

## REPORT TO SHAREHOLDERS

*2003 was a disappointing year for Churchill in terms of its financial performance. The Corporation was hit by a lag in industrial construction, delays in building construction projects, as well as company-specific operating problems. In spite of these factors, there were many positive achievements during the year. Your Corporation believes that 2004 and beyond will provide excellent opportunities in the traditional commercial and industrial construction markets, as well as the growing market in industrial maintenance.*

### CONTRIBUTING FACTORS TO A POOR 2003

#### *Building Construction Market*

The building construction market in western Canada suffered from project delays throughout much of the year. Stuart Olson did not avoid this problem; although the company was successful in securing a large number of new projects and had significant carryover from 2002, many projects were delayed. In keeping with its planned expansion, Stuart Olson had invested in people and systems in anticipation of substantially increased activity. In 2003 Stuart Olson was unable to utilize this increased capacity; in fact, slippage in budgeted revenue approached \$100 million. Notwithstanding these setbacks, Stuart Olson faces 2004 with a large backlog of work, an increased capacity to perform and the belief that many of the factors that impeded performance last year have now been mitigated.

#### *Industrial Market*

The industrial construction market, more particularly the oil and gas market in Alberta, also faced slowdowns. The uncertain impact of the Kyoto Accord and the substantial cost overruns experienced on large oil sands and heavy oil projects caused companies to pause to reassess the viability of new projects. Many companies revised their delivery strategies in an attempt to achieve greater cost certainty. This process affected all of Churchill's industrial construction businesses, most of all Triton.

#### *Triton Projects*

Triton incurred a significant loss in 2002, the first major loss in the company's 50 year history. Although the losses continued in 2003 (approximately \$2.9 million before tax), the results improved from quarter to quarter. Bruce Rintoul, Vice President of Churchill's Industrial Division, assumed the additional role as President of Triton and responsibility for rationalizing the business. The subsequent restructuring resulted in large severance and early retirement costs of approximately \$1.0 million in the second quarter of 2003. Triton has now added experienced people for its industrial markets and remains a key platform in Churchill's strategy.

#### *JTB Canadian Pork*

In February 2002, Stuart Olson suspended work on a pork processing plant for JTB, pending client financing to complete the project. A bad debt allowance had been established in Churchill's 2001 financial statements. A receiver-manager of JTB was appointed in September 2002. At the end of the second quarter of 2003 Churchill took an additional bad debt allowance of \$3.0 million. In the third quarter, however, a sale of the JTB assets occurred and Churchill was able to recover the \$3.0 million. The JTB job has been a significant distraction for management and consumed significant internal resources.



Fuller Austin: Storage tank insulation

## ACHIEVEMENTS IN 2003

### *Steady Improvement*

In spite of an overall loss for the year, throughout 2003 Churchill achieved steady improvement in its quarterly financial results. The quarterly revenue increased from \$62.2 million in Q1, to \$77.2 million in Q2, to \$84.2 million in Q3, and to \$95.6 million in Q4. Earnings before tax improved from a loss of \$2.9 million in Q1, to approximately a \$1.0 million loss in each of Q2 and Q3 (normalizing for the JTB bad debt loss and recovery), to earnings of \$0.3 million in Q4. These trends indicate that the Corporation is moving in the right direction.

### *Laird Electric Acquisition*

In February of 2003, Churchill acquired Laird Electric. Laird provides electrical, instrumentation and power-line construction and maintenance services. Laird has been in business for 42 years and has strong relationships with clients in the Fort McMurray area. During the year Laird opened a new office in Edmonton, from which the company was able to secure several new contracts. Laird made a significant contribution to Churchill's financial results in 2003 and the company expects significant growth in 2004 and beyond.

### *Industrial Insulation*

Churchill's industrial insulation businesses had a very successful year. Insulation is usually installed near the end of a project and thus the insulation companies were busy as several oil and gas projects were drawing to a close. Fuller Austin had a slow start but by the third quarter was working at a near record pace on two oil sands projects in Northern Alberta and a refinery project in Saskatchewan. Northern Industrial was busy throughout the year on an oil sands project for another client in the Fort McMurray area, as well as an expanding maintenance market. Lakehead Insulation, a company Churchill acquired in 2002, completed

substantial projects for a pulp mill and a major oil refinery in Ontario. The latter project was the first major insulation project Churchill companies have secured in the southern Ontario industrial market.

### *Triton Projects*

During the past year, Triton has been able to add several experienced large-project managers to its roster. The company has also expanded its office in Fort McMurray, and has positioned itself well for the upcoming major capital and maintenance expenditures planned for this region. As well, the company embarked on a new initiative in the boiler maintenance field with several successful boiler contracts that extend into 2004.

Large industrial projects are increasingly being constructed utilizing the off-site fabrication of modules that are then transported to the jobsite and assembled. Triton has completed smaller projects of this type through its fabrication shop in Bonnyville, Alberta. In late 2003, Churchill initiated the construction of a major modular fabrication facility near Edmonton. It is expected to be in operation by mid 2004 and provide Churchill's companies with a flagship facility for industrial projects.

### *Bundling of Services*

The activity levels of Churchill's industrial companies are providing increased opportunities to offer bundled services. Fuller Austin and Laird are working together on projects that include heat tracing and insulation. Triton and Northern Industrial work together on projects that include piping, insulation and siding. Stuart Olson partners with Triton on the building and civil works for industrial projects. Churchill's clients are able to mix-and-match companies to obtain a package that meets their specific needs.



Triton: Module fabrication for the heavy oil sector



Laird: Instrument installation to the oil sands market

### *Strong Backlog at Stuart Olson*

A result of the project delays in 2003 is that Stuart Olson has one of the largest year-end backlogs, \$263.5 million, in the company's history. Of this, \$216.3 million is expected to be completed in 2004 and the balance in 2005. Many of Stuart Olson's projects are large and therefore work obtained in one fiscal year might be executed in the next. Stuart Olson is thus expecting both higher revenue and improved profitability in 2004. Restructuring of the Edmonton branch in 2003 has already resulted in improvements in revenue, profit margins and backlogs.

### *British Columbia*

The building construction market in British Columbia has been slow for a number of years. In 2003 Stuart Olson's BC branch secured a number of new larger projects and several will carry forward into the 2004 construction year. The 2010 Winter Olympics are expected to trigger new construction opportunities related to the facilities themselves and associated work.



Stuart Olson: Alberta Hospital Ponoka Redevelopment - \$85 million hospital complex



Stuart Olson: Biotechnology Research building at the University of British Columbia, \$13 million

## STRATEGY

Churchill's goal is to build a highly profitable and sustainable construction, maintenance and industrial services company. Long-term revenue growth is an important part of Churchill's strategy; however, the current focus is on a return to profitability, followed by sustainable growth in earnings.

Key elements of Churchill's current focus include:

- Improving the operational performance of Churchill companies
- Emphasizing relationship-based methods of project delivery
- Increasing the diversity of industries, clients and geographic markets served by Churchill and the services provided
- Enhancing Churchill's position in the large project markets
- Increasing the base of recurring revenue through industrial maintenance activities



Stuart Olson: Modifications to Commonwealth Stadium for the Molson Canadian Heritage Classic Hockey game in Edmonton, AB

### IMPLEMENTATION OF STRATEGY

During 2003 Churchill implemented its strategic plan in several areas:

- The Churchill companies developed a corporate revitalization program focused on their relationships with clients
- Churchill companies implemented improvements to systems and processes for enhanced project execution
- Triton and Northern Industrial opened new offices or expanded existing offices in Fort McMurray
- Lakehead successfully completed a project in the southern Ontario market
- Churchill commenced construction on a new modular yard and fabrication shop
- Churchill acquired Laird Electric of Fort McMurray
- Laird subsequently opened a new office in Edmonton
- Stuart Olson successfully executed several large projects including the \$85 million Alberta Hospital Ponoka and the \$68 million Red Deer Hospital
- Churchill increased its level of recurring revenue through industrial maintenance work to approximately \$30.0 million
- Triton executed several contracts in industrial boiler maintenance work

## MARKET ENVIRONMENT

Churchill's markets are expected to improve in 2004 and by mid-year many of the large industrial projects will be into construction. This will not only provide direct construction opportunities but also spin-off improvements in the general construction market. Alberta would appear to be one of the best construction markets in North America over the next decade as the oil sands and heavy oil mega projects move into the construction phase.

Independent forecasts by Alberta Economic Development have identified \$64 billion of major projects planned for the next three years in the oil sands, oil and gas and power sectors of the industrial market. Of this, more than \$40 billion is planned for the Fort McMurray region. Churchill's companies are continuing to build their presence in the Fort McMurray area as a key part of the Churchill strategy.

In addition to the compelling industrial market, the institutional market in Alberta is expected to grow dramatically as public sector investment in infrastructure increases. The Alberta Government has created an infrastructure capital fund and is moving towards a three to five year planning cycle. Both initiatives are expected to provide stability to that segment of the construction industry. Stuart Olson should benefit from this as a major, experienced builder of institutional projects.

The British Columbia market is expected to improve as planning for the 2010 Winter Olympics commences and the provincial government's commitment to clear up the backlog of infrastructure shortfall starts to materialize into construction projects. As well, the BC government is expected to stimulate the oil and gas sector of their resource industry.

The Churchill Corporation completed 2003 with a near record level of work-in-hand of \$313.7 million. While Churchill expects the first part of 2004 to be a challenge, by mid-year both improved market conditions and performance on the large backlog of work should result in a noticeable improvement in financial results.

Churchill is well positioned to take advantage of the improved market conditions expected this year. The restructuring that occurred in 2003 will better enable the Corporation to achieve its corporate objectives. Churchill will focus on increasing shareholder value by growing a sustainable, profitable business through the delivery of outstanding services and value to our clients. On behalf of the Board of Directors, we would like to thank Churchill's employees, clients and shareholders for their continued support.

March 23, 2004



Gary R. Bardell  
*President and  
Chief Executive Officer*

Peter F. Adams  
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