performance. Our premium brands offer: consistent, high quality standards that meet customers’ needs, ASTM standards and applicable codes; broad range of products; short lead times; and technical support and reliable service. Our premium brands are Tree Island, Halsteel, K-Lath, TI Wire, Industrial Alloys, and Tough Strand.

Select Brand

Most of our select brand products are externally manufactured, and are limited to high-volume commodity items. Products within this group meet general industry specifications but are not customized to individual customer requirements. Select brand products allow us to enhance our relationship with those customers that require a diverse product line including competitively priced commodity products. These products typically create complementary pull through for our premium brands.

Direct Ship

As a service to our customers, we use our network of suppliers world-wide to source commodity wire products not manufactured by TIIL and direct ship to our customers.

The following summarizes the markets, premium brands, key product groups, the specific end-use markets, and regions we serve with of our products:

Markets	Premium Brand	Key Product Groups	Specific End-Use Markets	Regions
Industrial/OEM	Tree Island, TI Wire	Low carbon wire (bright/galvanized/annealed) High carbon wire (bright/galvanized/annealed) Hi-tensile baling wire	Wire fabricating, industrial applications, OEM manufacturing (i.e. mattresses, inner springs), forestry, recycling	North America and International
Residential Construction	Tree Island, Halsteel, K-Lath	Collated, bulk and packaged nails, and stucco reinforcing mesh	Construction and renovation for new and existing homes	North America and International
Commercial Construction	Tree Island, TI Wire	Welded wire reinforcement mesh and concrete reinforcing products	Commercial construction, mining, infrastructure projects	North America and International
Agricultural	Tree Island, Tough Strand	Hi-tensile game fence, farm fence, vineyard wire, barbed wire, and bailing wire	Agriculture, farming	North America
Specialty Applications	Industrial Alloys	Stainless spring wire, cold heading wire, shaped wire, specialty alloy bar, and wire	Consumer products, industrial applications, telecommunications, aerospace, automotive, oil industry	North America

Seasonality

Our operations are impacted by the seasonal nature of the various industries we serve, primarily the Canadian residential construction, commercial construction and agriculture industries. Accordingly, revenues, sales volumes and operating results for interim quarters are not necessarily indicative of the results that may be expected for the full fiscal year and fourth quarter results are traditionally lower than other quarters due to the onset of winter and the corresponding reduction in agricultural and construction activities.

4. DEVELOPMENTS AND 2012 BUSINESS OVERVIEW

Business Overview

Market conditions remained challenging during the year with continued uncertainty and volatility in the global economy. In addition, although the levels of housing starts in the United States continue to improve they remain below historical levels which continues to impact our traditional markets in the residential construction industry. In response to these challenges, we continue to diversify and manage our product mix, maintain price discipline, and manage our costs closely as part of our business strategy.

For the year ended December 31, 2012 gross profit improved to \$13.0 million from \$10.5 million in the year ended December 31, 2011. As a result, gross profit per ton increased to \$127 per ton from \$95 per ton. Tree Island achieved EBITDA of \$3.6 million versus EBITDA of \$1.3 million during 2011. The improvements in gross profit, gross profit per ton, and EBITDA were largely the result of closely managing costs, applying price discipline, and aligning price to costs as part of our strategy of profitable growth.

Senior Credit Facility

On June 11, 2012, the Fund renewed its senior banking facility with Wells Fargo Capital Finance Corporation Canada as Agent for the Canadian and U.S. Lenders ("Wells Fargo"). The four year senior secured committed banking facility (the "Senior Credit Facility") has been increased from \$35.0 million to \$40.0 million and now matures on June 11, 2016. Under the terms of the Senior Credit Facility, up to \$40.0 million may be borrowed for financing requirements in Canadian and/or US dollars ("Senior Revolving Facility") of which \$5 million has been advanced as a term loan ("Senior Term Loan"). Additionally, a \$10.0 million

Letter of Credit sub-facility will enable Tree Island to open documentary letters of credit for raw material purchases. Interest is charged at variable rates based on the Canadian and/or US Prime rate and the Canadian B.A. rate and/or the Eurodollar rate. The amount advanced under the Senior Revolving Facility at any time is limited to a defined percentage of inventories, accounts receivable and real estate, less certain reserves. The Senior Credit Facility is secured by a first charge over TIIL's assets supported by the appropriate guarantees, pledges and assignments, and requires that certain covenants be met by Tree Island.

Long-Term Debt Agreements

On June 11, 2012 certain amendments were made to long-term debt with both principal vendors. With one of the vendors, we entered into a Second Amendment to the long-term debt agreement ("Agreement"). Under the terms of this Agreement approximately US\$15.8 million in principal debt will be repaid monthly over a ten year amortization period. Interest is non-compounding, will be accrued on a declining balance starting in June 2017 and is payable over a four year period beginning June 2024. Additionally, approximately US\$16.7 million of principal debt to the other vendor was extinguished with a final payment of US\$5.0 million. As a result, a gain on renegotiation of debt of \$17.8 million, net of transaction costs, has been recorded.

Trust Conversion

On October 1, 2012, the Fund converted to a corporation. Unitholders of the Fund received common shares of Tree Island Steel, on a one-for-one basis. The business of the Fund continues to be conducted by Tree Island Steel and all interests and obligations of the Fund have been assumed by Tree Island Steel. The Debentures have become convertible subordinated debentures of Tree Island Steel and holders are entitled to receive Tree Island Steel common shares, rather than Units, at the same conversion price at which the Units were previously issuable upon conversion thereof, subject to adjustment in certain events as provided for in the Debenture Indenture. The Warrants will continue to be convertible, but into common shares of Tree Island Steel at the same price at which the Warrants were convertible into units of the Fund, subject to adjustment as provided for in the Warrant Certificates governing the Warrants.

Union Negotiations

On September 10, 2012 Tree Island and the International Brotherhood of Teamster Local 213 successfully concluded a new three-year collective agreement. The agreement covers hourly employees at Tree Island's Richmond, BC manufacturing facility. The new collective agreement is retroactive to July 1, 2012 and introduces, among other improvements, a new wage and benefit structure that will provide a long term foundation for improved labour and productivity costs.

Unit Buy-Back

On September 6, 2012, the normal course issuer bid was extended to September 6, 2013. Under the renewed normal course issuer bid the Fund, and subsequently Tree Island Steel, may purchase up to 1,700,000 units / shares. During the year ended December 31, 2012 the Fund and Tree Island Steel purchased 1,050,900 units / shares at an average cost of \$0.30 per unit / share, net of commission, under its normal course issuer bid. These units / shares were cancelled at the end of the month of purchase. After December 31, 2012, no additional shares were purchased or cancelled by Tree Island Steel.

Trade Action Reviews

During the first quarter of 2013 the Canada Border Services Agency announced that, as a result of a complaint made by Tree Island, it is initiating investigations into the alleged injurious dumping of certain galvanized steel wire from the People's Republic of China, the State of Israel, and the Kingdom of Spain, and the alleged injurious subsidizing of certain galvanized steel wire from the People's Republic of China. The investigations are in the preliminary stages and the impact on the Company's operating results is not determinable at this time.

During the fourth quarter of 2011 the US Department of Commerce announced, preliminary antidumping duties on certain galvanized wire imported into the United States from China and Mexico and on another trade action related to certain nails imported from the United Arab Emirates. The final determinations were released in the first quarter of 2012 and are not expected to have a material impact on operating results.

Remediation on Surplus Lands Sold

As described more fully in Note 22 of the Consolidated Financial Statements for the year ended December 31, 2011, the Fund completed the sale of 12.5 acres of surplus lands at its Richmond, BC manufacturing facility in 2009. The agreement contained a condition whereby \$1.5 million was held in trust to be released upon completion of the agreed upon remediation of the site.

In 2011, the Fund completed the remediation work based on the planned requirements and submitted the results for approval. During the year ended December 31, 2012, the final Certificate of Compliance was issued and the remaining holdback of \$422 thousand was received.

There are no further requirements or obligations under the purchase and sale agreement.

Outlook

While there have been modest improvements in the economic environment we remain cautious in our outlook due to the lack of visibility from a macro-economic perspective. Going forward, our focus remains on the alignment of pricing against volatile raw material costs balanced with closely managing costs, leveraging our capacity utilization as much as possible given uneven demand levels, and applying price discipline. To help minimize our exposure to raw material price volatility, we will continue to balance our inventory sourcing between international and domestic suppliers and closely manage our inventory levels. There can be no certainty that we can make changes to sales prices to match the volatility of raw material costs. As in the past we will also carefully monitor and evaluate our other cost drivers including freight costs, the cost of other materials required to produce our products, and our labour and staffing costs.

5. RESULTS FROM OPERATIONS

	Year Ended December 31			
		2012		2011
Summary of Results (\$000's except for tonnage and per unit amounts)				
Sales Volumes – Tons ⁽¹⁾				
Sales	\$	146,238	\$	150,030
Cost of sales		(130,132)		(136,331)
Depreciation		(3,074)		(3,241)
Gross profit		13,032		10,458
Selling, general and administrative expenses		(12,527)		(12,411)
Operating income (loss)		505		(1,953)
Foreign exchange gain (loss)		87		(722)
Gain on sale of property, plant and equipment		448		11
Impairment of property, plant, and equipment		-		(858)
Changes in financial liabilities recognized at fair value		(717)		2,331
Gain (loss) on renegotiated debt		17,805		(3,234)
Financing Expenses		(7,299)		(8,500)
Income (loss) before income taxes		10,829		(12,925)
Income tax (expense) recovery		(458)		64
Net income (loss)	\$	10,371	\$	(12,861)
Operating income (loss)	\$	505	\$	(1,953)
Add back depreciation		3,074		3,241
EBITDA ⁽²⁾	\$	3,579	\$	1,288
Foreign exchange gain (loss)		87		(722)
EBITDA including foreign exchange	\$	3,666	\$	566
Net income (loss)	\$	10,371	\$	(12,861)
Add back significant non-cash items				
Non-cash financing expenses		3,961		5,349
Non-cash (gain) loss on renegotiated debt		(17,805)		3,234
Changes in financial liabilities recognized at fair value		717		(2,331)
Deferred income tax recovery (expense)		1,207		(13)
Adjusted net loss ⁽²⁾	\$	(1,549)	\$	(6,622)
Per share / unit				
Net (loss) income per share / unit - basic	\$	0.47	\$	(0.56)
Net (loss) income per share / unit - diluted		0.25		(0.56)
Per ton				
Gross profit per ton	\$	127	\$	95
EBITDA per ton		35		12
Financial position				
		As at December 31, 2012		As at December 31, 2011
Total assets	\$	81,102	\$	91,005
Total non-current financial liabilities	\$	29,790	\$	42,789

⁽¹⁾ Sales volumes exclude tons which were processed as part of tolling arrangements

⁽²⁾ See definition of EBITDA and Adjusted Net Loss in Section 2 - Non-IFRS Measures

6. COMPARISON OF RESULTS FOR THE YEAR ENDED DECEMBER 31, 2012 AND 2011

Revenue

During the year ended December 31, 2012, we generated revenues of \$146.2 million, a decrease of \$3.8 million, or 2.5%, from the same period in 2011. The decrease in revenue primarily reflects a 7.2% decrease in sales volumes resulting from our continued focus on profitable growth in the marketplace. This decrease was partially offset by a 5.0% increase in revenue per ton as a result of our focus on pricing discipline.

Sales volumes by market were as follows:

Market	Year Ended Dec 31, 2012		Year Ended Dec 31, 2011	
	Tons	% of Sales Volumes	Tons	% of Sales Volumes
Industrial/OEM	40,943	39.9%	42,043	38.1%
Residential Construction	28,574	27.9%	32,214	29.2%
Commercial Construction	19,733	19.3%	22,525	20.4%
Agricultural	8,558	8.4%	7,557	6.8%
Specialty Applications	4,159	4.1%	4,261	3.9%
International Trading ⁽¹⁾	441	0.4%	1,714	1.6%
Total	102,408	100.0%	110,314	100.0%

(1) International includes Tree Island International trading sales and does not include North American import sales, which are reflected in our sales volumes to other markets

Overall our sales volumes are lower than the prior year due in part to our objective of focusing on profitable growth areas. Our sales volume to the industrial/OEM, residential construction, commercial construction, specialty applications, and international sectors declined as compared to the same period in 2011. Industrial/OEM sales volumes declined due to our efforts to maintain price discipline together with the competitiveness in the galvanized chain link and other wire markets. The decline was partially offset by growth in sales to the manufacturing and agricultural sectors. Despite some recovery in Western US housing, housing starts continue to be well below historical average levels and the residential construction market remains highly competitive. Our sales volume to this market was driven by our continuing focus on margin improvements in our product mix. Sales to the commercial construction sector declined driven by less welded wire fabric sales as a result of our efforts to redefine our product mix and focus on more profitable product sales. Sales to the specialty sector are consistent with the same period in 2011 and international trading sales decreased reflecting the discontinuation of certain projects in our Asian subsidiaries.

Though overall sales volumes declined year-over-year, sales volumes to the agricultural sector were driven by growth in vineyard and barbed wire sales. This is a result of increasing agricultural and fencing product demand due in part to more favourable weather conditions in the prairies during the first nine months of 2012.

The share of sales volumes from our import and trading activities, compared to the share of sales from products manufactured at our domestic manufacturing facilities, was as follows:

	Year Ended Dec 31, 2012		Year Ended Dec 31, 2011	
	Tons	% of Sales Volumes	Tons	% of Sales Volumes
North American Manufactured	96,223	94.0%	102,216	92.7%
Imported & Trading	6,185	6.0%	8,098	7.3%
Total	102,408	100.0%	110,314	100.0%

During the year ended December 31, 2012, sales volumes of our North American manufactured products increased as a percentage of total sales volumes resulting from our increased emphasis on manufacturing as a core competency. Going forward, we will continue to review and optimize the mix of manufactured versus imported products as we work to enhance profitability and provide our customers with value and the specific products they need.

Cost of Sales

For the year ended December 31, 2012, cost of sales decreased by \$6.2 million or 4.5% from the same period last year. This decrease in cost of sales reflects our lower sales volumes which were partially offset by higher overall raw material costs. Our average cost of carbon rod (representing 54.3% of total cost of sales) increased by 1.3% when compared to 2011. Because carbon rod is usually transacted in US dollars, the cost of carbon rod for our Canadian operations was negatively impacted by the 1.3% weakening of the Canadian dollar during the year. Offsetting the increase in carbon rod costs were decreases in the

cost of stainless steel and zinc. Stainless steel costs (representing 7.6% of total cost of sales) decreased 11.3% on a per-ton basis, compared to 2011 and the cost of zinc (representing 3.0% of total cost of sales) decreased 9.5%.

Gross Profit

During the year ended December 31, 2012, gross profit increased to \$13.0 million in 2012 from \$10.5 million in 2011, an increase of \$2.5 million or 24.6%. Gross profit per ton increased to \$127 per ton, compared to \$95 per ton in 2011. The increase in gross profit and gross profit per ton primarily reflects the increase in revenue per ton, driven by our focus on profitable growth and pricing discipline, which was partially offset by the increase raw material costs as noted above.

Selling, General, and Administrative Expenses

SG&A expenses increased to \$12.5 million in 2012 from \$12.4 million in 2011, an increase of \$0.1 million, or 0.9% due largely to costs incurred in 2012 for the Corporate Conversion.

EBITDA

EBITDA for the year ended December 31, 2012 increased to \$3.6 million from EBITDA of \$1.3 million in 2011. The \$2.3 million improvement reflects profitability gains made through our focus on cost management and improvements realized in our pricing structure.

Financing Expenses

For the year ended December 31, 2012, financing expenses decreased by \$1.2 million to \$7.3 million. The decrease is primarily due to the decrease in non-cash accretion of debt discount and interest on long-term debt as a result of the renegotiation of our long-term trade debt in June 2012. The components of financing expense are below:

	Year Ended December 31	
	2012	2011
Non-cash accretion of debt discount and interest on long term debt and Convertible Debentures	\$ 3,961	\$ 5,349
Cash interest on Convertible Debentures	1,940	1,938
Interest on Senior Credit Facility	707	586
Other interest and financing costs	305	347
Financing transaction costs and amortization of deferred financing costs	386	280
	\$ 7,299	\$ 8,500

Changes in Fair Value on financial liabilities recognized at fair value

The change in control option, conversion feature and Warrants associated with the Debentures, and an early payment option on long-term debt are recorded at fair market value and are re-measured each period. Prior to the completion of the Corporate Conversion, the fair market value of the conversion feature and Warrants associated with the Debentures incorporated the market value of the Fund's units and the risk-free interest rate and as such, the fair value of these instruments fluctuated inversely with the changes in the Fund's unit price or in the risk-free rate. Subsequent to the Corporate Conversion the conversion feature and Warrants associated with the Debentures were reclassified to equity and will no longer be re-measured at period end.

The change in fair value for the year ended December 31, 2012 was a loss of \$0.7 million in 2012 versus a gain of \$2.3 million in 2011. The loss is due to the increase in unit price experienced during the period prior to the Corporate Conversion on October 1, 2012.

Foreign Exchange Gain (Loss)

During the year ended December 31, 2012 Tree Island Steel reported a gain on foreign exchange of \$0.1 million, compared to a loss of \$0.7 million in 2011. As a portion of TIIL's assets, liabilities, sales and expenses are denominated in currencies other than the Canadian dollar, its functional currency, TIIL has exposure to fluctuations in the values of these currencies, in particular the US dollar, relative to the Canadian dollar. Foreign exchange gains and losses are unpredictable in nature and therefore can be expected to vary significantly from period-to-period and over time.

Income Taxes (Expense) Recovery

For the year ended December 31, 2012, we recorded an income tax expense of \$458 thousand, compared to an income tax recovery of \$64 thousand in 2011. The income tax expense represents a current income tax recovery of \$749 thousand (2011 - \$51 thousand recovery) and a deferred income tax expense of \$1,207 thousand (2011 - \$13 thousand recovery). The deferred

income tax expense increased primarily as a result of the amendments to our long-term debt agreements. The income tax expense was based on the statutory tax rate of 25.0% (2011 – 26.5%) applied to the income of subsidiaries before taxes, with adjustments for permanent differences between accounting and taxable income.

Net Income (Loss)

We reported net income of \$10.4 million for the year ended December 31, 2012 (2011 - net loss of \$12.9 million), or basic income per share / unit of \$0.47 and diluted income per share / unit of \$0.25 (2011 - net loss of \$0.56 per unit basic and diluted). The increase in the net income primarily reflects an increase in operating income to \$0.5 million (2011 – loss of \$2.0 million), an increase in foreign exchange gain to \$0.1 million (2011 - loss of \$0.7 million), an increase in the gain on sale of property, plant and equipment to \$0.4 million (2011 – gain of \$11 thousand), a decrease in impairment of property, plant, and equipment to \$nil (2011 – loss of \$0.9 million), an increase in gain on renegotiated debt to \$17.8 million (2011 – loss of \$3.2 million), and a decrease in financing expense to \$7.3 million (2011 - \$8.5 million). These amounts were partially offset by a loss on fair value of convertible instruments of \$0.7 million (2011 – gain of \$2.3 million) and an increase in income tax expense to \$0.5 million (2011 – income tax recovery of \$0.1 million).

Adjusted Net Loss

Adjusted for the impact of certain non-cash items recognized in net income (loss), Adjusted Net Loss for the year ended December 31, 2012 decreased to \$1.5 million from a loss of \$6.6 million during the same period in 2011. The \$5.1 million decrease in Adjusted Net Loss is primarily due to a \$2.5 million increase in operating income, a \$0.4 million increase in the gain on sale of property, plant, and equipment, a \$0.9 million decrease in impairment of property, plant, and equipment, an increase in foreign exchange gain of \$0.8 million, and an increase in current income tax expense of \$0.5 million.

7. FINANCIAL CONDITION AND LIQUIDITY

7.1. Working Capital

Our business requires an ongoing investment in working capital, comprised primarily of accounts receivable and inventories, financed primarily by credit in the form of our Senior Revolving Facility and accounts payable and accrued liabilities. Our largest investment in working capital is in our inventories. We rely on credit from our key suppliers to finance the purchase of the raw materials needed for our operations.

Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers and payments made to our suppliers. The commercial construction, residential construction, and agricultural markets are seasonal in nature. As a result, sales and working capital requirements may be higher in the first and second quarters when demand is historically highest.

A summary of the composition of our working capital as at December 31, 2012 and 2011 is provided below (\$'000's):

	December 31 2012	December 31 2011
Investment in working capital assets		
Cash	\$ 2,371	\$ 3,852
Accounts receivable	11,984	13,835
Inventories	32,732	36,123
Other current assets	2,200	2,533
	\$ 49,287	\$ 56,343
Less current liabilities		
Senior Revolving Facility	(10,785)	(11,247)
Accounts payable and accrued liabilities	(9,649)	(13,745)
Other current liabilities	(1,741)	(2,573)
Current portion of long-term debt	(1,748)	(4,882)
	(23,923)	(32,447)
Net investment in working capital	\$ 25,364	\$ 23,896

As at December 31, 2012 inventories and accounts receivable decreased in comparison to year-end 2011. The decrease in inventories relates to a reduction in fourth quarter inventory purchases. The decrease in accounts receivable is the result of the decrease in fourth quarter sales as compared to the fourth quarter of 2011. Offsetting these decreases were decreases in the

Senior Revolving Facility and accounts payable and accrued liabilities as less working capital investment was required due to the reduction in inventory balances.

Also, during the year, there was a significant reduction in the current portion of long term debt as a result of amendments to our long-term debt as discussed in more detail in Note 11 to the consolidated financial statements.

Our objective for managing the investment in working capital is to maximize the turnover of productive current assets, being accounts receivable and inventories. We manage our cash to keep utilization of our revolving credit line as low as practicable to maintain borrowing capacity for when it is needed and to reduce ongoing interest costs. We also work with our key vendors to avail ourselves of vendor credit where possible and on advantageous terms.

We manage our inventories with an emphasis on a continuous inflow of inventories to meet our production needs balanced with strategic purchases. We have also established processes to regularly adjust the levels of finished goods stocked in our warehouses so that we can both satisfy customer needs and meet our objective of minimizing inventories on hand.

We manage our accounts receivable and the related credit risk by focusing on well-established customers with favourable credit profiles. The credit worthiness of customers is assessed using credit scores supplied by a third party and through direct monitoring of their financial well-being on a continual basis. We have established guidelines for customer credit limits and when thresholds in these areas are reached, appropriate precautions are taken to improve collectability. We maintain provisions for potential credit losses (allowance for doubtful accounts) and such losses to date have been within our expectations.

7.2. Liquidity and Capital

Cash Flow

Following is a summary of our cash flow for the years ended December 31, 2012 and 2011 (\$000's – bracketed figures indicate use of cash):

	2012	2011
Net cash provided by operating activities	\$ 3,962	\$ 1,467
Working capital adjustments	\$ 133	\$ (8,260)
Net cash provided by (used in) investing activities	\$ 171	\$ (422)
Term loan, net	4,792	-
Repayment of long-term debt	(6,812)	(2,892)
Interest paid	(2,929)	(2,871)
Normal Course Issuer Bid	(317)	(26)
(Payment of) advance on Senior Revolving Facility	(462)	11,247
Net cash (used in) provided by financing activities	\$ (5,729)	\$ 5,458
Exchange rate changes on foreign cash balances	(19)	(25)
Decrease in cash balances	\$ (1,482)	\$ (1,782)

During the year ended December 31, 2012, cash flow provided by operating activities was \$4.0 million compared to \$1.5 million in 2011. The \$2.5 million increase in cash provided by operating activities for the year ended December 31, 2012 was primarily the result of increased EBITDA.

During the year ended December 31, 2012, working capital adjustments decreased by \$8.4 million primarily as a result of the timing of collections on our accounts receivable and reduction in quantity of inventories.

During the year ended December 31, 2012 investing activities provided \$0.2 million in cash (2011 – consumed \$0.4 million) which was comprised primarily of \$0.5 million (2011 - \$0.1) in cash from the receipt of the holdback from the sale of surplus land, and offset by \$0.3 million (2011 - \$0.5 million) in maintenance capital expenditures.

In regards to the long-term debt, during the year ended December 31, 2012 we made payments of \$6.8 million compared to \$2.9 million during 2011. The increase is the result of the \$5.0 million settlement of the long-term debt agreements with one of our trade creditors. The settlement was funded through proceeds received from the Senior Term Loan (described under “Senior Credit Facility”). During the year ended December 31, 2012 we made payments of \$0.2 million towards the term loan (2011 - \$nil).

During the year ended December 31, 2012, we repaid \$0.5 million of our Senior Revolving Facility (2011 - \$11.2 million in advances), decreasing the amount outstanding from \$11.2 million as at December 31, 2011 to \$10.8 million as at December 31, 2012.

Senior Credit Facility

The Senior Credit Facility was renewed and amended on June 11, 2012. Under the terms of the amended Senior Credit Facility, up to \$40 million may be borrowed in Canadian and US currency. Interest is charged at variable rates based on the Canadian and/or US prime rate and the Canadian B.A. and/or Euro dollar rate. The amended Senior Credit Facility matures on June 11, 2016.

The Senior Credit Facility consists of a Senior Revolving Facility and a \$5.0 million Senior Term Loan. Management expects that this is sufficient to accommodate Tree Island's current daily operating needs. The credit available at any given time under the Senior Credit Facility is limited to the amount of the calculated borrowing base, less a minimum availability and certain reserves.

The Senior Revolving Facility has defined covenants, primarily a quarterly test whereby Tree Island is required to meet a defined fixed charge coverage ratio if the availability on the Senior Revolving Facility falls below a certain threshold ("Availability Test"). In addition, there are other restrictive covenants that limit the discretion of management with respect to certain business matters.

As at December 31, 2012 the availability was in excess of the Availability Test and the Company was in compliance with its covenants on the Senior Credit Facility. For more details on the Senior Credit Facility please refer to Note 9 of Tree Island's consolidated financial statements for the year ended December 31, 2012.

8. CAPITAL EXPENDITURES AND CAPACITY

For the year ended December 31, 2012, we made capital expenditures of \$0.3 thousand (2011 - \$0.5 thousand) made up primarily of maintenance capital. We have planned capital expenditures for the 2013 fiscal year to a level which we believe will be sufficient to maintain the existing productive capacity of our manufacturing operations. Non-maintenance capital is funded out of our Senior Credit Facility and maintenance capital is funded from cash generated by operations. We anticipate that we will continue to have sufficient capacity to meet projected future demand.

9. CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As of December 31, 2012, we were committed to the contracts, operating leases and debt repayments (including scheduled interest payments on interest bearing debt) set out below, which will be financed through working capital and our Senior Revolving Facility.

	2013	2014	2015	2016	2017	Thereafter	Total
Commitments							
Wire Rod Purchases	\$ 21,145	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 21,145
Finished Goods	836	-	-	-	-	-	836
Operating Lease Agreements	1,345	806	759	696	-	-	3,606
	23,326	806	759	696	-	-	25,587
Financial Liabilities							
Senior Revolving Facility	10,785	-	-	-	-	-	10,785
Accounts Payable and accrued liabilities	9,649	-	-	-	-	-	9,649
Finance Lease	65	65	28	-	-	-	158
Senior Term Loan	500	500	500	500	500	2,292	4,792
Long-term debt	1,194	1,264	1,313	1,383	1,433	12,565	19,152
Debentures	1,918	21,408	-	-	-	-	23,326
Total	\$ 47,437	\$ 24,043	\$ 2,600	\$ 2,579	\$ 1,933	\$ 14,857	\$ 93,449

The wire rod purchases are for raw materials to be used in the day-to-day operations of our manufacturing facilities and are expected to be delivered in the first half of 2013.

We have leases for facilities and equipment that are considered to be operating leases for accounting purposes and as such are not recorded on the statement of financial position. During the second quarter of 2012 we entered into a new lease for equipment which is considered a finance lease for accounting purposes and as such the lease obligation was recorded on the statement of financial position with the leased asset included in property, plant, and equipment.

We have ongoing and renewing tolling agreements for contract manufacturing whereby our customers retain ownership of the raw materials and finished goods and we charge the customers a tolling fee for processing the raw material into finished goods. During 2012 tolling generated revenues of \$4.4 million (2011 - \$5.3 million).

10. SUMMARY OF QUARTERLY FINANCIAL INFORMATION

The table below provides selected quarterly financial information for the eight most recent fiscal quarters to December 31, 2012 (\$000's, except tons and per unit amounts). First and second quarter sales volumes are traditionally higher than the other quarters due to the seasonality of our business. Quarter-over-quarter results may also be impacted by unusual or infrequently occurring items.

These financial results are not necessarily indicative of results for any future period and should not be relied upon to predict future performance.

	Dec-31 2012	Sept-30 2012	Jun-30 2012	Mar 31 2012	Dec-31 2011	Sep-30 2011	Jun-30 2011	Mar 31 2011
Sales Volumes – Tons ⁽¹⁾	21,583	24,242	25,965	30,618	25,282	27,408	27,676	29,948
Revenue	\$ 28,657	\$ 33,962	\$ 39,622	\$ 43,997	\$ 35,081	\$ 38,005	\$ 38,000	\$ 38,944
Gross Profit	\$ 1,314	\$ 3,487	\$ 4,239	\$ 3,992	\$ 1,103	\$ 1,411	\$ 3,564	\$ 4,380
EBITDA	\$ (1,132)	\$ 998	\$ 1,985	\$ 1,728	\$ (1,133)	\$ (1,276)	\$ 1,725	\$ 1,972
Foreign exchange gain (loss)	\$ 12	\$ 163	\$ (397)	\$ 309	\$ 517	\$ (1,817)	\$ 160	\$ 418
EBITDA including foreign exchange	\$ (1,120)	\$ 1,161	\$ 1,588	\$ 2,037	\$ (616)	\$ (3,093)	\$ 1,885	\$ 2,390
Net Income (Loss)	\$ (2,345)	\$ (1,991)	\$ 15,125	\$ (418)	\$ (4,257)	\$ (4,594)	\$ 29	\$ (4,039)
Net Income (Loss) per Unit – Basic	\$ (0.11)	\$ (0.09)	\$ 0.69	\$ (0.02)	\$ (0.19)	\$ (0.20)	\$ 0.00	\$ (0.18)
Gross Profit per Ton	\$ 61	\$ 144	\$ 163	\$ 130	\$ 44	\$ 51	\$ 129	\$ 146
EBITDA per Ton	\$ (52)	\$ 41	\$ 76	\$ 56	\$ (45)	\$ (47)	\$ 62	\$ 66

(1) Sales volumes exclude tons which are part of tolling arrangements

- Q3 2012: The third quarter demonstrated the continuation of near term stability in our operating results; however, we are still faced with external pressures including ongoing limited market visibility and volatile input costs.
- Q2 2012: The second quarter demonstrated sustained improvements across key financial indicators, resulting from our profitable growth strategy, despite an uncertain economic environment.
- Q1 2012: Market conditions remained challenging during the period with continued uncertainty and volatility in global economic factors. In response to these challenges, we continued to manage our product mix, maintain price discipline and manage our costs closely as part of our business strategy. However, rising raw material costs compressed margins when compared to the same period in the prior year.
- Q4 2011: Although the fourth quarter experienced some seasonal impact, this was not as pronounced as in 2010, and overall the Fund's performance in the fourth quarter of 2011 and for the full year 2011 compare favorably with the same periods in 2010. However, we continued to observe weakness in our end markets.
- Q3 2011: Growth in our key markets resulted in higher volumes and as a result a better recovery of overhead costs contributing to an improved gross profit when compared to the same quarter in the prior year. However, when compared to the first and second quarters, rising raw material costs resulted in margin compression and consequently in lower gross profit as compared to the first and second quarters of 2011.
- Q2 2011: Continuing increases in steel prices required further price increases however the extent of realizing those price increases was not sufficient to fully mitigate the impact on gross profit. The continued strength of the Canadian dollar negatively impacted our US dollar-denominated sales but contributed to reductions in costs of sales and expenses relating to our US dollar-denominated costs.
- Q1 2011: Significant increases in steel prices required us to announce a series of price increases to mitigate the impact on our margins. A strong Canadian dollar also negatively impacted our US dollar-denominated sales but contributed to reductions in costs of sales and expenses relating to our US dollar-denominated costs.

11. COMPARISON OF RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2012 AND 2011

	Three Months Ended December 31	
	2012	2011
Summary of Results (\$000's except for tonnage and per unit amounts)		
Sales Volumes – Tons ⁽¹⁾	21,583	25,282
Sales	\$ 28,657	\$ 35,081
Cost of sales	(26,568)	(33,196)
Depreciation	(775)	(782)
Gross profit	1,314	1,103
Selling, general and administrative expenses	(3,221)	(3,018)
Operating loss	(1,907)	(1,915)
Foreign exchange gain	12	517
Gain on sale of property, plant and equipment	18	-
Impairment of property, plant, and equipment	-	(858)
Changes in financial liabilities recognized at fair value	10	30
Financing Expenses	(1,324)	(2,241)
Income before income taxes	(3,191)	(4,467)
Income tax recovery	846	210
Net loss	(2,345)	(4,257)
Operating loss	(1,907)	(1,915)
Add back depreciation	775	782
EBITDA ⁽²⁾	(1,132)	(1,133)
Foreign exchange gain (loss)	12	517
EBITDA including foreign exchange	(1,120)	(616)
Net loss	(2,345)	(4,257)
Add back significant non-cash items		
Non-cash financing expenses	648	1,387
Changes in financial liabilities recognized at fair value	(10)	(30)
Deferred income tax recovery	200	99
Adjusted net loss ⁽²⁾	(1,507)	(2,801)
Per unit		
Net loss per unit - basic	(0.11)	(0.19)
Net loss per unit - diluted	(0.11)	(0.19)
Per ton		
Gross profit per ton	61	44
EBITDA per ton	(52)	(45)
Financial position	As at December 31,	As at December 31,
	2012	2011
Total assets	\$ 81,102	91,005
Total non-current financial liabilities	29,790	42,789

⁽¹⁾ Sales volumes exclude tons which were processed as part of tolling arrangements

⁽²⁾ See definition of EBITDA and Adjusted Net Income in Section 2 - Non-IFRS Measures

Revenue

During the three months ended December 31, 2012, we generated revenues of \$28.7 million, a decrease of \$6.4 million, or 18.3%, from the same period in 2011. The decline in revenue primarily reflects a 14.6% decreases in sales volumes and a 4.3% decrease in revenue per ton. Revenue per ton decreased primarily as a result of the decrease in carbon rod cost during the quarter, as noted below, as we continue to align revenues with our input costs.

Sales volumes by market were as follows:

Market	Three Months Ended Dec 31, 2012		Three Months Ended Dec 31, 2011	
	Tons	% of Sales Volumes	Tons	% of Sales Volumes
Industrial/OEM	10,010	46.3%	10,235	40.4%
Residential Construction	5,076	23.6%	7,027	27.8%
Commercial Construction	4,636	21.5%	5,126	20.3%
Agricultural	804	3.7%	1,436	5.7%
Specialty Applications	957	4.4%	1,127	4.5%
International Trading ⁽¹⁾	100	0.5%	331	1.3%
Total	21,583	100.0%	25,282	100.0%

(1) International includes Tree Island International trading sales and does not include North American import sales, which are reflected in our sales volumes to other markets

Overall our sales volumes are lower than the prior year in all markets due in part to our objective of focusing on profitable growth areas. Industrial/OEM sales volumes declined driven by our efforts to maintain price discipline together with the competitiveness in the galvanized chain link, and other wire markets. The decline was partially offset by growth in sales to the manufacturing sector. Western US housing, housing starts are well below historical average levels and the residential construction market remains highly competitive. Our sales volume to this market was driven by our continuing focus on margin improvements in our product mix and decreased due to a temporary surge in housing starts during the prior period. Sales to the commercial construction sector were driven by less welded wire fabric sales which was the result of our efforts to redefine our product mix and focus on more profitable product sales. Agricultural sales declined during the fourth quarter due to lower sales of vineyard wire sales resulting from the timing of customer purchases as demand was filled during the first three quarters. Sales to the specialty sector declined due to lower sales of lashing wire. International trading sales decreased reflecting the discontinuation of certain projects in our Asian subsidiaries.

The share of sales volumes from our import and trading activities, compared to the share of sales from products manufactured at our domestic manufacturing facilities, was as follows:

	Three Months Ended Dec 31, 2012		Three Months Ended Dec 31, 2011	
	Tons	% of Sales Volumes	Tons	% of Sales Volumes
North American Manufactured	19,726	91.4%	23,446	92.7%
Imported & Trading	1,857	8.6%	1,836	7.3%
Total	21,583	100.0%	25,282	100.0%

During the three months ended December 31, 2012, sales volumes of our North American manufactured products decreased in total tons and as a percentage of total sales volumes. The decrease in manufactured product volumes relative to import and trading product volumes reflects the overall decrease in sales volumes as compared to the fourth quarter of 2011 primarily driven by the decrease in residential construction and agricultural sales as discussed above. Import and trading volumes have remained relatively consistent with the same period in 2011 reflecting our increased emphasis on manufacturing as a core competency. Going forward, we will continue to review and optimize the mix of manufactured versus imported products as we work to enhance profitability and provide our customers with value and the specific products they need.

Cost of Sales

For the three months ended December 31, 2012, cost of sales decreased by \$6.6 million or 20.0% from the same period last year. The decrease in cost of sales was driven by lower sales volumes and lower overall raw material costs when compared to the same period last year. Our average cost of carbon rod (representing 51.0% of total cost of sales) decreased by 9.3% when compared to the same period in 2011. Because carbon rod is usually transacted in US dollars, the cost of carbon rod for our Canadian operations was negatively impacted by the weaker Canadian dollar in the three months ended December 31, 2012. In addition, stainless steel costs (representing 7.0% of total cost of sales) decreased 10.5% on a per-ton basis and the cost of zinc (representing 1.8% of total cost of sales) decreased 8.5% compared to 2011.

Gross Profit

During the three months ended December 31, 2012, gross profit increased to \$1.3 million (2011 - \$1.1 million), while gross profit per ton increased by \$17 per ton to \$61 per ton, compared to \$44 per ton in the same period in 2011. The increase in gross profit and gross profit per ton primarily reflects the decrease in overall raw materials costs as noted above.

Selling, General, and Administrative Expenses

SG&A expenses increased to \$3.2 million in 2012 from \$3.0 million in 2011, an increase of \$0.2 million, or 6.7%. The increase in SG&A expense is largely the result of costs incurred in 2012 for the Corporate Conversion.

EBITDA

EBITDA for the three months ended December 31, 2012 was an EBITDA loss of \$1.1 million, consistent with 2011. Although there was a decline in volumes and revenue per ton in the fourth quarter of 2012 as compared to 2011, EBITDA has remained consistent which reflects profitability gains made through our focus on cost management, pricing, and price discipline.

Financing Expenses

For the three months ended December 31, 2012, financing expenses decreased by \$0.9 million to \$1.3 million. The decrease is primarily due to the \$0.7 million decrease in non-cash accretion of debt discount and interest on long-term debt as a result of the renegotiation of long-term debt in June 2012. The components of financing expense are below:

	Three months ended December 31	
	2012	2011
Non-cash accretion of debt discount and interest on long term debt and Convertible Debentures	\$ 648	\$ 1,387
Cash interest on Convertible Debentures	487	488
Interest on Senior Credit Facility	186	204
Other interest and financing costs	(18)	91
Financing transaction costs and amortization of deferred financing costs	21	71
	<u>\$ 1,324</u>	<u>\$ 2,241</u>

Changes in Fair Value on convertible instruments

The change in control option, conversion feature and warrants associated with the Debentures, and an early payment option on long-term debt are recorded at fair market value and are re-measured each period. Prior to the completion of the Corporate Conversion, the fair market value of the conversion feature and warrants associated with the Debentures incorporated the market value of the Fund's units and the risk-free interest rate and as such, the fair value of these instruments fluctuated inversely with the changes in the Fund's unit price or in the risk-free rate. Subsequent to the Corporate Conversion the conversion feature and warrants associated with the Debentures were reclassified to equity and will no longer be re-measured at period end.

The change in fair value for the three months ended December 31, 2012 was a gain of \$10 thousand versus a gain of \$30 thousand in 2011.

Foreign Exchange Gain

During the three months ended December 31, 2012 Tree Island reported a gain on foreign exchange of \$12 thousand, compared to a gain of \$517 thousand in 2011. As a portion of TIIL's assets, liabilities, sales and expenses are denominated in currencies other than the Canadian dollar, its functional currency, TIIL has exposure to fluctuations in the values of these currencies, in particular the US dollar, relative to the Canadian dollar. Foreign exchange gains and losses are unpredictable in nature and therefore can be expected to vary significantly from period-to-period and over time.

Income Tax Recovery

For the three months ended December 31, 2012, we recorded an income tax recovery of \$846 thousand, compared to an income tax recovery of \$210 thousand in 2011. The income tax recovery represents a current income tax recovery of \$646 thousand (2011 - \$100 thousand recovery) and a deferred income tax recovery of \$200 thousand (2011 - \$110 thousand recovery). The income tax recovery was based on the statutory tax rate of 25.0% (2011 - 26.5%) applied to the income of subsidiaries before taxes, with adjustments for permanent differences between accounting and taxable income.

Net Loss

We reported a net loss of \$2.3 million in the three months ended December 31, 2012 (2011 - net loss of \$4.3 million), or basic and diluted loss per share of \$0.11 (2011 - net loss of \$0.19 per share basic and diluted). The decrease in the net loss primarily reflects a decrease in impairment on property, plant, and equipment to \$nil (2011 – loss of \$0.9 million), a decrease in financing expense to \$1.3 million (2011 - \$2.2 million), and an income tax recovery of \$0.8 million (2011 – income tax recovery of \$0.2 million). These amounts were offset by an decrease in foreign exchange gain to \$12 thousand (2011 – gain of \$0.5 million)

Adjusted Net Loss

Adjusted for the impact of certain non-cash items recognized in net loss, Adjusted Net Loss for the three months ended December 31, 2012 decreased to a loss of \$1.5 million, from a loss of \$2.8 million during the same period in 2011. The \$1.3 million decrease in Adjusted Net Loss is primarily due to no impairment of property, plant and equipment in 2012 (2011 - \$0.8 million) and an increase in income tax recovery of \$0.6 million.

12. ACCOUNTING POLICIES AND ESTIMATES

Tree Island’s significant accounting policies are contained in Note 3 of the consolidated financial statements for the year ended December 31, 2012. Certain of these policies involve critical accounting estimates that require Tree Island to make subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under differing conditions or using different assumptions. Tree Island evaluates these estimates and assumptions regularly.

Critical Accounting Estimates

The areas that we consider to have critical accounting estimates are: going concern, financial instruments valued at fair value through profit and loss, inventory valuation, allowance for doubtful accounts, property, plant and equipment, and income taxes. These critical estimates and the judgments involved are discussed further in Tree Island’s consolidated financial statements for the year ended December 31, 2012 (Note 4).

13. RELATED PARTY TRANSACTIONS

Transactions with associated companies

One of the investors in the Recapitalization Transaction (as discussed in the Company’s Annual Information Form for the year ended December 31, 2012 under the header “*General Development of the Business and Three Year History*”), The Futura Corporation (“Futura”), is considered to be a related party to the Company, because of its ownership interest and the fact that Mr. Doman, the sole shareholder and president of Futura, and Mr. Rosenfeld, the Executive Vice President of Futura, sit on the Board of Directors. Futura has purchased \$5.0 million of Debentures and was issued 1,875,000 warrants. During the year ended December 31, 2012, Futura received interest settled in cash of \$500 thousand (2011 - \$500 thousand) on the Debentures at the stated rate of interest.

As well, TIIL sells products to subsidiaries of a company of which Mr. Doman is Chairman and CEO, CanWel Building Materials Group Ltd. (“CanWel”), which amounted to, net of rebates, \$3.9 million (2011 - \$4.5 million) during the year ended December 31, 2012 and trade accounts receivable owing from CanWel as at December 31, 2012 were \$86 thousand (2011 - \$140 thousand). Outstanding trade accounts receivable from CanWel at period end are unsecured, interest free and settlement occurs in cash.

Transactions with key management personnel

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Directors and officers of Tree Island. Short term employee benefits for key management personnel for the year ended December 31, 2012 were \$2.1 million (2011 - \$2.1 million) which includes wages, salaries, unit-based compensation and social security contributions, paid annual and sick leave, vehicle costs and bonuses. It also includes Directors’ fees paid to members of the Board.

14. RISKS AND UNCERTAINTIES

Investment in Tree Island Steel, is subject to a number of risks. Tree Island’s income is dependent upon the fabricated wire products business, which is susceptible to a number of risks. A detailed discussion of our significant business risks is provided in the 2012 Annual Information Form under the heading “Risk Factors” which can be found at www.sedar.com.

15. DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to: (a) provide reasonable assurance that material information required to be disclosed by us is accumulated and communicated to management to allow timely decisions regarding required disclosure; and (b) ensure that information required to be disclosed by us is recorded, processed, summarized, and reported within the time periods specified in applicable securities legislation.

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2012. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures, as defined by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, are effective for the purposes set out above.

Internal Control over Financial Reporting

Our management is responsible for designing, establishing and maintaining an adequate system of internal control over financial reporting. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes, in accordance with IFRS.

Our management, with the participation of the Chief Executive Officer and the Chief Financial Officer, has conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2012 based on the framework from the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, management concluded that our internal control over financial reporting, as defined by National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, is effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

Changes in Internal Control over Financial Reporting

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated changes in internal control over financial reporting that occurred during the fiscal quarter ended December 31, 2012 and found no change that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

Tree Island's Board of Directors and Audit Committee reviewed and approved the 2012 audited consolidated financial statements and this management's discussion and analysis prior to its release.



TREE ISLAND STEEL LTD.

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

MANAGEMENT'S STATEMENT OF RESPONSIBILITIES

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors. The consolidated financial statements have been prepared by management, in accordance with International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgments. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements.

The Company maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of the consolidated financial statements.

The Board of Directors ensures that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee. This committee reviews the consolidated financial statements and reports to the Directors. The auditors have full and direct access to the Audit Committee.

The consolidated financial statements have been independently audited by Ernst & Young LLP, in accordance with Canadian generally accepted auditing standards. Their report below expresses their opinion on the consolidated financial statements of the Company.

Dale R. MacLean
Director, President, CEO, Tree Island Steel Ltd.

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Tree Island Steel Ltd.

We have audited the accompanying consolidated financial statements of Tree Island Steel Ltd., which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of operations, comprehensive income (loss), shareholders / unitholders equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected

depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Tree Island Steel Ltd. as at December 31, 2012 and 2011 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Accountants
March 14, 2013
Vancouver, Canada

Tree Island Steel Ltd.
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(in thousands of Canadian dollars)

	December 31 2012	December 31 2011
Assets		
<i>Current</i>		
Cash	\$ 2,371	\$ 3,852
Accounts receivable (Note 6)	11,984	13,835
Inventories (Note 7)	32,732	36,123
Prepaid expenses	2,200	2,533
	49,287	56,343
<i>Property, plant and equipment (Note 8)</i>	31,592	34,303
<i>Other non-current assets (Note 9.1)</i>	223	359
	\$ 81,102	\$ 91,005
Liabilities		
<i>Current</i>		
Senior Revolving Facility (Note 9.1)	\$ 10,785	\$ 11,247
Accounts payable and accrued liabilities	9,649	13,745
Income taxes payable	1,346	2,093
Other current liabilities	83	158
Fair value of convertible instruments (Note 10)	312	322
Current portion of long term borrowings (Notes 9.2, 11, 22.6)	1,748	4,882
	23,923	32,447
<i>Convertible Debentures (Note 10)</i>	15,634	14,298
<i>Senior Term Loan (Note 9.2)</i>	4,292	-
<i>Long-term debt (Note 11)</i>	9,639	28,491
<i>Finance lease (Note 22.6)</i>	87	-
<i>Other non-current liabilities (Note 11)</i>	449	364
<i>Deferred income taxes (Note 18)</i>	1,973	766
	55,997	76,366
Shareholders' Equity	25,105	-
Unitholders' Equity	-	14,639
	\$ 81,102	\$ 91,005

Approved on behalf of Tree Island Steel Ltd.

[Signed]

"Amar S. Doman"

Director

[Signed]

"Dale R. MacLean"

Director

See accompanying Notes to the Consolidated Financial Statements

Tree Island Steel Ltd.**CONSOLIDATED STATEMENT OF OPERATIONS***(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)*

	Year Ended December 31	
	2012	2011
Sales	\$ 146,238	\$ 150,030
Cost of goods sold (Note 7)	130,132	136,331
Depreciation (Note 8)	3,074	3,241
Gross profit	13,032	10,458
Selling, general and administrative expenses	12,527	12,411
Operating income (loss)	505	(1,953)
Foreign exchange gain (loss)	87	(722)
Gain on sale of property, plant and equipment	448	11
Property, plant and equipment impairment (Note 8)	-	(858)
Changes in financial liabilities recognized at fair value	(717)	2,331
Gain (loss) on renegotiated debt (Note 11)	17,805	(3,234)
Financing expenses (Note 12)	(7,299)	(8,500)
Income (loss) before income taxes	10,829	(12,925)
Income tax (expense) recovery (Note 18)	(458)	64
Net income (loss) for the year	\$ 10,371	\$ (12,861)
Net income (loss) per share / unit (Note 21)		
Basic	\$ 0.47	\$ (0.56)
Diluted	\$ 0.25	\$ (0.56)
Weighted-average number of shares / units (Note 21)		
Basic	21,978,006	22,856,544
Diluted	60,590,535	22,856,544

See accompanying Notes to the Consolidated Financial Statements

Tree Island Steel Ltd.**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)***(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)*

	Year Ended December 31	
	2012	2011
Net income (loss) for the year	10,371	(12,861)
Other comprehensive (loss) income		
Unrealized (loss) income on translating financial statements of subsidiary operations, net of tax	(486)	655
Comprehensive income (loss) for the year	\$ 9,885	\$ (12,206)

See accompanying Notes to the Consolidated Financial Statements

Tree Island Steel Ltd.

CONSOLIDATED STATEMENT OF SHAREHOLDERS / UNITHOLDERS EQUITY

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

	Shareholders' Capital (Note 14)	Unitholders' Capital (Note 15)	Warrants and Equity Component of Convertible Debentures (Note 10)	Accumulated Deficit	Distributions	Accumulated Other Comprehensive Income (Loss)	Total
Balance as at December 31, 2011	\$ -	\$ 211,450	\$ -	\$ (37,899)	\$ (159,248)	\$ 336	\$ 14,639
Units exchanged into common shares (Notes 14 and 15)	211,158	(211,158)	-	-	-	-	-
Reclassification of distributions to accumulated deficit	-	-	-	(159,248)	159,248	-	-
Conversion of phantom units (Notes 13 and 15)	-	9	-	-	-	-	9
Conversion of Convertible Debentures (Note 10)	169	-	(7)	-	-	-	162
Normal course issuer bid (Notes 14 and 15)	(16)	(301)	-	-	-	-	(317)
Reclassification of convertible instruments to equity (Note 10)	-	-	727	-	-	-	727
Net Income	-	-	-	10,371	-	-	10,371
Other comprehensive loss	-	-	-	-	-	(486)	(486)
Balance as at December 31, 2012	\$ 211,311	\$ -	\$ 720	\$ (186,776)	\$ -	\$ (150)	\$ 25,105
Balance as at December 31, 2010	\$ -	\$ 211,460	\$ -	\$ (25,038)	\$ (159,248)	\$ (319)	\$ 26,855
Conversion of phantom units (Notes 13 and 15)	-	16	-	-	-	-	16
Normal course issuer bid (Note 15)	-	(26)	-	-	-	-	(26)
Net Loss	-	-	-	(12,861)	-	-	(12,861)
Other comprehensive income	-	-	-	-	-	655	655
Balance as at December 31, 2011	\$ -	\$ 211,450	\$ -	\$ (37,899)	\$ (159,248)	\$ 336	\$ 14,639

See accompanying Notes to the Consolidated Financial Statements

Tree Island Steel Ltd.

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

	Year Ended December 31	
	2012	2011
Cash flows from operating activities		
Net income (loss) for the year	\$ 10,371	\$ (12,861)
Adjustments for		
Depreciation	3,074	3,241
Changes in financial liabilities recognized at fair value	717	(2,331)
Gain on sale of property, plant and equipment	(448)	(11)
Property, plant and equipment impairment	-	858
(Gain) loss on renegotiated debt	(17,805)	3,234
Net finance costs	7,299	8,500
Deferred income tax recovery	1,207	(13)
Fair value change on Phantom Units	(64)	33
Exchange revaluation on foreign denominated debt	(389)	817
Working capital (Note 24)	133	(8,260)
Net cash provided by (used in) operating activities	4,095	(6,793)
Cash flows from investing activities		
Proceeds on disposal of property, plant and equipment	520	49
Purchase of property, plant and equipment	(349)	(471)
Net cash provided by (used in) investing activities	171	(422)
Cash flows from financing activities		
Senior Term Loan, net	4,792	-
Repayment of long-term debt	(6,812)	(2,892)
Interest paid	(2,929)	(2,871)
Normal course issuer bid (Notes 14 and 15)	(317)	(26)
(Payment of) advance on Senior Revolving Facility	(462)	11,247
Net cash (used in) provided by financing activities	(5,728)	5,458
Effect of exchange rate changes on cash	(19)	(25)
Decrease in cash	(1,481)	(1,782)
Cash, beginning of year	3,852	5,634
Cash, end of year	\$ 2,371	\$ 3,852

See accompanying Notes to the Consolidated Financial Statements

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

1. NATURE OF BUSINESS

These consolidated financial statements of Tree Island Steel Ltd. ("Tree Island Steel" or the "Company") for the year ended December 31, 2012 were authorized for issue in accordance with a resolution of the Board of Directors on March 14, 2013.

Tree Island Steel is a corporation established under the laws of Canada on August 2, 2012 and is headquartered at 3933 Boundary Road, Richmond, British Columbia, Canada. Tree Island's shares are publicly traded on the Toronto Stock Exchange ("TSX") under the symbol TSL.

Tree Island Steel owns 100% of the common shares of Tree Island Industries Ltd. ("TIIL") (collectively "Tree Island"). TIIL supplies a diverse range of steel wire and fabricated steel wire products to customers in Canada, the United States, and internationally.

Prior to October 1, 2012, TIIL was owned by Tree Island Wire Income Fund (the "Fund"). Each unitholder participated pro rata in distributions of net earnings and, in the event of termination of the Fund, participated pro rata in the net assets remaining after satisfaction of all liabilities. On October 1, 2012, pursuant to an information circular dated August 15, 2012, the Fund was converted, on a tax deferred basis, from an open-ended limited purpose trust to an incorporated corporation (the "Corporate Conversion") pursuant to a plan of arrangement (the "Arrangement") under the Canada Business Corporations Act. Pursuant to the Corporate Conversion, Tree Island Steel acquired all of the outstanding units of the Fund ("Units"), in exchange for Common Shares ("Shares"), on the basis of one Share for each Unit. The Convertible Debentures have become debentures of Tree Island Steel. The Convertible Debentures will continue to be convertible, but into Shares of Tree Island Steel at the same price at which the Convertible Debentures were convertible into units of the Fund, subject to adjustment as provided for in the trust indenture governing the Convertible Debentures. Effective October 3, 2012, the Convertible Debentures are listed on the TSX (listing symbol TSL.DB). The Warrants have become warrants of Tree Island Steel and will continue to be convertible, but into Shares of Tree Island Steel at the same price at which the Warrants were convertible into Units of the Fund, subject to adjustment as provided for in the Warrant Certificates governing the Warrants. As a result of the Corporate Conversion, Tree Island Steel became the sole holder of the outstanding Units. On October 1, 2012, the Fund was dissolved and all of its assets were transferred to, and all of its liabilities were assumed by, Tree Island Steel on that date. The exchange of the Units of the Fund to Tree Island Steel was recorded at the carrying values of the Fund's assets and liabilities on October 1, 2012.

2. BASIS OF PREPARATION

Basis of presentation

The consolidated financial statements as at and for the year ended December 31, 2012 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Certain comparative information has been reclassified to conform to the presentation adopted during the period.

These consolidated financial statements have been prepared on a historical cost basis except for certain financial liabilities categorized as fair value through profit or loss. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

Basis of consolidation

The consolidated financial statements include the accounts of Tree Island and TIIL, and TIIL's wholly-owned subsidiaries, Tree Island Wire Holdings (USA) Inc. ("TIWH") and Tree Island Wire (USA) Inc. ("TIW"), Tree Island International Ltd. ("TI International") and its subsidiary General Industries & Products International Trade (Tianjin) Co. Ltd. ("GIP"). Tianjin S G United Wire Co Ltd. ("Shoutung") an inactive subsidiary of TI International was dissolved during the year. Intercompany accounts and transactions have been eliminated on consolidation.

Functional currency

The functional and presentation currency of Tree Island and its subsidiary TIIL is the Canadian Dollar. The functional currencies of Tree Island's subsidiaries are: TIW and TIWH is the US Dollar; TI International is the US dollar; and GIP is the Chinese Renminbi ("RMB").

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

3. SIGNIFICANT ACCOUNTING POLICIES, CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATES

The accounting policies applied in the preparation of these consolidated financial statements are set out below:

a) Revenue recognition

Tree Island recognizes revenue on the sale of goods when the significant risks and rewards of ownership pass to the buyer which is considered to be when legal title passes to customers, the revenue can be reliably measured and collectability is reasonably assured. Revenue related to contract manufacturing is recognized at the point at which the items are ready to ship to the customer, the revenue can be reliably measured and collectability is reasonably assured. For both the sale of goods and contract manufacturing, revenue is stated net of early payment discounts, rebates granted and costs to ship product to customer locations if incurred by Tree Island.

b) Cash

Cash is comprised of bank balances, net of outstanding items in deposit and disbursement accounts, cash balances in excess of revolving credit outstanding on the Senior Credit Facility, and cash on hand.

c) Inventories

Raw materials and consumable supplies and spare parts inventories are stated at the lower of weighted average cost and net realizable value. Finished and semi finished products are stated at the lower of first-in first-out cost and net realizable value. Cost for finished and semi-finished products includes direct costs incurred in production including direct labour, materials, freight, depreciation and directly attributable overhead costs and indirect overhead costs based on normal operating capacity. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs to sell. Consumable supplies and spare parts are inventories that are expected to be consumed in operations.

d) Property, plant and equipment and depreciation

As part of the transition to IFRS, the Fund elected under IFRS 1 to value machinery and equipment at fair value on transition, which then becomes the deemed cost on which to amortize/depreciate in future periods. Land, building and improvements continue to be valued at cost less accumulated depreciation and/or impairment losses recognized. Assets acquired or constructed after the transition date are recorded at historic cost, including borrowing costs for long-term construction projects if the recognition criteria are met.

No depreciation is charged on capital projects during the period of construction. Regular repair and maintenance costs are recognized in the income statement as incurred.

Depreciation is determined using the straight-line method over the estimated useful lives of the depreciable assets. When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment. Depreciation methods, asset residual values and useful lives are reviewed annually and adjusted prospectively as required.

Depreciation is calculated over the following rates:

Land and improvements	not depreciated
Buildings and improvements	19 to 30 years
Machinery and equipment	3 to 17 years

An item of property, plant and equipment and any significant part initially recognized is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the statement of operations when the asset is derecognized.

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

e) Impairment of non-financial assets

Impairment Charges

Tree Island performs annual impairment tests on long-lived assets when events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its recoverable amount, and is charged to income.

Tree Island assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, Tree Island estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's ("CGU") fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

In determining fair value less costs to sell, fair value is based on quoted market prices, prices for similar assets or other valuation techniques.

The impairment analysis contains estimates due to the inherently speculative nature of forecasting long-term estimated cash flows and determining the ultimate useful lives of assets. If any of these estimates change, future net cash flows from the assets could be lower, which would result in additional impairment. As well, as much as practicable, third-party valuers are used to provide fair values which also contain assumptions concerning current market information for similar or same assets and if applicable functional and economic obsolescence.

Impairment losses of continuing operations, including impairment on inventories, are recognized in the statement of operations in those expense categories consistent with the function of the impaired asset.

Reversal of Previous Impairments

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, Tree Island estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's or CGU's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the statement of operations.

f) Financial instruments and risks

Financial Assets

Tree Island classifies, at recognition, its financial assets in the following category: loans and receivables. The financial assets are classified depending on the purpose for which the financial assets were acquired. Tree Island currently has the following types of financial assets:

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are classified as current assets or non-current assets based on their maturity date. Loans and receivables are carried at amortized cost less any impairment. Loans and receivables are comprised of accounts receivable.

Tree Island assesses at each reporting date whether there is objective evidence that financial assets under loans and receivables are impaired. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in payments, the probability that they will enter bankruptcy or other financial reorganization. Impaired loans and receivables are charged to the statement of operations as bad debts and allowance for doubtful accounts is recognized.

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

Financial Liabilities

Tree Island classifies its financial liabilities in the following categories: borrowings and other financial liabilities and financial liabilities at fair value through profit and loss.

(i) Borrowings and other financial liabilities

Borrowings and other financial liabilities are classified as current or non-current based on their maturity date and recognized initially at fair value, net of transaction costs incurred and are subsequently stated at amortized cost. Any difference between the amounts originally received, net of transaction costs, and the redemption value is recognized in the statement of operations over the period to maturity using the effective interest method.

Financial liabilities include the Senior Revolving Facility, accounts payable and accrued liabilities, finance lease, Senior Term Loan, long-term debt, and Convertible Debentures.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of operations as a gain or loss on renegotiated debt.

(ii) Financial liabilities at fair value through profit and loss

Financial liabilities at fair value through profit and loss are initially recognized at their fair value on the date the contract or transaction is entered into and are subsequently re-measured at their fair value at each reporting period with changes in the fair value recognized through the statement of operations. Financial liabilities at fair value through profit and loss include the change in control premium, conversion feature, and Warrants associated with the Convertible Debentures and the early payment option. As a result of the Corporate Conversion, the conversion feature and Warrants associated with the Convertible Debentures were reclassified to equity at their fair value on the conversion date (Note 10).

g) Convertible Debentures

The Convertible Debentures are hybrid instruments and the proceeds received were bifurcated to record the fair value of the associated elements, which include the embedded financial derivative for the change of control premium, the conversion feature and Warrants issued, with the residual being allocated to the Convertible Debentures. Transaction costs were allocated pro rata between the elements of the Convertible Debentures.

The fair value of the change of control premium is determined using a probability weighted future cash flow stream and is recorded as a financial liability. The probability of change of control is based on management's best estimate of the likelihood of a change of control event occurring during the term of the Convertible Debentures. The change of control premium is revalued at each reporting date, with changes in the fair value recorded as charges or credits to changes in liabilities recorded at fair value.

The fair value of the conversion feature and Warrants were determined using an option pricing model that takes into account assumptions on volatility of the Fund's units and the risk-free interest rates of return. The conversion feature and Warrants were classified as financial liabilities and the related transaction costs were expensed when incurred. As a result of the Corporate Conversion, the conversion feature and Warrants have characteristics of equity, as they are convertible into Shares of Tree Island on a fixed basis. Thus, the conversion feature and Warrants with fair value of \$727 as at October 1, 2012 (conversion date) were reclassified as equity instruments.

The residual amount recorded for the Convertible Debentures is at a discount from the face amount and this discount, together with the stated interest on the Convertible Debentures and associated transaction costs, are amortized as a charge to financing expense over the life of the instrument using the effective interest method.

Upon exercise of the conversion feature or Warrants, the related portions of the financial liability and equity for all the elements are derecognized. The Shares are recorded in share capital based on amortized cost of the Convertible Debentures and the remainder is allocated to the conversion feature and Warrants.

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

Upon maturity of the Convertible Debentures, to the extent that they are not exercised, any financial liabilities remaining on the change in control premium will be recorded as a gain in the statement of operations and any balance remaining on the conversion features and Warrants will be transferred within the Shareholders equity account from Warrants and equity component of Convertible Debentures to share capital.

h) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and are classified as either finance or operating. Leases that transfer substantially all the benefits and risks of ownership of the leased item to Tree Island are accounted for as finance leases. Assets under finance lease would be accounted for as assets and amortized over the lesser of the estimated useful life or the lease term. A finance lease obligation would be recognized to reflect the present value of future lease payments and the finance element of the lease payments would be charged to income over the term of the lease.

Operating lease payments are recognized as an operating expense in the statement of operations on a straight-line basis over the term of the lease.

i) Provisions

General

Provisions are recognized when Tree Island has an obligation (legal or constructive) as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made on the amount of the obligation. Where Tree Island expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the statement of operations, net of any reimbursement.

Asset decommissioning and retirement obligations

Tree Island recognizes obligations associated with the retirement of property, plant and equipment that result from the acquisition, construction, development or normal operations of the assets. These obligations, if material, are recorded at fair value and capitalized and depreciated as part of the cost of the related asset. Management has determined that Tree Island does not have any material asset decommissioning or retirement obligations.

Onerous contracts

An onerous contract is one whereby the unavoidable costs of meeting the obligation exceed the expected economic benefits. Costs associated with non-cancellable lease obligations relating to the exiting of an activity or location that do not qualify for treatment as discontinued operations, net of any sub-lease receipts, are accrued as a provision for an onerous contract. If the effect of the time value of money is material, the provision is discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

j) Post-retirement benefits

Tree Island has three defined contribution pension plans. The cost of defined contribution pensions are expensed as earned by employees.

k) Taxes

Current income tax

Current income tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date in the countries where Tree Island operates and generates taxable income.

Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Tree Island Steel Ltd.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2012 and 2011

(in thousands of Canadian dollars, except shares / units and per-share / unit amounts)

Deferred tax

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax assets and liabilities are recognized for all taxable temporary differences, except in respect of taxable temporary differences associated with investments in subsidiaries when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary difference to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax losses can be utilized, except in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Sales tax

Revenues, expenses and assets are recognized net of the amount of sales tax, except when the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item, as applicable.

Receivables and payables are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the statement of financial position.

l) Phantom units

The Fund maintained a Long-Term Incentive Plan which granted Phantom Units that appreciated or depreciated with increases or decreases in the market price of the Fund's units. Phantom Units granted were considered to be in respect of future services. Vested Phantom Units could be converted to regular units of the Fund at any time after vesting. Upon conversion, Phantom Units were exchanged for units issued from treasury for no further consideration.

The Phantom Units were considered to be financial liabilities and were accounted for under IFRS 2 as cash-settled awards whereby the outstanding Phantom Units were accounted for at fair value at each reporting period and changes in fair value are recognized in compensation expense. As there was no exercise price, the fair value of the Phantom Units was considered to be the market price for the Fund's units. The changes in fair value for unvested awards were recognized over the vesting period and the changes in fair value of vested awards are recognized in full each period until converted to Shares or forfeited.

Phantom Units that expired or were forfeited before vesting were derecognized as a financial liability and the balance was recorded as a reduction of employee benefits expense in the period.

On August 20, 2012, prior to the Corporate Conversion, the Phantom Unit Plan was terminated. There are no continuing obligations with respect to the Plan.

m) Net income (loss) per Share / Unit

Basic net income (loss) per Share / Unit is calculated by dividing net income (loss) by the weighted-average number of Shares / Units outstanding during the period. Diluted net income (loss) per Share / Unit is calculated by factoring in the impact of dilutive

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instruments, including Phantom Units (prior to termination of the plan), the conversion of debentures to Shares / Units using the "if-converted" method, and Warrants using the treasury stock method, which assumes that the proceeds from in-the-money Warrants are used to repurchase Shares / Units at the average market price during the period.

n) Foreign exchange

Transactions in currencies other than the functional currency are recorded at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities that are denominated in foreign currencies are translated at the rate prevailing at each reporting date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date the fair value was determined. Non-monetary items that are measured at historical cost in a foreign currency are translated at the exchange rate on the date of the transaction.

On consolidation the assets and liabilities of foreign operations are translated into Canadian dollars at the rate of exchange prevailing at the reporting date and their income statements are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation for consolidation are recognised in other comprehensive income.

4. CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingencies 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. Significant areas that involve estimates including the assessment are listed below:

Going concern

In the context of the current economic climate, especially in the United States, and the mixed economic conditions in our principal markets in both Canada and the United States management has assessed the entity's ability to continue as a going concern. Management has forecast Tree Island's financial results and cash flows for fiscal 2013. The forecasts are based on management's best estimates of operating conditions in the context of management's best estimates of the current economic climate. The judgments and assumptions that can most directly impact these forecasts are the expected sales volumes and prices realized, costs of raw materials and in particular carbon rod, costs of imported finished goods, foreign exchange fluctuations, and collectability rates on accounts receivables.

With a \$40 million Senior Revolving Facility, working capital of \$25 million as at December 31, 2012, and forecasts projecting credit availability through 2013, Tree Island believes that there is sufficient capital to continue as a going concern. The assumptions and estimates used to make this conclusion are based on the available information and management's best estimates of future earnings, cash flows and working capital turnover.

Financial instruments valued at fair value through profit and loss

Tree Island records certain of its financial instruments at fair value using various techniques. These include estimates of fair values based on prevailing market rates (bid and ask prices, as appropriate) for instruments with similar characteristics and risk profiles or internal or external valuation models, such as discounted cash flow analysis and option pricing models, using, to the extent possible, observable market-based inputs. Refer to notes 10 and 19 for significant assumptions used in the valuation of these financial instruments and carrying amount as at December 31, 2012 and 2011.

Inventory valuation

Inventories must be recognized at the lower of cost or their Net Realizable Value ("NRV"), which is the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale. IFRS requires that the estimated NRV be based on the most reliable evidence available at the time the estimates are made of the amounts that inventories are expected to realize.

The measurement of an inventory write-down to NRV is based on our best estimate of the NRV and of our expected future sale or consumption of our inventories. Due to continued uneven economic activity, continued volatility in certain product group sales prices and the commodity nature of our significant raw materials, there is uncertainty as to whether the NRV of the inventories will remain consistent with those used in our assessment of NRV at period end. As a result there is the risk that a write-down of on-

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hand and unconsumed inventories could occur in future periods. Also, a certain portion of inventory may become damaged or obsolete. A slow moving reserve is recorded, as required, based on an analysis of the length of time product has been in inventory and historical rates of damage and obsolescence. Refer to note 7 for the inventory provision as at December 31, 2012 and 2011.

Allowance for doubtful accounts

It is possible that a certain portion of required customer payments will not be made, and as such an allowance for these doubtful accounts is maintained. The allowance is based on estimation of the potential of recovering the accounts receivable and incorporates current and expected collection trends. The estimates will change, as necessary, to reflect market or specific industry risks, as well as known or expected changes in the customers' financial position. Refer to note 6 for the carrying amount of allowance for doubtful accounts as at December 31, 2012 and 2011.

Property, plant and equipment

Property, plant and equipment comprises a large component of the total assets of Tree Island and as such the capitalization of costs, the determination of estimated recoverable amounts and the estimates of useful lives of these assets have a significant effect on Tree Island's financial results.

Management uses the best available information to identify the point at which a development project is capitalized. Changing assumptions about future selling prices of products, exchange rates, and production costs may change the estimate of the useful life of these assets and as a result the amount of depreciation or amortization recognized.

The carrying value of long-lived assets is reviewed annually. The impairment analysis contains estimates that can change due to the inherently speculative nature of forecasting long-term estimated cash flows and determining the ultimate useful lives of assets. If any of these estimates change significantly, future net cash flows from the property, plant and equipment could be lower or higher, which would result in additional impairment or reversal of impairments recognized in prior periods. As well, as much as practicable, third-party valuers are used to provide fair values that also contain assumptions concerning current market information for similar or same assets and if applicable functional and economic obsolescence. Refer to note 8 for impairment charge as at December 31, 2012 and 2011.

Income taxes

At each balance sheet date, a deferred income tax asset would be recognized for all deductible temporary differences, unused tax losses and income tax reductions, but only to the extent that their realization is probable. The determination of this requires significant judgment. This evaluation includes review of: (1) the ability to carry back operating losses to offset taxes paid in prior years; (2) the carry-forward periods of the losses; (3) an assessment of the excess of fair value over the tax basis of Tree Island's net assets, and, (4) appropriate and feasible corporate actions with respect to repatriation of foreign earnings. If based on this review, it is not probable such assets will be realized, then no deferred income tax asset is recognized. Refer to Note 18 for deferred income tax assets and liabilities as at December 31, 2012 and 2011.

5. FUTURE IFRS STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE

Unless otherwise indicated below, Tree Island is in the process of assessing whether there will be any significant changes to its consolidated financial statements upon adoption of these new standards, interpretations, or amendments. At this time, Tree Island does not plan to early adopt any of these new standards, interpretations, or amendments.

IFRS 9 Financial Instruments – in November 2009, the IASB issued IFRS 9 as a first step in the process to replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces new requirements for classifying and measuring financial assets, and could affect Tree Island's accounting for its financial assets. The standard is required to be adopted for annual periods beginning on or after January 1, 2015.

IFRS 10 Consolidated Financial Statements – in May 2011, the IASB issued IFRS 10, which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities and is required to be adopted for annual periods beginning January 1, 2013.

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IFRS 12 *Disclosure of Interests in Other Entities* – in May 2011, the IASB issued IFRS 12, which aggregates and amends disclosure requirements included within other standards. The new standard requires Tree Island to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The Standard is required to be adopted for annual periods beginning on or after January 1, 2013.

IFRS 13 *Fair Value Measurement* – in May 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS required fair value to be used. IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. The disclosure requirements are substantial. IFRS 13 is required to be adopted for annual periods beginning on or after January 1, 2013.

IAS 1 *Presentation of Items of other Comprehensive Income* – in June 2011, the IASB issued amendments to IAS 1 – presentation of financial statements to split items of other comprehensive income between those that are reclassified to income and those that are not. This new standard is required to be adopted for annual periods beginning on or after July 1, 2012.

6. ACCOUNTS RECEIVABLE

Below is the composition and aging of Tree Island's accounts receivable at year end:

	December 31	
	2012	2011
Accounts Receivable		
Up to date	\$ 8,092	\$ 10,508
Under 30 days past due	2,936	2,823
30-60 days past due	816	607
61-90 days past due	121	109
Over 91 days past due	314	89
	12,279	14,136
Allowance for doubtful accounts	(295)	(301)
Balance, end of year	\$ 11,984	\$ 13,835

Accounts receivable are non-interest bearing and are generally due on 30-day to 90-day terms. These terms are consistent for related party receivables as disclosed in Note 16.

The maximum credit risk that Tree Island was exposed to by way of its accounts receivable is equal to the gross amount of \$12,279 as at December 31, 2012.

At the end of each reporting period a review of the provision for bad and doubtful accounts is performed. It is an assessment of the potential amount of trade accounts receivable that will be paid by customers after the balance sheet date. The assessment is made by reference to age, status and risk of each receivable, current economic conditions and historical information. The trade accounts receivable balance is reduced through the use of the allowance for doubtful accounts and the amount of the loss is recognized in the statement of operations. Reversals to the allowance for doubtful accounts occur when previously allowed for trade accounts receivable are collected. Individual trade accounts receivable, together with any associated allowance previously recognized, are written off when there is no realistic prospect of future recovery.

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The following table represents a summary of the movement of the allowance for doubtful accounts:

	December 31 2012	December 31 2011
Opening Balance	\$ 301	\$ 974
Additions during the year	75	63
Reversals during the year	(41)	(70)
Write-offs during the year	(38)	(676)
Foreign exchange revaluation	(2)	10
Balance, end of year	\$ 295	\$ 301

See Note 19.3 on credit risk of trade receivables to understand how credit quality of accounts receivable that are neither past due nor impaired are managed and measured.

7. INVENTORIES

Tree Island had the following categories of inventory as at:

	December 31 2012	December 31 2011
Raw materials	\$ 6,562	\$ 8,598
Finished and semi finished products	18,360	19,889
Consumable supplies and spare parts	7,810	7,636
	\$ 32,732	\$ 36,123

At each year end, the ending inventories on hand are reviewed to determine if a write down to net realizable value is required. Tree Island has recognized a cumulative charge over the year ended December 31, 2012 of \$11 (2011 - \$347) in cost of sales to write down inventories to net realizable value. In the year ended December 31, 2012 and 2011, Tree Island recognized, in income, inventory costs for the following:

	Year Ended December 31	
	2012	2011
Opening inventory	\$ 36,123	\$ 30,878
Raw material purchases	86,600	99,860
Finished goods purchased for resale	5,741	5,984
Conversion costs	34,411	36,079
Writedowns	(11)	(347)
Inventories, closing	(32,732)	(36,123)
Cost of goods sold	\$ 130,132	\$ 136,331

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8. PROPERTY, PLANT, AND EQUIPMENT

	Land & Improvements	Building & Improvements	Machinery & Equipment	Construction in progress	Total
Cost					
As at December 31, 2010	\$ 9,105	\$ 38,684	\$ 17,559	\$ 37	\$ 65,385
Additions	-	46	103	326	475
Disposals	-	-	(44)	-	(44)
Foreign currency translation	31	118	238	-	387
As at December 31, 2011	\$ 9,136	\$ 38,848	\$ 17,856	\$ 363	\$ 66,203
Additions	-	69	662	(215)	516
Disposals	-	-	(1,299)	-	(1,299)
Foreign currency translation	(31)	(116)	(108)	-	(255)
As at December 31, 2012	\$ 9,105	\$ 38,801	\$ 17,111	\$ 148	\$ 65,165
Accumulated depreciation and impairment					
As at December 31, 2010	\$ -	\$ 23,762	\$ 3,871	\$ -	\$ 27,633
Depreciation charge for the year	-	1,407	1,828	-	3,235
Impairment	-	-	858	-	858
Disposals	-	-	6	-	6
Foreign currency translation	-	106	62	-	168
As at December 31, 2011	\$ -	\$ 25,275	\$ 6,625	\$ -	\$ 31,900
Depreciation charge for the year	-	1,398	1,676	-	3,074
Disposals	-	-	(1,227)	-	(1,227)
Foreign currency translation	-	(37)	(137)	-	(174)
As at December 31, 2012	\$ -	\$ 26,636	\$ 6,937	\$ -	\$ 33,573
Net book values as at:					
December 31, 2011	\$ 9,136	\$ 13,573	\$ 11,231	\$ 363	\$ 34,303
December 31, 2012	\$ 9,105	\$ 12,165	\$ 10,174	\$ 148	\$ 31,592

During the year ended December 31, 2012 additions to machinery and equipment related to assets under finance lease were \$170 (2011 - \$nil). The carrying value of machinery and equipment held under finance lease at December 31, 2012 was \$128 (2011 - \$nil). The leased asset is pledged as security for the related finance lease.

The carrying value of long-lived assets is reviewed annually. Where the carrying value of the assets is not expected to be recoverable from future cash flows, they are written down to their recoverable amount. Tree Island has reviewed certain machinery and equipment and concluded that impairment was indicated and likely and as a result an impairment charge of \$nil was recognized in 2012 (2011 - \$858).

9. SENIOR CREDIT FACILITY

On June 11, 2012, the Fund amended and restated its senior secured committed credit facility ("Senior Credit Facility") with Wells Fargo Capital Finance Corporation. Under the terms of the Senior Credit Facility, up to \$40 million may be borrowed in Canadian and US currency under a revolving credit facility ("Senior Revolving Facility") and a \$5 million term loan ("Senior Term Loan"). Interest is charged at variable rates based on the Canadian and/or US prime rate and the Canadian Bankers Acceptance and/or Euro rate. The Senior Credit Facility matures on June 11, 2016.

The Senior Credit Facility is collateralized by a first charge over Tree Island's assets including a first charge on the real and personal property of TIIL, TIW and TI International and guarantees, pledges and assignments between its subsidiaries. All existing and after-acquired real and personal property of Tree Island and its subsidiaries are pledged as collateral against the Senior Credit Facility.

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9.1 Senior Revolving Facility

The Senior Revolving Facility includes a \$10.0 million Letter of Credit sub-facility which enables TIIL and TIW to open documentary letters of credit for raw material purchases. There were no Letters of Credit outstanding as at December 31, 2012.

The amount available under the revolving portion of the Senior Revolving Facility is limited to the amount of the calculated borrowing base, less minimum availability, less issued Letters of Credit, and less principal due under the Senior Term Loan (Note 9.2). The borrowing base is calculated as 85% of eligible receivables, plus the lesser of (a) 85% of the net orderly liquidation value of inventory and (b) 65% of eligible inventory.

The Senior Revolving Facility has financial tests and other covenants with which Tree Island must comply. Quarterly, Tree Island is required to meet a rolling 4 quarters defined fixed charge coverage ratio of 1:1 if the availability on the Senior Credit Facility falls below the availability threshold. As well, the Senior Revolving Facility contains restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of TIIL and TIW to incur additional indebtedness, to create liens or other encumbrances, to pay dividends or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

As at December 31, 2012 TIIL was in compliance with both the financial and non-financial covenants on the Senior Revolving Facility.

The following amounts are outstanding under the Senior Revolving Facility:

	December 31 2012	December 31 2011
Senior Revolving Facility ⁽¹⁾	\$ 10,785	\$ 11,247
Deferred financing costs ⁽²⁾	(223)	(359)
	\$ 10,562	\$ 10,888

(1) The portion of the Senior Revolving Facility denominated in US dollars is \$2,509 (Dec 31, 2011 - \$2,256).

(2) Deferred financing costs are included in other non-current assets on the statement of financial position.

9.2 Senior Term Loan

On June 11, 2012, the Fund, through its subsidiaries, entered into a term loan with Wells Fargo Capital Finance Corporation (the "Senior Term Loan"). The Senior Term Loan matures on June 11, 2016 and is repayable over 10 years through monthly principal installments of \$42 plus interest at variable rates based on the Canadian prime rate and the Canadian Bankers Acceptance rate. The proceeds of the Senior Term Loan were used to settle long-term debt (Note 11).

The following amounts are outstanding under the Senior Term Loan:

	Year of Maturity	December 31, 2012	December 31 2011
Senior Term Loan, beginning of year	2016	\$ -	\$ -
Advances		5,000	-
Payments		(208)	-
Senior Term Loan, end of year		4,792	-
Less current portion		(500)	-
		\$ 4,292	\$ -

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10. CONVERTIBLE DEBENTURES

On November 26, 2009, the Fund completed a private placement with certain investors to issue an aggregate of \$9,750 principal amount of Convertible Debentures along with 4,875,000 Warrants (see Note 14). In the first quarter of 2010, an additional \$10,000 in Convertible Debentures were issued through a rights offering to unitholders. All Convertible Debentures have the same rights and terms governed by those described in the trust indenture regardless of when they were issued.

In connection with the Corporate Conversion, Tree Island assumed all obligations of the Fund relating to the outstanding Convertible Debentures. Holders are entitled to receive shares, rather than Units, at the same conversion price at which the Units were previously issuable upon conversion.

The Convertible Debentures mature on November 26, 2014 and are convertible into Shares at \$0.50 each. The conversion price is subject to change based on certain events described in the trust indenture. The Convertible Debentures are subordinated debt until all outstanding commitments on the Senior Credit Facility have been fully settled. If a change of control event occurs, as defined in the trust indenture, Tree Island is required to offer to purchase the outstanding Convertible Debentures for 110% of the principal owing. Tree Island has the option to redeem the Convertible Debentures at par after November 26, 2012 and up to the day prior to maturity so long as the weighted average trading price per Share for the 30 consecutive days prior to redemption is not greater than 150% of the conversion price and no event of default has occurred.

The Convertible Debentures pay interest quarterly, 30 days in arrears, at a stated rate of 10%. Interest is payable in cash unless Tree Island is restricted from doing so under certain circumstances (an "Interest Block Condition"). An Interest Block Condition can be triggered by certain events including Tree Island being in default under its Senior Credit Facility or the aggregate borrowing availability under the Senior Credit Facility on the date interest is payable and for a period of 30 days prior is the availability threshold. If the quarterly interest cannot be paid in cash then the interest payable, subject to regulatory approval, can be settled by issuing additional Convertible Debentures equal to the amount of the interest owing; or by deferring payment of interest. Deferred interest will accrue additional interest at 10% per annum until paid in full.

Upon issuance, the Convertible Debentures, less fair values allocated to the conversion feature, change of control premium, and Warrants issued are classified as a liability. The liability was discounted using the effective interest rate method and a discount rate of 21.9%. The debt discount, together with the stated interest and associated transaction costs, are being amortized as interest expense over the life of the Convertible Debentures.

As a result of the Corporate Conversion, the conversion feature and Warrants have characteristics of equity, as they are convertible into Shares of Tree Island on a fixed basis. Thus, the conversion feature and Warrants with fair value of \$727 as at October 1, 2012 (conversion date) were reclassified as equity instruments.

The change of control option continues to be recorded as a financial liability under IAS 32 and is accounted for at fair value. Changes in fair value are recognized in the statement of operations at each period end. The carrying value of the Convertible Debentures at period end is:

	December 31		December 31	
	2012		2011	
December 31, 2011	\$	14,298	\$	13,108
Accretion of debt discount for the year		3,435		3,128
Payment of interest in cash		(1,940)		(1,938)
Conversion of debentures to Tree Island shares		(159)		-
December 31, 2012	\$	15,634	\$	14,298

During the year ended December 31, 2012, \$195 principal value of Convertible Debentures were converted into 390,000 Shares resulting in an increase to shareholders capital of \$169 (net of proportionate issuance costs of \$26) offset by charges of \$159 to the Convertible Debentures, \$3 to the change of control premium, and \$7 to the conversion option. As at December 31, 2012, there were 191,896 (2011 – 193,846) Convertible Debentures outstanding. Subsequent to December 31, 2012, 5,980 Convertible Debentures were converted into 1,196,000 Shares.

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The fair values, change in fair value, and reclassifications to equity for the other elements are:

	Conversion Feature	Warrants	Change of Control Premium	Total
December 31, 2011	\$ 2	\$ -	\$ 320	\$ 322
Change in fair value	700	25	(8)	717
Reclassification to equity	(702)	(25)	-	(727)
December 31, 2012	\$ -	\$ -	\$ 312	\$ 312

11. LONG-TERM DEBT

	Year of Maturity ⁽¹⁾	December 31, 2012	December 31, 2011
Beginning of year	2028	\$ 33,373	\$ 27,538
(Gain) loss on renegotiated debt		(17,805)	3,234
Payments		(6,812)	(2,375)
Foreign exchange revaluation		(389)	817
Accretion of debt discount		2,466	4,159
End of year		10,833	33,373
Less current portion ⁽¹⁾		(1,194)	(4,882)
		\$ 9,639	\$ 28,491

(1) The long-term debt agreements were amended on June 11, 2012 to extend the repayment term by fourteen years so that they now mature in 2028. The current portion as at December 31, 2011 is based on the previous terms of the agreements.

On June 11, 2012, the long-term debt with one trade creditor was extinguished ("Settlement and Release Agreement") and the long-term debt with the other trade creditor was amended ("Second Amendment Agreement").

With respect to the Settlement and Release Agreement, long-term debt with a carrying amount of \$18,001 was settled for a sum of US\$5,000. The settlement resulted in a gain on renegotiated debt of \$12,881, net of transaction costs, for accounting purposes and the extinguishment of US\$19,842 in principal and accrued interest. The current income tax associated with the Settlement and Release Agreement is offset through the utilization of non-capital losses available to TIIL and TIW respectively. All transaction costs associated with the settlement have been expensed. There is no continuing obligation with respect to the Settlement and Release Agreements.

The Second Amendment Agreement extended the repayment term to June 2028 with principal payments over a 10 year amortization period and non-compounding interest at 4% commencing June 2017, payable monthly over 4 years commencing June 2024. Principal payments are monthly in the amounts of US\$100 in years 1 and 2, US\$110 in years 3 and 4, US\$120 in years 5, 6 and 7, and US\$185 in years 8, 9 and 10. For accounting purposes, it was determined that the June 11, 2012 amendment resulted in an exchange of debt instruments with substantially different terms. As a result, the amendment was accounted for as an extinguishment of the original financial liabilities and the recognition of new financial liabilities at their present value resulting in a gain on renegotiated debt of \$4,924, net of transaction costs which were expensed. Present value was determined using discounted cash flows and a credit adjusted discount rate of 9%. The discount rate, together with the stated interest, comprises the debt discount. Using the effective interest rate method, the debt discount is amortized as accretion and charged to interest expense over the term of the amended long-term debt agreements.

The principal under the Second Amendment Agreement is denominated in US dollars.

A provision exists for early payment of a portion of the principal outstanding if certain conditions are met. As at December 31, 2012 a provision of \$138 has been accrued and is included in other noncurrent liabilities.

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12. FINANCING EXPENSES

	Year Ended December 31	
	2012	2011
Non-cash accretion of debt discount and interest on long-term debt and Convertible Debentures	\$ 3,961	\$ 5,349
Cash interest on debentures	1,940	1,938
Interest on revolving credit and term loan	707	586
Other interest and financing costs	305	347
Amortization and write-off of deferred financing costs	386	280
	\$ 7,299	\$ 8,500

13. PHANTOM UNITS

On August 20, 2012 the Phantom Unit Plan was terminated. There are no continuing obligations with respect to the Plan and as a result the liability for the Phantom Units at December 31, 2012 was \$nil (December 31, 2011 - \$52). The change in fair value related to Phantom Units for the year ended December 31, 2012 was \$64 (2011 - \$33). The expense is included in selling, general and administrative expense. A summary of Tree Island's Phantom Units changes during the years ended December 31, 2012 and 2011 are as follows:

	Year Ended December 31			
	2012		2011	
	Vested	Unvested	Vested	Unvested
Balance, beginning of year	245,504	-	63,999	54,081
Granted	-	-	200,000	-
Cash Settlement ⁽¹⁾	(219,847)	-	-	-
Vested	-	-	20,748	(20,748)
Forfeited	(11)	-	-	(33,333)
Converted	(25,646)	-	(39,243)	-
Balance, end of year	-	-	245,504	-

(1) The cash settlement was determined as the closing unit price on August 20, 2012 multiplied by the number of Phantom Units outstanding.

14. SHAREHOLDERS' CAPITAL

On September 13, 2012, unitholders and holders of the Special Voting Units of the Fund approved the reorganization of the Fund's income trust structure into a corporation, pursuant to the Arrangement. The effective date of the Arrangement was October 1, 2012. Unitholders of the Fund exchanged their Units for Shares of Tree Island on a one-for-one basis.

Tree Island is authorized to issue an unlimited number of common shares. The Shares have no par value. Shares issued and outstanding are as follows:

	Shares	Gross	Issuance Costs ⁽¹⁾	Net
Shareholders' capital - December 31, 2011	-	\$ -	\$ -	\$ -
Issued pursuant to Corporate Conversion	21,797,550	222,558	11,400	211,158
Conversion of Convertible Debentures	390,000	169	-	169
Normal course issuer bid	(32,400)	(16)	-	(16)
Shareholders' capital - December 31, 2012	22,155,150	\$ 222,711	\$ 11,400	\$ 211,311

(1) Issuance costs were incurred as a result of the November 2002 Initial Public Offering and October 2004 Secondary Offering.

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Normal Course Issuer Bid

On September 2, 2011, the Fund announced that it had received approval from the TSX to commence a normal course issuer bid (the "Bid"). The Bid commenced on September 7, 2011 and was renewed on September 6, 2012. Subject to renewal, the Bid will terminate on the earlier of September 6, 2013 and the date on which Tree Island has acquired the maximum number of Shares permitted under the Bid. Tree Island may acquire up to 1,700,000 Shares under the Bid, such number representing approximately 10% of the public float of Tree Island's issued and outstanding Shares at the date hereof. Tree Island has no obligation to purchase any Shares under the Bid. Subject to certain exemptions for block purchases, the maximum number of Shares that Tree Island may purchase on any one trading day is 3,483 Shares up to and including September 6, 2013, representing 25% of the average daily trading volume for the previous six months. During the year ended December 31, 2012 Tree Island and the Fund purchased 1,050,900 Shares / Units at an average market price of \$0.30 per Share / Unit, net of commission. These Shares / Units were cancelled upon being purchased.

Warrants

The Fund issued 4,875,000 Warrants to certain investors. The Warrants have an exercise price of \$0.57 and expire November 26, 2014. As discussed in Note 10, the Warrants were measured at fair value prior to the Corporate Conversion. As a result of the Corporate Conversion, all Warrants were exchanged on an one-for-one basis for Warrants of Tree Island effective October 1, 2012 and were reclassified to equity. As at December 31, 2012, no Warrants have been exercised since issuance. Subsequent to December 31, 2012, 300,000 Warrants were exercised and for proceeds of \$171.

15. UNITHOLDERS' CAPITAL

As a result of the Corporate Conversion, all Fund Units were exchanged on an one-for-one basis into Shares of Tree Island effective October 1, 2012. During the year, the Fund had the following Unit transactions:

	Units	Gross	Issuance Costs ⁽¹⁾	Net
Unitholders' capital - December 31, 2010	22,861,661	\$ 222,860	\$ 11,400	\$ 211,460
Conversion of Phantom Units	39,243	16	-	16
Normal course issuer bid	(110,500)	(26)	-	(26)
Unitholders' capital - December 31, 2011	22,790,404	\$ 222,850	\$ 11,400	\$ 211,450

	Units	Gross	Issuance Costs ⁽¹⁾	Net
Unitholders' capital - December 31, 2011	22,790,404	222,850	11,400	211,450
Conversion of Phantom Units	25,646	9	-	9
Normal course issuer bid	(1,018,500)	(301)	-	(301)
Units exchanged for common shares on October 1, 2012 pursuant to the Corporate Conversion	(21,797,550)	(222,558)	(11,400)	(211,158)
Unitholders' capital - December 31, 2012	-	-	-	-

(1) Issuance costs were incurred as a result of the November 2002 Initial Public Offering and October 2004 Secondary Offering.

16. RELATED PARTY TRANSACTIONS

Transactions with associated companies

The Futura Corporation ("Futura"), is considered to be a related party of Tree Island because of its ownership interest and holding two positions on the Board of Directors. Futura has purchased \$5,000 of the Convertible Debentures and was issued 1,875,000 Warrants. During the year ended December 31, 2012, Futura received interest settled in cash of \$500 (2011 - \$500) on the Convertible Debentures at the stated rate of interest.

Tree Island Steel Ltd.

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As well, Tree Island sells products to subsidiaries of a company of which Mr. Doman is Chairman and CEO, CanWel Building Materials Group Ltd. ("CanWel"), which amounted to, net of rebates, \$3,869 (2011 - \$4,507) during the year ended December 31, 2012 and trade accounts receivable owing from CanWel as at December 31, 2012 was \$86 (2011 - \$140). Outstanding trade accounts receivable from CanWel at year end are unsecured, interest free and settlement occurs in cash.

Transactions with key management personnel

Included in the definition of key management for purposes of disclosure of related party transactions are members of Board of Trustees / Directors and officers of Tree Island. Short-term employee benefits for key management personnel for the year ended December 31, 2012 were \$2,128 (2011 - \$2,147) which includes wages, salaries, unit-based compensation and social security contributions, paid annual and sick leave, vehicle costs and bonuses. It also includes Directors fees paid to members of the Board.

17. POST RETIREMENT BENEFITS

Tree Island has three defined contribution pension plans for the benefit of all eligible personnel employed by Tree Island's subsidiaries. Contributions made by Tree Island's subsidiaries amounted to \$1,159 (2011 - \$1,111). Funding obligations are satisfied upon making contributions.

18. INCOME TAXES

A provision for income taxes is recognized for Tree Island, TIIL, and its wholly owned subsidiaries, as Tree Island, TIIL, and its wholly owned subsidiaries are subject to tax.

Income tax (expense) recovery

The income tax (expense) recovery is divided between current and deferred taxes as follows:

	Year Ended December 31	
	2012	2011
<i>Recorded in the statement of operations</i>		
Current tax recovery	\$ 749	\$ 51
Deferred tax (expense) recovery	(1,207)	13
	\$ (458)	\$ 64

Tree Island Steel Ltd.

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The expense or recovery of income taxes varies from the amount that would be expected if computed by applying the Canadian federal and provincial and US federal and state statutory income tax rates to the income before income taxes as shown in the following table:

	Year Ended December 31	
	2012	2011
Income (loss) before provision for income taxes	\$ 10,829	\$ (12,925)
Loss (income) of the Fund subject to tax in the hands of the recipient	900	(872)
Income (loss) of wholly-owned subsidiary companies before income taxes	11,729	(13,797)
Tax Rate	25.0%	26.5%
Expected (income tax expense) recovery of income taxes	\$ (2,932)	\$ 3,656
Increased (reduced) by:		
Revisions of prior year estimates	3	(120)
Items not taxable	(80)	(32)
Non-taxable foreign exchange loss included in other comprehensive income (loss)	-	(352)
Differential tax rates on U.S. and Chinese subsidiaries	517	972
Increase in statutory future income tax rate	-	(8)
Unrecognized (recognized) deferred tax benefits	796	(4,045)
Change in tax reserves	749	-
Items of the Fund	560	14
Other	(71)	(21)
Income tax (expense) recovery	\$ (458)	\$ 64

Deferred income tax assets and liabilities

The components of deferred income tax assets and liabilities as at December 31 are as follows:

	December 31	December 31
	2012	2011
Deferred tax assets (liabilities)		
Non-capital tax loss carry-forwards	\$ 3,843	\$ 6,439
Deferred gain and financing costs	244	506
Reserves and other liabilities	35	395
Property, plant and equipment	(5,153)	(5,787)
Convertible Debentures	(586)	(1,883)
Long-term debt	(1,106)	(249)
Unrealized foreign exchange losses	843	-
Goodwill and intangibles	62	-
Other	(155)	(187)
Deferred tax liability, net	\$ (1,973)	\$ (766)

	2012	2011
Opening balance as at January 1	\$ (766)	\$ (779)
Deferred tax (expense) recovery during the year	(1,207)	13
Closing balance as at December 31	\$ (1,973)	\$ (766)

Tree Island offsets tax assets and liabilities if and only if it has a legally enforceable right to offset current tax assets and current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

Tree Island Steel Ltd.

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No deferred tax assets have been recognized on the consolidated balance sheets where Tree Island has concluded that it is not probable that the benefits of recognized deferred income tax assets will be realized prior to their expiry. As such, Tree Island has not recognized a deferred tax asset on the following items:

	December 31 2012	December 31 2011
Non-capital tax loss carry-forwards	\$ 10,392	\$ 10,389
Goodwill and intangibles	2,836	3,497
Deferred gain and financing costs	6	144
Unrealized foreign exchange losses	1,066	1,811
Reserves and other liabilities	1,075	1,674
Property, plant and equipment	87	-
Other	5,374	4,324
Deferred tax asset	\$ 20,836	\$ 21,839

Income tax loss carry-forwards

As at December 31, 2012, Tree Island had income tax loss carry forwards of \$83,984 available to offset future taxable income with expiries as shown in the table below:

Year of Expiry	Canada	US - Federal	US - State	China
2014	\$ -	\$ -	\$ -	\$ 181
2015	-	-	-	287
2016	-	-	-	371
2017	-	-	-	360
2021	-	-	3,855	-
2028	-	7,522	-	-
2029	9,003	3,867	-	-
2030	-	3,962	-	-
2031	359	5,633	43,026	-
2032	265	2,634	2,659	-
	\$ 9,627	\$ 23,618	\$ 49,540	\$ 1,199

19. FINANCIAL INSTRUMENTS

19.1 Fair value of financial instruments

Tree Island records certain of its financial instruments at fair value using various techniques. These include estimates of fair values based on prevailing market rates (bid and ask prices, as appropriate) for instruments with similar characteristics and risk profiles or internal or external valuation models, such as discounted cash flow analysis and option pricing models, using, to the extent possible, observable market-based inputs.

Tree Island Steel Ltd.

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Below is a comparison by class of the carrying amounts and fair value of Tree Island's financial instruments that are carried in the financial statements.

	December 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash	\$ 2,371	\$ 2,371	\$ 3,852	\$ 3,852
Accounts receivable	11,984	11,984	13,835	13,835
Total financial assets	\$ 14,355	\$ 14,355	\$ 17,687	\$ 17,687
Financial liabilities				
Senior Revolving Facility	\$ 10,785	\$ 10,785	\$ 11,247	\$ 11,247
Accounts payable and accrued liabilities	9,649	9,649	13,745	13,745
Finance lease	141	141	-	-
Senior Term Loan	4,792	4,792	-	-
Long-term debt	10,833	11,543	33,373	32,329
Convertible debentures	15,634	17,916	14,298	14,410
Change of control premium	312	312	320	320
Conversion feature	-	-	2	2
Early payment option	138	138	-	-
Total financial liabilities	\$ 52,284	\$ 55,276	\$ 72,985	\$ 72,053

The fair values of the financial assets and financial liabilities is included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- Cash, accounts receivable, Senior Revolving Facility, and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term nature of these instruments.
- Fair value on the Company's finance lease, Senior Term Loan, and long-term debt are based on estimated market interest rate on similar borrowings. The fair value of the finance lease and term loan approximate fair value as the interest rates approximate market. A 1% change in the market interest rate would change the fair value of long term debt by \$699.
- Convertible Debentures are traded on the TSX and the fair value disclosed is based on the closing price at period end less the fair values of the change of control premium, conversion feature, and Warrants.
- Fair value of the change of control premium is estimated using the Black-Scholes Option Pricing Model.
- Prior to the Corporate Conversion, fair value of the conversion feature and Warrants were estimated using the Black-Scholes Option Pricing Model,
- Fair value of the early payment option was estimated using a discounted cash flow analysis and a discount rate of 9%.

19.2 Fair value hierarchy

The financial instruments have been categorized on a fair value hierarchy based on whether the inputs to those valuation techniques are observable (inputs reflect market data obtained from independent sources) or unobservable (inputs reflect the Fund's market assumptions).

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The three levels of fair value estimation are:

Level 1 – quoted prices in active markets for identical instruments.

Level 2 – quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The following tables summarize the bases used to measure certain financial liabilities at fair value through profit and loss. The Fund does not have any financial assets valued at fair value through profit and loss. Financial liabilities carried at fair value have been classified into three levels based upon a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

	Classification ⁽¹⁾	December 31,		Level 1	Level 2	Level 3
		2012				
Change of control premium	HFT	\$ 312	\$	-	\$ -	\$ 312
Early payment option	HFT	138		-	-	138
		\$ 450	\$	-	\$ -	\$ 450

	Classification ⁽¹⁾	December 31		Level 1	Level 2	Level 3
		2011				
Change of control premium	HFT	\$ 320	\$	-	\$ -	\$ 320
Conversion feature	HFT	2		-	-	2
		\$ 322	\$	-	\$ -	\$ 322

(1) Held for Trading ("HFT")

Refer to Note 10 for a reconciliation of the opening and closing balances of the change of control premium, conversion feature, and Warrants. The balance of the early payment option is consistent with the initial valuation as at June 11, 2012.

19.3 Risk exposure and management

The Fund, and following Corporate Conversion, Tree Island, is exposed to various risks associated with its financial instruments. These risks are categorized as credit risk, liquidity risk and market risk.

Credit risk

Credit risk consists of credit losses arising in the event of non-payment of accounts receivable of customer accounts. However, the credit risk is minimized through selling to well-established customers of high-credit quality. The credit worthiness of customers is assessed using credit scores supplied by a third party and through direct monitoring of their financial well-being on a continual basis. Management establishes guidelines for customer credit limits and should thresholds in these areas be reached, appropriate precautions are taken to improve collectability. Provisions for potential credit losses (allowance for doubtful accounts) are maintained and any such losses to date have been within management's expectations.

Liquidity risk

Liquidity arises from our financial obligations and in the management of our assets, liabilities and capital structure. This risk is managed by regular evaluation of our liquid financial resources to fund current and long-term obligations and to meet its capital commitments in a cost-effective manner.

The main factors that affect liquidity include realized sales prices, production levels, cash production costs, working capital requirements, future capital expenditure requirements, scheduled payments on financial liabilities and lease obligations, credit capacity and expected future debt and equity capital market conditions.

Tree Island Steel Ltd.

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The table below summarizes the future undiscounted contractual cash flow requirements for financial liabilities (including scheduled interest payments on interest bearing liabilities) as at December 31, 2012 and December 31, 2011:

December 31, 2012	Carrying Amount	Contractual Cash Flow	Less than 1 Year	1 - 2 Years	Greater than 2 Years
Senior Revolving Facility (Note 9.1)	\$ 10,785	\$ 10,785	\$ 10,785	\$ -	\$ -
Accounts payable and accrued liabilities	9,649	9,649	9,649	-	-
Finance lease (Note 22.6)	141	158	65	93	-
Senior Term Loan (Note 9.2)	4,792	4,792	500	1,000	3,292
Long-term debt (Note 11)	10,833	19,151	1,194	2,577	15,380
Convertible debentures (Note 10)	15,634	23,326	1,918	21,408	-
	\$ 51,834	\$ 67,861	\$ 24,111	\$ 25,078	\$ 18,672

December 31, 2011	Carrying Amount	Contractual Cash Flow	Less than 1 Year	1 - 2 Years	Greater than 2 Years
Senior Revolving Facility (Note 9.1)	\$ 11,247	\$ 11,247	\$ 11,247	\$ -	\$ -
Accounts payable and accrued liabilities	13,745	13,745	13,745	-	-
Long-term debt (Note 11)	33,373	43,587	4,882	38,705	-
Convertible debentures (Note 10)	14,298	25,008	1,938	23,070	-
	\$ 72,663	\$ 93,587	\$ 31,812	\$ 61,775	\$ -

Liquidity requirements are met through a variety of sources including cash balances on hand, cash generated from operations, existing credit facilities, and debt and equity capital markets. Management monitors and manages liquidity risk by preparing annual budgets, monthly projections to the end of the fiscal year and regular monitoring of financial liabilities against the constraints of the available revolving credit facilities.

Market risk

Foreign currency risk

The significant market risk exposures affecting the financial instruments are those related to foreign currency exchange rates and interest rates which are explained as follows:

	December 31 2012
Increase (decrease) to net comprehensive loss of a \$0.01 increase in Cdn\$ to US\$ exchange rate	90
Increase (decrease) to net comprehensive loss of a \$0.01 increase in Cdn\$ to RMB exchange rate	31

Tree Island's US dollar-denominated cash, accounts receivable, accounts payable and accrued liabilities, Senior Credit Facility and long-term debt are exposed to foreign currency exchange rate risk because the value of these financial instruments will fluctuate with changes in the US/Canadian dollar exchange rate. Tree Island's RMB denominated cash, accounts receivable, accounts payable and accrued liabilities are exposed to foreign currency exchange rate risk because the value of these financial instruments will fluctuate with changes in the RMB/Canadian dollar exchange rate.

Interest rate risk

Tree Island is exposed to interest rate risk on its Senior Credit Facility, which is further discussed in Note 9.1. A 1% increase in the interest rates charged on the Senior Credit Facility would increase financing expenses by \$108. Tree Island does not use derivative instruments to manage the interest rate risk.

Tree Island Steel Ltd.

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For the years ended December 31, 2012 and 2011

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20. MANAGEMENT OF CAPITAL

Our objectives when managing its capital are:

- (i) To maintain a capital base so as to preserve and enhance investor, creditor, and market confidence and to sustain viability and future development of the business;
- (ii) To manage capital in a manner that will comply with the financial covenants on the Senior Credit Facility, term loan, Convertible Debentures and long-term debt agreements as described further in Notes 9.1, 9.2, 10, and 11.

Management manages the capital structure in accordance with these objectives, as well as considerations given to changes in economic conditions and the risk characteristics of the underlying assets, in particular by close monitoring of cash flows and compliance with external debt covenants.

The capital structure is as follows:

	December 31 2012	December 31 2011
Total shareholders' / unitholders' equity	\$ 25,105	\$ 14,639
Senior Revolving Facility (Note 9.1)	10,785	11,247
Senior Term Loan (Note 9.2)	4,292	-
Convertible debentures (Note 10)	15,634	14,298
Long-term debt (Note 11)	9,639	28,491
Total capital	\$ 65,455	\$ 68,675

21. NET INCOME (LOSS) PER SHARE / UNIT

Basic earnings per Share / Unit amounts are calculated by dividing net income (loss) for the year by the weighted average number of Shares / Units outstanding during the year.

Diluted earnings per Share / Unit amounts are calculated by dividing the net income (loss) for the year (after adjusting for interest and accretion, net of tax, on the convertible preference shares and the change in fair value of the Phantom Units) by the weighted average number of Shares / Units outstanding during the year plus the weighted average number of Shares / Units that would be issued on conversion of all the dilutive potential units into Shares / Units.

The following reflects the income (loss) and Share / Unit data used in the basic and diluted earnings per Share / Unit computations:

	For the Year Ended December 31	
	2012	2011 ⁽¹⁾
Net income (loss) for the year	10,371	(12,861)
Dilutive effect of:		
Convertible Debentures	4,887	-
Phantom units	64	-
Warrants ⁽²⁾	-	-
Net income (loss) for the year adjusted for the effect of dilution	15,322	(12,861)

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	For the Year Ended December 31	
	2012	2011 ⁽¹⁾
Weighted average number of shares / units		
outstanding during the year - basic	21,978,006	22,856,544
Dilutive effect of:		
Convertible Debentures	38,379,200	-
Phantom units	233,329	-
Warrants ⁽²⁾	-	-
Weighted average number of shares / units		
outstanding during the year - diluted	60,590,535	22,856,544

(1) There was a loss for the year ended December 31, 2011; therefore all Convertible Debentures, Phantom units, and Warrants have been excluded from the calculation of diluted loss per Share / unit because they would be anti-dilutive.

(2) The Warrants are anti-dilutive and have been excluded from all calculations.

	For the Year Ended December 31	
	2012	2011
Net income (loss) per share / unit		
Basic	0.47	(0.56)
Diluted	0.25	(0.56)

Between December 31, 2012 and March 14, 2013, 5,980 Convertible Debentures were converted into 1,196,000 Shares and 300,000 Warrants were exercised. These transactions would have a nominal impact on the both the basic and diluted income (loss) per Share. There have been no additional transactions involving Shares or potential Shares between the reporting date and the date of completion of these consolidated financial statements.

22. PROVISIONS AND COMMITMENTS

22.1 Litigation and claims

Tree Island is party to certain legal actions and claims, none of which individually, or in the aggregate, is expected to have a material adverse effect on its financial position, statement of operations or cash flows.

22.2 Environmental remediation on sale of surplus land

The Fund completed the sale of 12.5 acres of surplus lands at its Richmond, BC manufacturing facility in 2009. The agreement contained a condition whereby \$1.5 million was held in trust to be released upon completion of the agreed upon remediation of the site. In 2011, the Fund completed the remediation work based on the planned requirements and submitted the results for approval. During the year ended December 31, 2012, the Fund received the final Certificate of Compliance and a gain of \$372 was recognized for the difference between the \$1,500 holdback and the total costs incurred for the environmental remediation.

There are no further requirements or obligations under the purchase and sale agreement.

22.3 Closure of facilities

As part of prior restructuring activities, certain facilities were closed in 2009. The full amount of the costs associated with the non-cancellable lease obligations are accrued as a provision for onerous contracts and a charge has been recorded to cost of goods sold in the year the facility was vacated. Because the remaining term exceeded one year, the liability was recorded at the discounted future cash flows using a discount rate of 13% and was being amortized with a charge to financing expense over the remaining term using the effective interest method.

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Below is a table summarizing the provisions:

	Corona	Ontario Warehousing Facility	Total
Balance at December 31, 2010	\$ 1,117	\$ 171	\$ 1,288
Provisions made during the year	145	22	167
Provisions used during the year	(240)	(172)	(412)
Foreign exchange effect	73	(1)	72
Balance at December 31, 2011	\$ 1,095	\$ 20	\$ 1,115
Provisions made during the year	78	-	78
Provisions used during the year	(1,154)	(20)	(1,174)
Foreign exchange effect	(19)	-	(19)
Balance at December 31, 2012	\$ -	\$ -	\$ -

22.4 Purchase commitments

Tree Island's wholly owned subsidiaries have committed to rod purchases totaling \$21,145 (US\$21,254) at December 31, 2012 and imported finished goods purchases of \$836 (US\$840).

22.5 Operating lease commitments

Tree Island and its subsidiaries have various operating lease agreements with remaining terms of up to five years with varying renewal options. Annual lease rental payments due under non-cancelable operating leases, including payments for US facilities which have been accrued as discussed above, are as follows:

Less than 1 year	\$ 1,345
1 to 5 years	2,261
More than 5 years	-
	<u>\$ 3,606</u>

During the year ended December 31, 2012, Tree Island recognized \$2,003 (2011 – \$2,626) in operating lease payments, net of sub-lease receipts, in cost of sales.

22.6 Finance lease commitments

Tree Island has a finance lease for certain machinery and equipment which bears interest at 5.5% per annum and matures in May 2015. Future minimum lease payments under the finance lease with the present value of the net minimum lease payments are as follows:

	Minimum Payments	2012 Present Value of Payments	Minimum Payments	2011 Present Value of Payments
Less than 1 year	\$ 65	\$ 54	\$ -	\$ -
1 to 5 years	93	87	-	-
More than 5 years	-	-	-	-
Total minimum lease payments	158	141	-	-
Less amounts representing finance charges	(17)	-	-	-
Present value of minimum lease payments	<u>\$ 141</u>	<u>\$ 141</u>	<u>\$ -</u>	<u>\$ -</u>

Tree Island Steel Ltd.

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23. SEGMENTED INFORMATION

Tree Island operates primarily within one industry, the steel wire and fabricated wire products industry, with no separately reportable operating segments. Tree Island groups its products into the following: industrial / Original Equipment Manufacturer ("OEM"), residential construction, commercial construction, agricultural, and specialty. Revenues for each group for the year ended December 31, 2012 and 2011 were as follows:

	Year Ended December 31	
	2012	2011
Industrial / OEM ⁽¹⁾	\$ 51,429	\$ 53,715
Residential construction	44,046	45,047
Commercial construction	23,866	25,728
Agricultural	12,171	10,421
Specialty	14,726	15,119
	\$ 146,238	\$ 150,030

No one customer is more than 10% of total revenue.

Geographic information

The products are sold primarily to customers in the United States and Canada.

	Year Ended December 31	
	2012	2011
Sales ⁽¹⁾		
Canada	\$ 57,462	\$ 59,640
United States	84,180	84,780
China	34	1,260
Other	4,562	4,350
	\$ 146,238	\$ 150,030

⁽¹⁾ Sales are attributed to geographic areas based on the location of customers.

Non-current assets for this purpose consist of property, plant and equipment and other non-current assets. These assets are attributed to geographic areas based on the locations of the subsidiary company owning the assets.

	December 31,	
	2012	2011
Non-current assets		
Canada	\$ 24,948	\$ 26,943
United States	6,801	7,654
China	66	65
	\$ 31,815	\$ 34,662

24. CHANGES IN WORKING CAPITAL

	Year Ended December 31	
	2012	2011
Accounts receivable (Note 6)	1,738	(4,029)
Inventories (Note 7)	3,095	(4,949)
Accounts payable and accrued liabilities	(4,021)	294
Income and other taxes	(747)	(49)
Other	68	473
	133	(8,260)

SHAREHOLDER
INFORMATION
TREE ISLAND
STEEL LTD.
(formerly Tree
Island Wire
Income Fund)

Board of Directors:

Amar S. Doman –
Chairman of the Board

Dale R. MacLean

Harry Rosenfeld

Michael Fitch

Sam Fleiser

Theodore A. Leja



Leadership Team:

Dale R. MacLean
*President and Chief
Executive Officer*

Nancy Davies
*Chief Financial Officer
and Vice President,
Finance*

Stephen Ogden
*Vice President,
Operations*

Remy Stachowiak
*Vice President, Sales and
Marketing*
(effective January 7,
2013)

James Miller
*Vice President, Corporate
Development and
Procurement*
(effective January 7,
2013)

Shares:

Market Information

On October 1, 2012, Tree
Island Wire Income Fund
converted to a
corporation. Effective
October 3, 2012, the
corporation, Tree Island
Steel Ltd., is listed on the
Toronto Stock Exchange
trading symbol: TSL.

*Registrar and Transfer
Agent*

Computershare Investor
Services Inc.

Convertible

Debentures:

Market Information

Effective October 3,
2012, Tree Island Steel
Ltd. has Convertible
Debentures listed on the
Toronto Stock Exchange
trading symbol: TSL.DB.

Debenture Trustee

Valiant Trust Company

Corporate Head Office:

3933 Boundary Road
Richmond, B.C.
Canada, V6V 1T8

Website:

www.treeisland.com

Investor Relations:

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