Russel Metals Inc.

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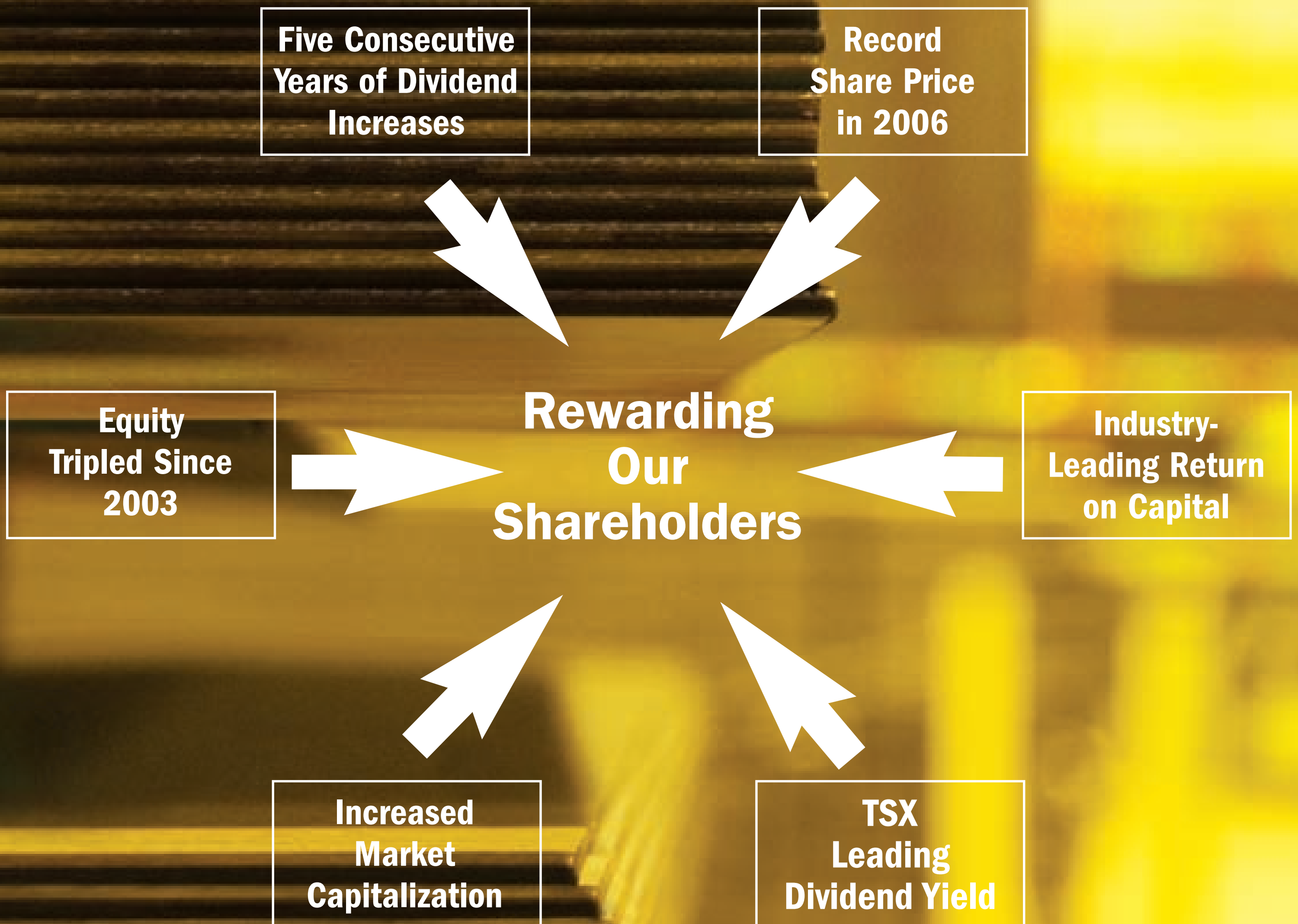
Annual
Report

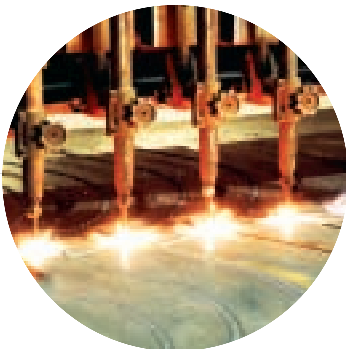


corporate profile Russel Metals is one of the largest metals distribution companies in North America. We conduct business primarily in three metals distribution segments: metals service centers; energy tubular products; and steel distributors.

> businesses at a glance

metals service centers

We provide processing and distribution services to a broad base of more than 19,000 end users through a network of 52 Canadian locations and 4 U.S. locations. Our metals service centers carry a broad line of products in a wide range of sizes, shapes and specifications, including carbon hot rolled and cold finished steel, pipe and tubular products, stainless steel and aluminum. We purchase these products primarily from steel producers in North America and process and package them in accordance with end user specifications. We service all major geographic regions of Canada and the Midwest region in the United States.



energy tubular products

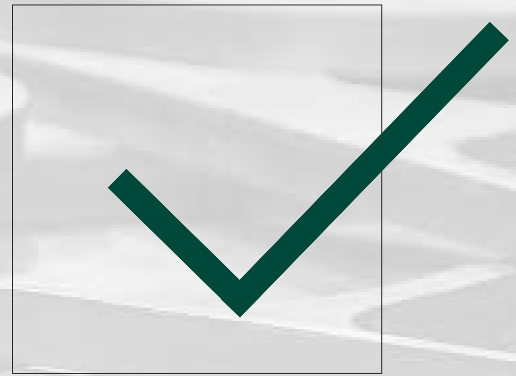
These operations distribute oil country tubular goods (OCTG), line pipe, tubes, valves and fittings, primarily to the energy industry in Western Canada and the western United States, from 5 Canadian and 2 U.S. locations. We purchase these products either from the pipe processing arms of North American steel mills, independent manufacturers of pipe and pipe accessories or international steel mills.

steel distributors

Our steel distributors act as master distributors selling steel in large volumes to other steel service centers and equipment manufacturers mainly on an "as is" basis. Our U.S. operation processes some coil for its customer base at its cut to length facility in Houston, Texas. Our steel distributors source their steel both domestically and offshore. The international sourcing provides our other business segments with valuable insight regarding international pricing trends and their potential impact on steel markets in North America.

The main steel products sourced by this segment are structural beam, plate, coils, pipe and tubing.

focused on shareholders' returns



60%	27%	50%	22%	6%
higher dividends	higher net income	larger market capitalization	higher share price	dividend yield

Our share price increased for the fifth straight year, and in 2006 the increase was 22%. Our industry-leading dividend increased by 60% to $1.60 per share.

> five-year financial highlights

For the years ended December 31		**2006**		2005		2004		2003		2002
OPERATING RESULTS (millions)										
Revenues	**$**	**2,692.1**	$	2,614.1	$	2,411.4	$	1,503.8	$	1,403.3
Net income		**158.7**		124.5		177.8		18.5		29.2
EBIT (Notes)		**250.2**		202.5		305.7		55.1		67.9
EBIT as a % of revenue		**9.3%**		7.7%		12.7%		3.7%		4.8%
EBITDA (Notes)		**270.2**		221.7		324.3		71.4		83.1
EBITDA as a % of revenue		**10.0%**		8.5%		13.4%		4.7%		5.9%
Basic earnings per common share ($)	**$**	**2.65**	$	2.47	$	3.64	$	0.41	$	0.71
BALANCE SHEET INFORMATION (millions)										
Metals										
Accounts receivable	**$**	**324.7**	$	356.1	$	356.8	$	247.5	$	197.6
Inventories		**664.0**		474.0		553.9		303.1		329.4
Prepaid expenses and other assets		**3.8**		1.3		1.7		2.0		2.8
Accounts payable and accruals		**(262.8)**		(291.2)		(318.5)		(207.9)		(178.6)
Net working capital – Metals	**$**	**729.7**	$	540.2	$	593.9	$	344.7	$	351.2
Fixed assets		**170.9**		162.3		161.6		165.1		88.9
Goodwill		**9.2**		9.2		9.2		4.2		2.7
Net assets employed in metals operations	**$**	**909.8**	$	711.7	$	764.7	$	514.0	$	442.8
Other operating assets		**21.5**		22.0		22.4		23.3		24.7
Net income tax assets and liabilities		**(19.3)**		(9.6)		(59.3)		(1.5)		0.8
Deferred financing charges		**6.8**		7.2		8.4		3.5		5.0
Pension and benefit liabilities		**(2.6)**		(8.9)		(10.2)		(11.5)		(9.6)
Other corporate assets and liabilities		**(27.6)**		(24.6)		(26.2)		(5.5)		(2.6)
Total net assets employed	**$**	**888.6**	$	697.8	$	699.8	$	522.3	$	461.1
CAPITALIZATION (millions)										
Bank indebtedness, net of (cash)	**$**	**(209.9)**	$	(44.9)	$	32.6	$	59.1	$	(3.9)
Long-term debt		**203.9**		204.0		210.6		209.4		242.6
Total interest bearing debt, net of (cash)	**$**	**(6.0)**	$	159.1	$	243.2	$	268.5	$	238.7
Market capitalization (Notes)		**1,665.2**		1,106.8		773.3		378.2		194.1
Total firm value	**$**	**1,659.2**	$	1,265.9	$	1,016.5	$	646.7	$	432.8
OTHER INFORMATION (Notes)										
Common shareholders' equity (millions)	**$**	**894.6**	$	538.7	$	456.6	$	253.8	$	222.4
Book value per share	**$**	**14.34**	$	10.63	$	9.15	$	5.90	$	5.84
Free cash flow (millions)	**$**	**158.8**	$	130.6	$	189.4	$	7.6	$	45.2
Capital expenditures (millions)	**$**	**27.6**	$	26.5	$	25.4	$	34.9	$	12.8
Depreciation and amortization (millions)	**$**	**20.0**	$	19.2	$	18.6	$	16.3	$	15.2
Earnings multiple		**10.1**		8.8		4.3		21.4		7.2
Firm value as a multiple of EBIT		**6.6**		6.3		3.3		11.7		6.4
Firm value as a multiple of EBITDA		**6.1**		5.7		3.1		9.1		5.2
Interest bearing debt/EBITDA		**0.8**		0.9		0.6		3.8		2.9
Debt as a % of capitalization		**19%**		27%		32%		51%		52%
Market capitalization as a % of book value		**186%**		205%		169%		149%		87%
Return on capital employed		**28%**		29%		44%		11%		15%
COMMON SHARE INFORMATION										
Ending outstanding common shares		**62,366,842**		50,656,009		49,887,659		43,023,342		38,057,001
Average outstanding common shares		**59,887,382**		50,461,330		48,671,915		40,021,479		38,024,034
Dividend yield (Notes)		**6.0%**		4.6%		4.5%		3.6%		4.7%
Dividend per share (Notes)	**$**	**1.60**	$	1.00	$	0.70	$	0.32	$	0.24
Share price – High	**$**	**29.38**	$	22.75	$	15.75	$	8.90	$	5.49
Share price – Low	**$**	**21.61**	$	13.40	$	11.61	$	4.65	$	3.46
Share price – Ending	**$**	**26.70**	$	21.85	$	15.50	$	8.79	$	5.10

NOTES:

(1) In this Annual Report we use certain financial measures that do not comply with Canadian generally accepted accounting principles (GAAP) or have standardized meanings, and thus, may not be comparable to similar measures presented by other issuers, for example EBIT and EBITDA and Other Information in the above table. Management believes that EBIT and EBITDA may be useful in assessing our operating performance and as an indicator of our ability to service or incur indebtedness, make capital expenditures and finance working capital requirements. EBIT and EBITDA should not be considered in isolation or as an alternative to cash from operating activities or other combined income or cash flow data prepared in accordance with Canadian GAAP. EBIT, EBITDA and a number of the ratios provided under Other Information are used by debt and equity analysts to compare our performance against other public companies.

This terminology is defined on page 48, under Definitions. See financial statements for GAAP earnings.

(2) Statements contained in this document that relate to Russel Metals' beliefs or expectations as to certain future events are not statements of historical fact and are forward-looking statements. Russel Metals cautions readers that there are important factors, risks and uncertainties, including but not limited to economic, competitive and governmental factors affecting Russel Metals' operations, markets, products, services and prices that could cause the Company's actual results, performance or achievements to be materially different from those forecasted or anticipated by Russel Metals in such forward-looking statements. All dollar references in this report are in Canadian dollars unless otherwise stated.

focused on profitability

With the 10-year anniversary of the appointment of the current management team, we thought we would reflect on your Company, the industry, the corporate environment and shareholder returns, and share our thoughts on the future. Our team has enjoyed the support of our Board of Directors, shareholders, customers, suppliers, and most importantly, our employees, who have played such a major part in our successes. Before we begin, I would like to thank each and every one of our stakeholders for their past and continued support.

The Company

In 1997, our shareholders sent a clear message for change as was indicated in our inaugural Annual Report of that year. At that time, we reduced layers of management, modified compensation plans to emphasize pay for performance, centralized metals service centers purchasing and stressed a renewed focus on bottom line performance. Over our tenure, these priorities have never wavered and once the financial health of the Company warranted it, we were able to reward our shareholders through escalating earnings distributions.

In 2006, we generated the second best earnings results in our history and we now enjoy a balance sheet that evidences a financial strength that we could not have envisioned 10 years ago. 2006 was the third straight year of outstanding performance for the Company, mirroring the resurgence and stability of the steel sector. Our industry-leading dividend increased by 60% to $1.60 per share in 2006, further strengthening the financial return to our shareholders. The dividend has increased in each of the last five years reflecting the Company's philosophy of rewarding our shareholders.

All three of our operating segments had an excellent year in 2006. The operating profit in our metals service centers segment improved over 2005 to $126 million. The metals service centers return on ending net assets of 27% was very strong for the third straight year.

During the last half of 2006, the impact of the strong Canadian dollar was felt in our Canadian operations as our manufacturing customers were negatively impacted on products they export to the United States. The Canadian dollar has recently weakened, which could potentially help Canadian manufacturers if it remains at current levels.

Despite one of the mildest winters in history, our energy tubular products segment produced record earnings levels for the second straight year. This segment generated operating earnings of $62 million and a return on ending net assets employed of 23%. Comco Pipe and Supply Company in Alberta enjoyed its second straight year of record profits and Pioneer Pipe in Colorado produced record earnings from

operations in 2006. Oil prices remained high throughout most of 2006. Recent drops in the price of crude oil and natural gas coupled with the perceived negative impact on oil and gas drilling activity in Canada due to tax changes for income trusts could result in slower oil and gas exploration activities in 2007, which was evidenced in the fourth quarter of 2006.

Our steel distributors segment had an extraordinary year and produced earnings from operations of $77 million, up 65% from 2005, which was near the peak that was experienced in 2004. The steel distributors' 42% return on ending net assets employed led our three business segments for the third straight year.

With our continued high level of profitability and our common share issue early in 2006, we have further strengthened our balance sheet. We are now positioned to be a major participant in the accelerating consolidation occurring in the steel sector. Our cash on hand is slightly greater than our total debt and our shareholders' equity increased 66% to $895 million, or $14.34 per share.

The balance sheet is currently under leveraged and we continue to evaluate internal and external growth opportunities. We believe that an opportunity to significantly add value for our shareholders through an acquisition, or acquisitions, will occur in due course, and we have the financial strength in our balance sheet to execute any transaction that may occur in the sector.

During the first half of 2006, we experienced volume increases that led to working capital levels that proved to be unsustainable due to the drop in our business activities during the second half. We successfully addressed these issues in the metals service centers segment in the fourth quarter and we will continue to be focused on reducing our working capital usage in the other two segments in the first half of 2007.

Steel prices began and closed 2006 at similar levels, but within the year we experienced price increases in the third quarter and price declines in the fourth quarter. On the demand side, 2006 opened with very strong demand in Canada, which softened later in the year.

The Industry

The trends in the industry continue to indicate support for the ongoing steel sector recovery that started in early 2004. The price of steel remains volatile, but the high and low points in pricing are at higher and more economically viable levels, for both producers and service centers. During 2006, the steel producers managed the production of steel in such a fashion that supply and demand remained fairly balanced, although, there was an inordinate inventory build in the second half. The consolidation trend within the steel sector continued in 2006, both with steel producers and service centers. Strategic buyers have executed the majority of acquisitions in the producer area, whereas in the service center area both strategic and financial sponsors have been very active.

Growth through acquisition remains a priority for us. Our patience and discipline in evaluating acquisitions was tested during 2006 as both strategic and financial buyers acquired some excellent service center operations. Despite being interested, we felt that the operations that were sold did not meet our minimum criteria at the amounts paid. Consequently, we elected to pass on the prospects that were presented as we felt that eventually there would be better opportunities.

2006 was the third straight year of outstanding performance

The environment ten years ago in 1997 was very similar to today. We were made aware of several acquisition opportunities, but we were either uncomfortable with the high purchase prices ultimately paid or declined to participate at all for strategic reasons. In our 1997 Annual Report, we stated "we are of the view that the prices being offered and paid for those metals distribution operations were not justifiable over the course of the steel cycle". Our patience allowed us to wait and acquire some quality operations including A.J. Forsyth, Williams Steel, Spartan Steel, Triumph Tubulars and Acier Leroux at more reasonable pricing levels.

The Corporate Environment

Over the past ten years corporate governance practices have evolved significantly, and governance now has a higher profile than at any other time in history. Our website includes the Company's Values Statement, the Code of Business Conduct and the Charter of the Board of Directors and its Committees. Our corporate governance practices have been enhanced to reflect the emerging best practices in Canada. Our efforts were recognized with both an improved and a high ranking in *The Globe and Mail*'s board games analysis of Canada's top corporations.

There is currently a requirement for executive certifications on internal control over financial reporting. We support the view expressed by the International Federation of Accountants – "it was felt that those companies that viewed internal control as sound business practices were more likely to have embedded it into their normal business processes, and more likely to feel that they had benefited as a result". We have stressed internal controls throughout the Company, and over the last ten years we have reinforced this culture through an active internal audit department. This practice is part of our business environment and is well accepted within our culture.

A second topic of discussion in the governance area that has gained media attention is the backdating of share option grants. We have consistently employed very rigorous pricing rules for the granting of options and we have never backdated options. Our share option plan requires options to be priced at or above the close of the market on the day prior to our Board meeting. When financial information or other material information is released, our Board imposes stricter requirements, namely, the common share options be priced at the greater of the price on the close of the market on the day prior to the Board meeting and the close of the market on the second day following the Board meeting.

Shareholder Returns

In 1997, when current management was appointed, our share price was $4.95 per share, we did not pay dividends to common shareholders and our market capitalization was $252 million. Once the financial health of our Company was stabilized, we emphasized shareholder returns as a primary management priority. At the end of 2006, our share price was $26.70, we paid dividends of $0.40 per quarter and our market capitalization was $1.7 billion. Our share price increased for the fifth straight year, and in 2006 the increase was 22%. Since 2001, our share price has appreciated 742% in the six-year period.

In Canada, the attractiveness of dividend paying stocks strengthened further in 2006 following the 2005 announcement that dividends would attract lower individual income tax rates. In 2006, the Canadian

government proposed the implementation of taxes on income trusts which further levelled the playing field for dividend generating stocks. For the fifth consecutive year, our dividend was increased and it grew by 60% in 2006 alone. Our annual dividend of $1.60 per share has made our common shares one of the top yielding securities in the S&P/TSX Composite Index and our shares currently yield about 6%.

Outlook

As mentioned earlier, we noticed softness in demand in both the metals service centers and the energy tubular products segments in the last quarter of 2006. The metals service centers were negatively impacted by the strength of the Canadian dollar. We believe that this affected our customers who sell manufactured products into the U.S.

When I compare the state of our Company and the current steel environment to the period prior to 2004, I am very pleased. We have just finished three years of record earnings, pay one of the highest yielding dividends on the TSX, have more cash than long-term debt, and are poised to grow the Company both organically and through external acquisitions. Entering 2007, North American steel prices appear to be stabilizing. The service center industry inventory overhang is shrinking, steel imports are declining as steel prices outside of North America increase, and demand is improving over the fourth quarter of 2006. Looking back on the last 10 years, management feels a sense of pride at what has been accomplished. We are, however, far from complacent as we live in a competitive, highly cyclical industry. We are well positioned to capitalize on any eventualities that may present themselves.

E.M. Siegel, Jr.
President and Chief Executive Officer

> management's discussion and analysis

For the year ended December 31, 2006

The Management's Discussion and Analysis of Financial Condition and Results of Operations of Russel Metals Inc. and its subsidiaries provides information to assist the reader and should be read in conjunction with the audited Consolidated Financial Statements for the year ended December 31, 2006, including the notes thereto. Statements contained in this document that relate to our beliefs or expectations as to certain future events are not statements of historical fact and are forward-looking statements. We caution readers that there are important factors, risks and uncertainties, including but not limited to economic, competitive and governmental factors affecting our operations, markets, products, services and prices that could cause our actual results, performance or achievements to be materially different from those forecasted or anticipated by us in such forward-looking statements. All dollar references in this report are in Canadian dollars unless otherwise stated.

This Management's Discussion and Analysis of Financial Condition and Results of Operations includes a number of measures that are not prescribed by generally accepted accounting principles (GAAP) and as such may not be comparable to similar measures presented by other companies. We believe these measures are commonly employed to measure performance in our industry and are used by analysts, investors, lenders and other interested parties to evaluate financial performance and our ability to incur and service debt to support our business activities. The measures we use are specifically defined where they are first used in this report.

While we believe that non-GAAP measures are helpful supplemental information, they should not be considered in isolation as an alternative to net income; cash flows generated by operating, investing or financing activities; or other financial statement data presented in accordance with GAAP.

> ***Additional information related to Russel Metals Inc., including our Annual Information Form, may be obtained from SEDAR at www.sedar.com or on our website at www.russelmetals.com.***

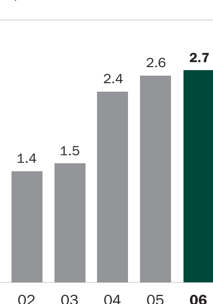
Overview

We are one of the largest metals distribution companies in North America. We conduct business primarily in three metals distribution segments: metals service centers; energy tubular products; and steel distributors.

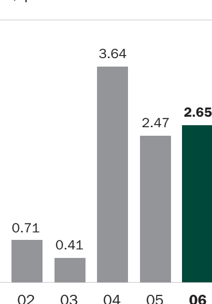
Continued high, stable steel prices and strong demand resulted in higher operating profits for 2006 in all three segments compared to the same period in 2005.

Our basic earnings per share of $2.65 for 2006 are higher than the $2.47 reported for 2005. Our operating profits increased by 24% and our net earnings increased by 27% for the year ended December 31, 2006 compared to 2005. Our basic earnings per share for 2006 increased by a smaller percentage than the net earnings increased, as our weighted average shares outstanding increased 19% due to common shares issued during 2006.

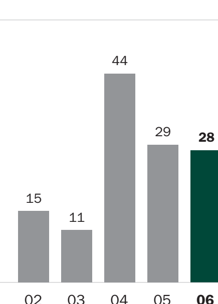
Total Revenues
$ billions



Earnings per Share
$ per share



Return on Capital Employed
%



Summarized Financial Information

The table discloses selected information related to revenues, earnings and common share information over the last eight quarters.

2006

(millions, except per share data and volumes)	**Three Months Ended Mar. 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Year Ended Dec. 31**
Revenues	**$ 740.7**	**$ 685.9**	**$ 672.3**	**$ 593.2**	**$ 2,692.1**
Earnings from operations	**61.2**	**70.0**	**69.2**	**48.6**	**249.0**
Net earnings					
– continuing operations	**37.3**	**46.2**	**44.6**	**30.6**	**158.7**
Net earnings	**37.3**	**46.2**	**44.6**	**30.6**	**158.7**
Basic earnings per common share					
– continuing operations	**$ 0.71**	**$ 0.74**	**$ 0.72**	**$ 0.49**	**$ 2.65**
Basic earnings per common share	**$ 0.71**	**$ 0.74**	**$ 0.72**	**$ 0.49**	**$ 2.65**
Diluted earnings per common share					
– continuing operations	**$ 0.70**	**$ 0.74**	**$ 0.71**	**$ 0.49**	**$ 2.63**
Diluted earnings per common share	**$ 0.70**	**$ 0.74**	**$ 0.71**	**$ 0.49**	**$ 2.63**
Market price of common shares					
High	**$ 27.50**	**$ 27.47**	**$ 29.05**	**$ 29.38**	**$ 29.38**
Low	**$ 21.61**	**$ 22.15**	**$ 24.30**	**$ 25.95**	**$ 21.61**
Number of common shares traded	**17,295,366**	**18,556,903**	**16,513,705**	**15,387,461**	**67,753,435**

2005

(millions, except per share data and volumes)	Three Months Ended Mar. 31	June 30	Sept. 30	Dec. 31	Year Ended Dec. 31
Revenues	$ 693.6	$ 644.5	$ 629.3	$ 646.7	$ 2,614.1
Earnings from operations	58.8	39.2	42.6	60.8	201.4
Net earnings					
– continuing operations	33.5	23.5	25.8	41.8	124.6
Net earnings	33.4	23.5	25.8	41.8	124.5
Basic earnings per common share					
– continuing operations	$ 0.67	$ 0.46	$ 0.51	$ 0.82	$ 2.47
Basic earnings per common share	$ 0.67	$ 0.46	$ 0.51	$ 0.82	$ 2.47
Diluted earnings per common share					
– continuing operations	$ 0.66	$ 0.46	$ 0.51	$ 0.81	$ 2.44
Diluted earnings per common share	$ 0.66	$ 0.46	$ 0.51	$ 0.81	$ 2.44
Market price of common shares					
High	$ 18.78	$ 16.84	$ 18.84	$ 22.75	$ 22.75
Low	$ 14.60	$ 13.40	$ 13.85	$ 17.25	$ 13.40
Number of common shares traded	12,304,628	17,461,794	13,890,518	13,100,827	56,757,767

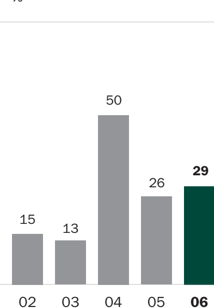
Results of Operations

The following table provides operating profits from continuing operations before interest, taxes and restructuring costs. The corporate expenses included are not allocated to specific operating segments. Gross margins (revenue minus cost of sales) as a percentage of revenues for the operating segments are also shown below. The table shows the segments as they are reported to management and they are consistent with the segmented reporting in the consolidated financial statements.

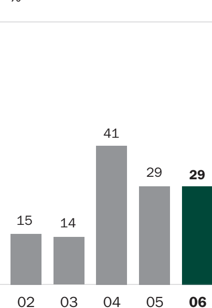
(millions, except percentages)	**2006**	2005	2004	**2006 Change as a % of 2005**	2005 Change as a % of 2004
Segment Revenues					
Metals service centers	**$ 1,507.9**	$ 1,538.5	$ 1,530.9	**(2%)**	0%
Energy tubular products	**614.3**	595.2	395.3	**3%**	51%
Steel distributors	**559.4**	468.7	471.2	**19%**	(1%)
Other	**10.5**	11.7	14.0		
	$ 2,692.1	$ 2,614.1	$ 2,411.4	**3%**	8%
Segment Operating Profits					
Metals service centers	**$ 126.4**	$ 115.2	$ 209.4	**10%**	(45%)
Energy tubular products	**62.2**	54.0	47.2	**15%**	14%
Steel distributors	**76.7**	46.6	78.2	**65%**	(40%)
Corporate expenses	**(18.2)**	(16.8)	(16.3)	**(8%)**	(2%)
Other	**1.9**	2.4	4.6		
Operating profits from continuing operations	**$ 249.0**	$ 201.4	$ 323.1	**24%**	(38%)
Segment Gross Margin as a % of Revenues					
Metals service centers	**25.1%**	23.1%	30.9%		
Energy tubular products	**16.5%**	14.6%	19.6%		
Steel distributors	**18.3%**	14.3%	23.5%		
Total operations	**21.9%**	19.8%	27.8%		
Segment Operating Profits as a % of Revenues					
Metals service centers	**8.4%**	7.5%	13.7%		
Energy tubular products	**10.1%**	9.1%	11.9%		
Steel distributors	**13.7%**	9.9%	16.6%		
Total operations	**9.3%**	7.7%	13.4%		

Return on Averaged Capital Employed

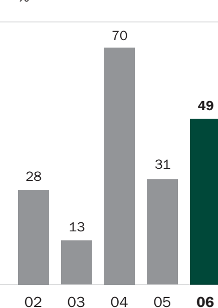
Metals Service Centers
%



Energy Tubular Products
%



Steel Distributors
%



Metals Service Centers

a) Description of operations

We provide processing and distribution services to a broad base of more than 19,000 end users through a network of 52 Canadian locations and 4 U.S. locations. Our metals service centers carry a broad line of products in a wide range of sizes, shapes and specifications, including carbon hot rolled and cold finished steel, pipe and tubular products, stainless steel and aluminum. We purchase these products primarily from steel producers in North America and process and package them in accordance with end user specifications. We service all major geographic regions of Canada and the Midwest region in the United States. Within Canada, our service centers operate under the names Russel Metals, Métaux Russel, A.J. Forsyth, Acier Leroux, Acier Loubier, Acier Richler, B&T Steel, Leroux Steel, Mégantic Métal, McCabe Steel and York-Ennis. Our U.S. service center operations are conducted under the names Russel Metals Williams Bahcall and Baldwin International. Our Williams Bahcall operations focus primarily on the distribution of general line carbon products through three facilities located in Wisconsin. Baldwin International distributes specialty alloy products from its facility in Ohio.

Our metals service centers revenues and cost of sales for 2005 and 2004 have been restated to report customer rebates as a reduction in the corresponding revenue as required by a new Canadian accounting standard adopted January 1, 2006. This restatement decreased our annual revenues and cost of sales by $1.2 million for 2005 and $1.1 million for 2004. There was no impact on 2005 or 2004 net earnings.

b) Factors affecting results

The following is a general discussion of the significant factors affecting our metals service centers results. More specific information on how these factors impacted 2006, 2005 and 2004 is found in the sections that follow.

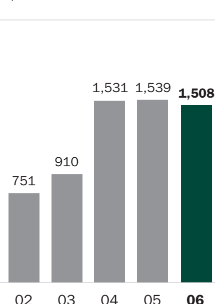
Steel pricing fluctuates significantly throughout the business cycle. Steel prices are influenced by overall demand, trade sanctions, scrap steel pricing and product availability. Supply side management, practiced by steel producers in North America, and international supply and demand, which impacts steel imports, affect product availability. Trade sanctions are initiated either by steel mills or government agencies in North America and, less directly, worldwide. Steel prices continue to be volatile; however, they are currently at levels above historical norms.

Demand is significantly affected by economic cycles with revenues and operating profit fluctuating with the level of general business activity in the markets serviced. We are most impacted by the manufacturing (excluding automotive), resource and construction segments of the Canadian economy. Demand has been relatively stable over the last several years.

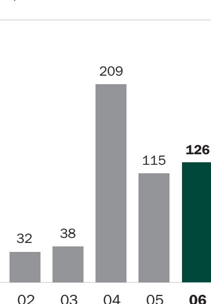
Canadian service centers, which represent the majority of our metals service center operations, are particularly affected by regional general economic conditions. We have operations in all regions of Canada and believe that we have a national market share above 25%. This large market share and our diverse customer base of approximately 19,000 customers suggest that our results should mirror the performance of the regional economies of Canada excluding the automotive sector in which we are not a significant participant.

Metals Service Centers

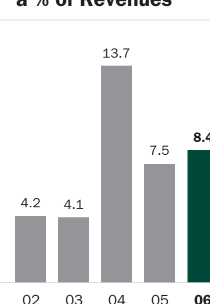
Revenues
$ millions



Operating Profits
$ millions



Operating Profits as a % of Revenues



c) Metals service centers segment results – 2006 compared to 2005

Revenues for 2006 were 2% lower than revenues for 2005. The average selling price of steel for 2006 declined approximately 3% from the average selling price for 2005. Our average selling price declined each quarter for the first three quarters in 2005. Average selling price remained relatively constant after that, with the average selling price for the 2006 year being equivalent to the average selling price for the fourth quarter of 2005.

Overall tons shipped for 2006 were approximately 1% higher than those shipped in 2005. Tons shipped in Alberta and British Columbia were both up 10% due to oil and gas related activity in Alberta and infrastructure building in both provinces. Volumes were strong at our Williams Bahcall operations with an increase of approximately 12% in tons shipped due to improved customer demand in the Wisconsin region. Tons shipped declined approximately 9% in our Atlantic region due to lack of project work in this area. All other regions had tons shipped that approximated those shipped in 2005.

Gross margin as a percentage of revenues improved from 23.1% for 2005 to 25.1% for 2006 related to stable inventory costs during 2006. We estimated that our 2005 operating profit included a before tax inventory holding loss of approximately $38 million. The average cost per ton of our inventory at December 31, 2006 approximated that of December 31, 2005.

The average revenue per invoice for 2006 was approximately $1,906 compared to the average for 2005 of approximately $1,888.

We believe that the strength of the Canadian dollar adversely impacted our customers in Ontario and Quebec who sell finished product to the U.S. and consequently we had reduced volumes in these regions. The change in the Canadian dollar versus the U.S. dollar has not been a significant factor in the metals service centers in relation to inventory costs as inventory is purchased for our Canadian operations from Canadian or U.S. suppliers based on the landed cost at the specific location in Canada.

Operating expenses in our metals service centers segment increased by $11.8 million, or 5%, compared to 2005. This was primarily due to higher compensation expense, delivery costs and bad debt expense. The increase in compensation expense relates to higher wages in regions where the volumes are up, as well as higher costs to maintain staff in Western Canada and higher amounts within our pay for performance plans. The increase in bad debt expense occurred in the first quarter of 2006 from a specific customer and does not relate to a general deterioration.

Metals service centers operating profits for 2006 of $126.4 million were $11.2 million higher than 2005, related to the lower cost of goods sold and the elimination in 2006 of inventory holding losses experienced in 2005.

d) Metals service centers segment results – 2005 compared to 2004

Revenue for 2005 approximated that of 2004. The average selling price of steel for the year ended December 31, 2005 was approximately the same as the year ended December 31, 2004. The average selling price increased during the first nine months of 2004 to a price peak in September 2004. The price declined since that date to July 2005 and has been relatively stable since then.

Overall tons shipped in 2005 approximated those in 2004. Tons shipped declined in eastern Canada and improved in the Prairie region and at Williams Bahcall. Tons shipped in the Prairie region were approximately 8% higher in 2005 compared to 2004, due to strong oil and gas activity in that area. Demand was strong at the Williams Bahcall operations with approximately a 5% increase in tons due to customer demand in that region. We believe that the decline in tons shipped in the eastern Canadian regions primarily related to a slowdown in manufacturing activity and reductions in inventories at our customers' locations.

In January 2004, steel mills initiated raw material surcharges due to sharp price increases in scrap metal and other input costs that caused the price of steel to increase substantially. These surcharges, which were being applied to most of the service center carbon steel products, approximated $190 per ton in September 2004. Since then, many mills have included the surcharge within their base metal price and eliminated the surcharge as a separate cost. The average price of metal has declined since September 2004; however, the 2005 average price of metal is high compared to the price prior to the implementation of surcharges. Based on our product mix, the average cost of metal received, including surcharges, in the month of December 2005 was approximately 44%

above the price for the month of December 2003 prior to the implementation of surcharges. Based on the same information in the month of December 2006, the price is approximately 6% above the price for the month of December 2005 due to mill pricing pressure in the last half of 2006.

Gross margin as a percentage of revenues declined from 30.9% for the year ended December 31, 2004 to 23.1% for the year ended December 31, 2005.

We estimated that our operating profit for the year ended December 31, 2004 included a before tax inventory holding gain of approximately $63 million due to rising steel prices. For the year ended December 31, 2005, we estimated that our operating profit included a before tax inventory holding loss of approximately $38 million due to falling steel prices. The majority of our inventories are accounted for using average cost. The inventory holding gains or losses were estimated based on the best information available. We are unable to quantify with precision inventory holding gains or losses due to the complexity of our 56 service center locations, which buy and sell over 14,000 different SKUs.

The average revenue per invoice for 2005 was approximately $1,888 compared to the average for 2004 of approximately $1,866 and for 2003 of approximately $989.

Operating expenses in the metals service center segment decreased by $23.8 million, or 9%, for 2005 compared to 2004, primarily as a result of variable compensation programs that reflected the decreased earnings, year over year, and lower compensation paid in locations that were restructured in 2004 or early 2005.

Metals service center operating profits for 2005 decreased $94.2 million, or 45%, compared to 2004. The decline related to an unfavourable change in inventory holding gains and losses of approximately $101 million for 2005 compared to 2004, offset by lower expenses.

Energy Tubular Products

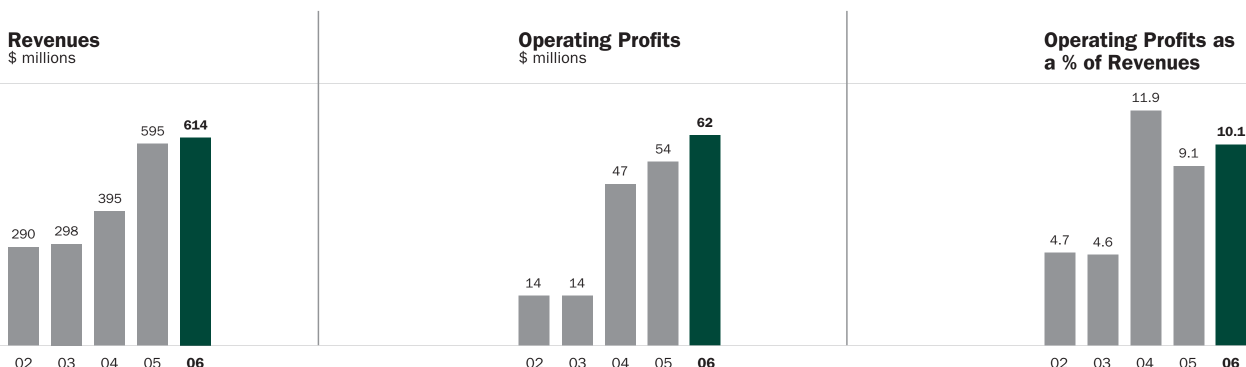
a) Description of operations

These operations distribute oil country tubular goods (OCTG), line pipe, tubes, valves and fittings, primarily to the energy industry in Western Canada and the western United States, from 5 Canadian and 2 U.S. locations. We purchase these products either from the pipe processing arms of North American steel mills, independent manufacturers of pipe and pipe accessories or international steel mills. Our energy tubular products segment operates under the names Comco Pipe and Supply Company, Fedmet Tubulars, Triumph Tubular & Supply, Pioneer Pipe and Spartan Steel.

b) Factors affecting results

The following is a general discussion of the factors affecting our energy tubular products segment operations. More specific information on how these factors impacted 2006, 2005 and 2004 is found in the sections that follow.

Energy Tubular Products



Oil and gas pricing, which is one of the factors that can impact oil rig count and subsequent drilling activities particularly in Western Canada, has the ability to significantly affect demand for our product. Oil and gas pricing has been high throughout 2005 and 2006. Oil and gas prices have dropped during 2006, with gas prices declining most significantly. Oil prices have declined further in 2007.

Oil and gas drilling in Western Canada peaks during the period from October to March; thus revenues and operating profits have been historically higher during our first and fourth quarters. In 2006, activity declined in the fourth quarter such that fourth quarter revenues and operating profits approximated those of the third quarter of 2006 and revenues declined approximately 8% from the fourth quarter of 2005.

Our Canadian operations are affected by the U.S. dollar exchange rate since some products are sourced outside Canada and are priced in U.S. dollars. While metal pricing has impacted our earnings more significantly, the appreciation of the Canadian dollar has also contributed by reducing our average cost of metal.

Pricing is influenced by overall demand, trade sanctions and product availability. Trade sanctions are initiated either by steel mills or government agencies in North America. Trade sanctions have not been a factor for pipe products during the reported periods.

c) Energy tubular products segment results – 2006 compared to 2005

Revenues increased 3% to $614.3 million for 2006 compared to 2005. The increase in revenues is related to strong volumes sold to the oil and gas drilling industry in both Western Canada and the western United States. The second and third quarters of 2005 had significant project revenue related to infrastructure build for the oil sands of northern Alberta that was not present in 2006. Revenues were significantly higher than the levels prior to 2005.

Gross margin as a percentage of revenues was 16.5% for 2006, an increase from 14.6% for 2005. This improved margin was generated by higher margins on tubular products in short supply. The 2006 results include a smaller portion of lower margin energy project revenues resulting in a higher gross margin as a percentage of revenues. Gross margin dollars increased 16% in 2006 mainly related to higher volumes.

Operating expenses were higher by $5.9 million for 2006 compared to 2005 due to higher delivery costs related to volume increases and variable compensation related to higher profitability.

Operating profits increased by $8.2 million, or 15%, to $62.2 million for 2006 compared to 2005. This increase in operating profits was driven by higher volumes and gross margins.

d) Energy tubular products segment results – 2005 compared to 2004

Revenues increased 51% to $595.2 million in 2005 compared to 2004. Oil and gas related activity in Alberta was the driving factor for this large increase in volume. Project revenue, mainly from large projects in the oil sands of northern Alberta, accounted for approximately 23% of the revenue increase. Continued high oil and gas pricing and more rig activity during 2005 compared to 2004 accounted for the rest of the increase in revenue.

This segment's gross margin as a percentage of revenues was 14.6% for 2005 compared to 19.6% for 2004. The lower margin mainly relates to the increased cost of goods sold resulting from higher metal pricing.

Operating profits increased by $6.8 million, or 14%, in 2005 compared to 2004. This increase in operating profits was driven by higher volumes and higher metal prices.

Steel Distributors

a) Description of operations

Our steel distributors act as master distributors selling steel in large volumes to other steel service centers and equipment manufacturers mainly on an "as is" basis. Our U.S. operation processes some coil for its customer base at its cut to length facility in Houston, Texas. Our steel distributors source their steel both domestically and offshore. The international sourcing provides our other business segments with valuable insight regarding international pricing trends and their potential impact on steel markets in North America.

The main steel products sourced by this segment are structural beam, plate, coils, pipe and tubing. The operations in this sector are Wirth Steel and Sunbelt Group. Arrow Steel, a division of Sunbelt Group, processes coils.

b) Factors affecting results

The following is a general discussion of the factors affecting our steel distributors. More specific information on how these factors impacted 2006, 2005 and 2004 is found in the sections that follow.

Steel pricing is influenced by overall demand, trade sanctions and product availability both domestically and worldwide. Trade sanctions are initiated either by steel mills or government agencies in North America. Mill capacity by product line in North America and international supply and demand impact steel imports and significantly affect product availability.

Demand for steel that is sourced offshore fluctuates significantly, mainly driven by price and product availability in North America. During 2006, demand was high due to North American shortages of certain products. Our steel distributors have a significant number of customers who buy from them on a periodic basis, which can result in large fluctuations in revenues reported from period to period.

Movement in the U.S. dollar has had some effect on our Canadian steel distributor operations since inventory is purchased mainly in U.S. dollars. Steel is predominantly transacted in U.S. dollars and the Canadian mills adjust the price accordingly. The effect of the strengthening Canadian dollar was fully offset by rising metal prices.

c) Steel distributors segment results – 2006 compared to 2005

Steel distributors revenues increased 19% to $559.4 million for 2006 compared to 2005. Higher volumes accounted for most of the increase in revenues. Volumes were significantly higher due to strong demand for steel.

Gross margin as a percentage of revenues of 18.3% for the year ended December 31, 2006 was higher than the 14.3% for 2005 due to strong demand for our products resulting in higher metal pricing in 2006.

Operating expenses were $5.1 million higher for 2006 compared to 2005, mainly due to variable compensation related to higher profitability.

Operating profits for 2006 were $76.7 million, which is $30.1 million higher than 2005, generated by higher volumes and selling prices. Operating profits for 2006 were $1.5 million less than operating profits for our record year in 2004; however, volumes were more of a factor in 2006 with pricing being the principal factor in 2004.

d) Steel distributors segment results – 2005 compared to 2004

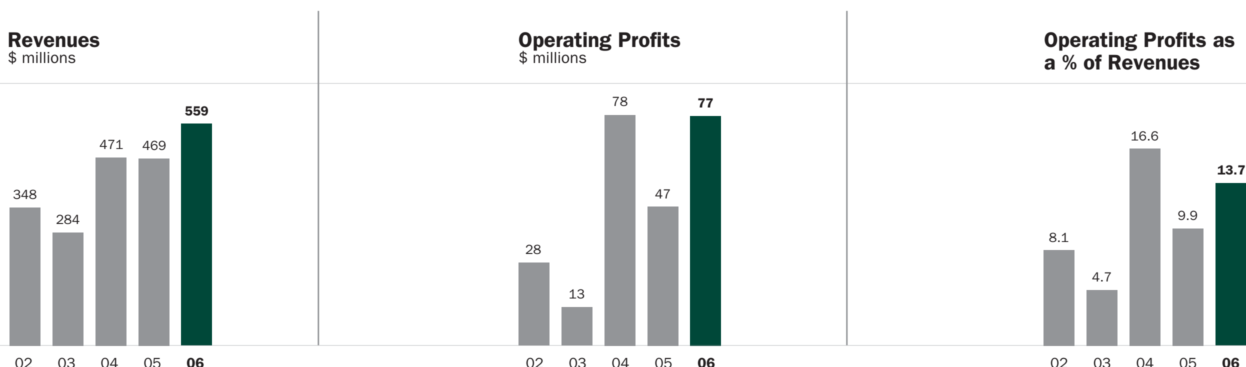
Steel distributors revenues decreased 1% in 2005 compared to 2004. While revenue was flat, 2005 revenues were generated by lower average selling prices offset by higher volumes.

Gross margin as a percentage of revenues declined from 23.5% in 2004 compared to 14.3% for 2005. This decline primarily related to the price of steel being at the highest levels in 2004 and stronger demand for certain products in 2004. The 2005 results were also impacted by holding losses versus holding gains in 2004.

Operating expenses were 37% lower for 2005 compared to 2004, which was mainly due to lower variable compensation.

Operating profits for 2005 were $46.6 million, which was $31.6 million lower than 2004, mainly driven by steel pricing.

Steel Distributors



Other – 2006 Compared to 2005 and 2004

Other revenues and income represents the results of our bulk commodities handling terminal in Thunder Bay, Ontario. Revenues and operating profits for 2006 have declined due to lower volumes handled.

Corporate Expenses – 2006 Compared to 2005 and 2004

Corporate expenses increased primarily due to higher stock-based compensation expense in 2006.

Consolidated Results – 2006 Compared to 2005 and 2004

Operating profits from continuing operations before other costs were $249.0 million in 2006, compared to $201.4 million in 2005 and $323.1 million in 2004. Higher volumes and stable, high metal pricing were the factors that contributed to the increase in 2006. Strong results for 2006 resulted in operating earnings for each of our three metals segments being higher than the results for the same period in 2005.

Interest Expense

The following table shows the components of our interest expense.

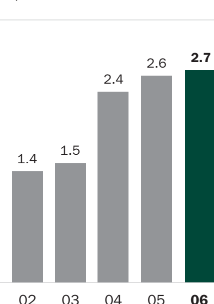
(millions)	**2006**	2005	2004
Interest on long-term debt			
6.375% Senior Notes	**$ 14.8**	$ 15.2	$ 13.5
10% Senior Notes	**–**	–	2.9
8% Convertible Debentures	**–**	–	0.5
	14.8	15.2	16.9
Other interest (net)	**(8.1)**	2.3	3.1
Total interest	**$ 6.7**	$ 17.5	$ 20.0

Consolidated interest expense for 2006 decreased by $10.8 million to $6.7 million compared to 2005. The proceeds from our issue of common shares in March 2006 were partially used to repay short-term debt and resulted in cash on hand and corresponding interest income. The change in interest expense on long-term debt relates to lower exchange rates in 2006 on the US$75 million of unhedged long-term debt.

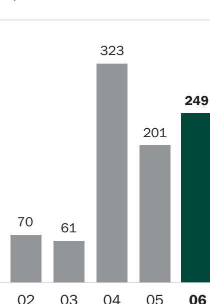
Debt Restructuring Costs

During the first quarter of 2004, we restructured our long-term debt at interest rates that significantly reduced the interest costs. We issued US$175 million of 6.375% Senior Notes due March 1, 2014. As of June 1, 2004, all other long-term debt was redeemed. We also entered into fixed interest cross currency swaps to hedge US$100 million of the 6.375% Senior Notes to eliminate the foreign exchange exposure. The currency swaps result in an additional interest cost of $0.3 million per quarter, which is included in the interest expense.

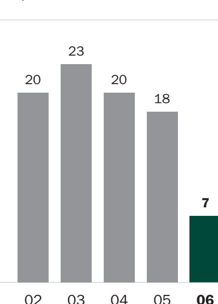
Total Revenues
$ billions



Total Operating Profits
$ millions



Interest Expense
$ millions



On February 23, 2004, we redeemed US$95.5 million of our 10% Senior Notes at US$1,072.50 per US$1,000 unit. The US$72.50 per unit premium as well as the deferred costs related to the debt redeemed resulted in a charge of $11.3 million in the first quarter of 2004.

The remaining US$20.1 million of 10% Senior Notes was redeemed on June 1, 2004 at US$1,050 per US$1,000 unit. The US$50.00 per unit premium and the remaining deferred costs resulted in a charge of $1.9 million in the second quarter of 2004. The remaining deferred costs of $0.5 million related to the previous bank facility were charged to debt redemption costs in the fourth quarter of 2004.

Restructuring

We sold our Milton, Ontario facility in May 2006. We realized a gain on sale before income taxes of approximately $1.2 million. This property was classified as an asset held for sale in 2005. The restructuring charges for 2005 mainly related to our Lachine, Quebec facility, which was sold in the second quarter of 2005, and our Milton, Ontario facility, which was closed in December 2005, prior to its sale in 2006.

Income Taxes

Our provision for income taxes for 2006 was $84.8 million, which was higher than 2005 due to higher earnings in 2006. In 2006, our income tax rate was 34.8%. We estimate our normalized effective income tax rate to be approximately 35%.

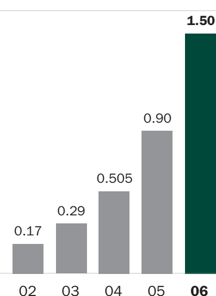
Our income tax expense for 2006 was lower as we were able to utilize unrecorded capital losses against the capital gain on the sale of our Milton facility. During the second quarter of 2006, the Canadian Federal budget, which proposed rate reductions from 2008 to 2010, was enacted. This change reduced our future tax liabilities by approximately $0.4 million resulting in lower tax expense. Non-deductible expenses related to the accounting treatment of stock options negatively impacted our income tax rate.

During 2005, the Company recorded income tax recoveries of $6.7 million related to tax reassessment, issues under appeal with the tax authorities and adjustments related to prior years' taxes. This recovery of taxes reduced the income tax rate for 2005 to 32.6%. Excluding the tax recoveries, our income tax rate for the year ended December 31, 2005 would have been 36.2%. For the year ended December 31, 2004, the income tax rate of 36.8% was higher than the average combined statutory rate due to non-deductible items.

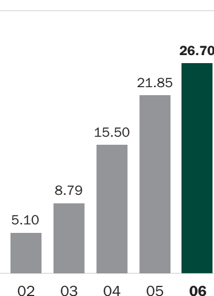
Earnings

Net earnings for 2006 were $158.7 million compared to $124.5 million for 2005. Basic earnings per common share for 2006 were $2.65 compared to $2.47 for 2005. Our higher net earnings in 2006 were driven by strong results in all three metals segments.

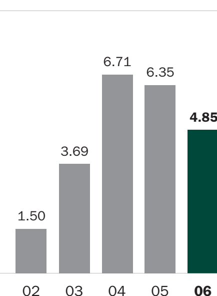
Dividends Paid per Common Share
$ per share



Common Share Price
$ per share



Common Share Appreciation
$ per share



Shares Outstanding and Dividends

In March 2006, we issued 11 million common shares at $25.75 per common share. As at December 31, 2006, we had 62,366,842 common shares outstanding and at February 19, 2007 we had 62,367,242 common shares outstanding.

The weighted average number of common shares outstanding for 2006 was 59,887,382 compared to 50,461,330 for 2005 and 48,671,915 for 2004. The 2006 increase relates to the public offering of 11 million common shares in March 2006 and the exercise of employee stock options.

We have returned a portion of our earnings to our shareholders by paying common share dividends of $89.4 million in 2006, $45.4 million in 2005 and $25.0 million in 2004. The increase relates to additional shares outstanding and the increased dividend rate. The cash dividend paid was $1.50 per share for 2006, $0.90 per share for 2005 and $0.505 per share for 2004.

Our U.S. Senior Notes indenture provides that any dividend payment in excess of $0.08 per common share per quarter is considered a restricted payment. We currently have $432 million available for restricted payments.

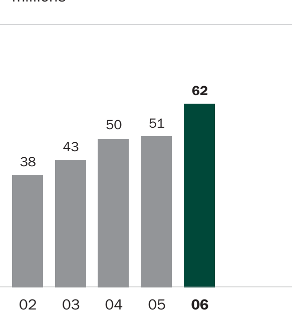
EBITDA

The following table shows the reconciliation of GAAP earnings from continuing operations to EBITDA:

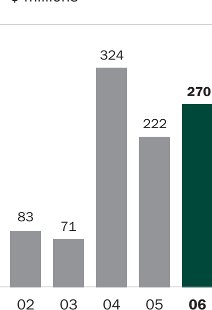
(millions)		**2006**		2005		2004
Earnings from continuing operations	**$**	**158.7**	$	124.6	$	180.4
Provision for income taxes		**84.8**		60.4		105.3
Interest expense, net		**6.7**		17.5		20.0
Earnings before interest and income taxes (EBIT)		**250.2**		202.5		305.7
Depreciation and amortization		**20.0**		19.2		18.6
Earnings before interest, income taxes, depreciation and amortization (EBITDA)	**$**	**270.2**	$	221.7	$	324.3

We believe that EBITDA may be useful in assessing our operating performance and as an indicator of our ability to service or incur indebtedness, make capital expenditures and finance working capital requirements. The items excluded in determining EBITDA are significant in assessing our operating results and liquidity. Therefore, EBITDA should not be considered in isolation or as an alternative to cash from operating activities or other combined income or cash flow data prepared in accordance with GAAP.

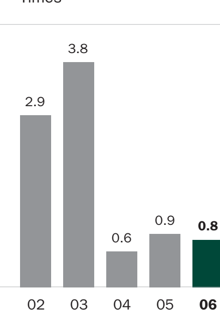
Common Shares Outstanding
millions



EBITDA
$ millions



Interest Bearing Debt to EBITDA
Times



Capital Expenditures

Capital expenditures were $27.6 million for 2006 compared to $26.5 million for 2005. We are currently expanding some of our locations and adding laser burning equipment to certain of our metals service center operations.

Capital expenditures mainly relate to replacement of capital items, the purchase of additional processing equipment across a broad base of our operations and upgrades to our existing facilities and computer systems. Our expectation is for capital expenditures to be at levels higher than depreciation expense over a period of years due to the construction of larger facilities in growing markets and for expanding product lines and processing capabilities.

Depreciation expense was $18.4 million in 2006 and $17.7 million in 2005.

Liquidity

We stress working capital management to ensure that working capital is minimized and leverage reduced over the economic cycle. The metals distribution business experiences significant swings in cash flow in order to fund working capital. Inventory and accounts receivable represent a large percentage of our total assets employed and vary throughout each cycle. At December 31, 2006, current assets represented 85% of our total assets versus 81% at December 31, 2005. Total assets increased from $1.1 billion at December 31, 2005 to $1.4 billion at December 31, 2006 primarily due to cash on hand from the issue of common shares in March 2006 and an increase in inventory levels.

The balances disclosed in our consolidated cash flow statements are adjusted to remove the non-cash component related to foreign exchange rate fluctuations impacting inventory, accounts receivable, accounts payable and income tax balances of our U.S. operations.

Overall inventory turns declined due to an increase in inventory in all segments in the last half of 2006. The increase in inventory utilized $188.2 million of cash. Although sales volumes remain strong, inventory levels will be reduced over the next several quarters. Our goal is to ensure that we keep our inventory levels as low as possible while still satisfying the needs of our customers in order to minimize inventory valuation risk.

Inventory turns are calculated using our cost of sales for the quarter annualized, divided by our inventory position at the end of the quarter.

Inventory Turns

	Quarter Ended				
	Dec. 31 2006	**Sept. 30 2006**	**June 30 2006**	**Mar. 31 2006**	Dec. 31 2005
Metals service centers	**3.8**	**3.7**	**4.6**	**4.8**	4.8
Energy tubular products	**2.3**	**2.7**	**2.5**	**4.5**	3.8
Steel distributors	**2.2**	**4.1**	**4.7**	**4.7**	4.4
Total operations	**2.9**	**3.4**	**3.9**	**4.7**	4.4

Metals service centers inventory turns decreased during the last two quarters compared to prior quarters due to higher inventories and lower cost of goods sold during the last half of 2006 compared to prior periods. Our metals service centers reduced inventories by $36.4 million during the fourth quarter of 2006. We expect our metals operations to turn over their inventory at higher rates than the industry average. Based on information published by the Metals Service Center Institute in its monthly Metals Activity Report, average inventory turns for U.S. based steel companies for the three months ended December 31, 2006 were 3.0 turns and for Canadian based companies were 2.7 turns.

Both the energy tubular products segment and the steel distributors segment had significantly more inventory at December 31, 2006 compared to December 31, 2005. These inventories are to support anticipated sales in the first quarter of 2007. Our energy tubular products segment increase partially relates to the timing of receipt for purchases of material from offshore. More import material was purchased in 2006 due to availability and pricing.

The other major components of working capital are accounts receivable and accounts payable. Accounts receivable as at December 31, 2006, decreased $30.3 million since December 31, 2005 as a result of lower revenues during the fourth quarter of 2006. Accounts payable decreased $30.9 million in 2006, which mainly relates to a decline in service center trade payables as inventory purchases were reduced during the fourth quarter of 2006 to help bring the inventory levels more in line with current requirements.

During 2006, we made income tax payments of $71.0 million compared to payments of $110.4 million in 2005. The 2005 payments included final installments of $60.7 million for the 2004 year.

During 2006, we utilized cash of $27.6 million on capital expenditures and $89.4 million on common share dividends. During 2005, we utilized cash of $26.5 million on capital expenditures and $45.4 million on common share dividends.

Free Cash Flow

(millions)	**2006**	2005	2004
Cash from operating activities before working capital	**$ 178.5**	$ 149.6	$ 210.3
Purchase of fixed assets	**(27.6)**	(26.5)	(25.4)
Proceeds on sale of fixed assets	**1.7**	1.6	0.8
Proceeds from assets held for sale and sale of businesses	**6.2**	5.9	3.7
	$ 158.8	$ 130.6	$ 189.4

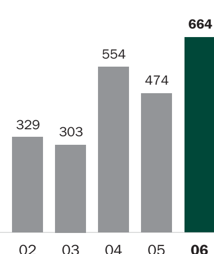
Free cash flow may be useful in assessing our ability to pay dividends, reduce outstanding debt and fund working capital growth. Free cash flow is a non-GAAP measure regularly used by investors and analysts to evaluate companies.

Cash, Debt and Credit Facilities

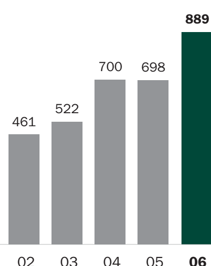
At December 31, 2006, we had cash and cash equivalents, net of outstanding cheques, of $209.9 million. In March 2006, we issued 11 million common shares for $25.75 per share resulting in net proceeds of $271.4 million. The proceeds were used to pay down short-term debt and the remainder is in short-term investments until a suitable acquisition or other use of cash occurs. An acquisition is not currently imminent.

Our long-term debt balance at December 31, 2006 was $203.9 million. We have outstanding US$175 million of 6.375% Senior Notes due in 2014. On US$100 million of this debt we have fixed interest cross currency swaps. These swaps eliminate the foreign exchange exposure on the portion of the debt not hedged by our investment in our U.S. subsidiaries.

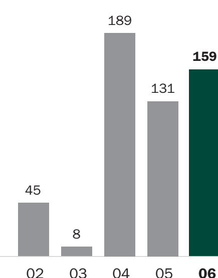
Inventories
$ millions



Net Assets Employed
$ millions



Free Cash Flow
$ millions



Cash and Bank Credit Facilities

As at December 31, 2006 (millions)	Russel Metals Facility	U.S. Subsidiary Facility	Total
Bank loans	$ –	$ –	$ –
Cash net of outstanding cheques	**191.3**	**18.6**	**209.9**
Cash	**191.3**	**18.6**	**209.9**
Facilities availability	**200.0**	**58.3**	**258.3**
Letters of credit	**54.8**	**42.1**	**96.9**
Undrawn facilities	**145.2**	**16.2**	**161.4**
Total cash and undrawn facilities	**$ 336.5**	**$ 34.8**	**$ 371.3**

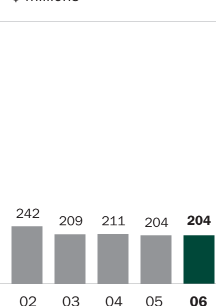
We have a facility, with a syndicate of Canadian and U.S. banks, for a revolving loan of $200 million, including letters of credit, which expires on October 29, 2009. We may extend this facility annually with the consent of the syndicate. We are entitled to borrow, on a revolving basis, up to an amount equal to the sum of specified percentages of our eligible accounts receivable and inventories, to a maximum of $200 million. We are currently entitled to borrow $200 million, including letters of credit, under this facility. At December 31, 2006, we had no borrowings and had letters of credit of $54.8 million. At December 31, 2005, we had no borrowings and had letters of credit of $46.1 million under this facility.

In addition, a U.S. subsidiary has its own one-year bank credit facility. The maximum borrowing under this facility at December 31, 2006 is US$50 million. At December 31, 2006, this subsidiary had no borrowings and had letters of credit of US$36.1 million. At December 31, 2005, this subsidiary had no borrowings and had letters of credit of US$30.6 million.

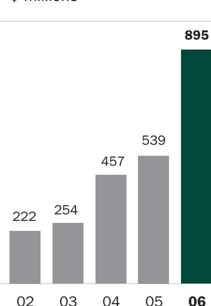
Cash generated from operating activities before working capital changes was $178.5 million for 2006 and was $149.6 million for 2005. The increase primarily relates to higher earnings.

Based on cash and our bank facilities, we have access to approximately $371 million of cash based on December 31, 2006 balances. In the past, we have made several acquisitions and we believe we can continue to grow by acquisition. We believe we have the ability to fund future acquisitions through the utilization or expansion of our existing bank facilities. We believe we have the ability to significantly increase the bank facility, if required.

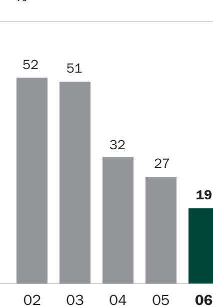
Interest Bearing Debt
$ millions



Shareholders' Equity
$ millions



Debt to Capitalization
%



Contractual Obligations

As at December 31, 2006, we were contractually obligated to make payments under our long-term debt agreement, cross currency swap agreements and operating lease obligations that come due during the following periods.

(millions)	Long-Term Debt Maturities	Cross Currency Swaps	Long-Term Debt Interest	Lease Obligations	Total
2007	$ –	$ –	$ 15.2	$ 10.8	$ 26.0
2008	–	–	15.2	9.0	24.2
2009	–	–	15.2	8.5	23.7
2010	–	–	15.2	7.8	23.0
2011	–	–	15.2	6.1	21.3
2012 and beyond	203.9	15.3	32.9	11.9	264.0
Total	$ 203.9	$ 15.3	$ 108.9	$ 54.1	$ 382.2

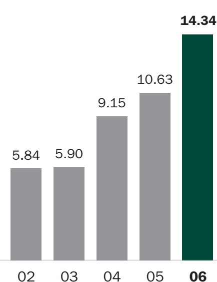
Our fixed interest cross currency swaps obligate us to purchase US$100 million at $1.3180 for each US$1.00. Based on the December 31, 2006 exchange rate, we would incur an obligation of $15.3 million in addition to our long-term debt obligation of $203.9 million. The long-term debt interest in the table includes the impact of our swaps. Actual long-term debt interest has been estimated based on current exchange rates for the unhedged portion.

Off-Balance Sheet Arrangements

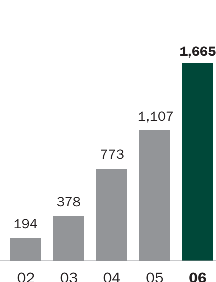
Our off-balance sheet arrangements consist of the letters of credit disclosed in the bank credit facilities table, operating lease obligations disclosed in the contractual obligation table and short-term foreign exchange contracts. At December 31, 2006, our short-term foreign exchange contracts used to hedge specific inventory purchases were approximately US$16.5 million and mature in the first half of 2007.

We have multiple defined benefit pension plans in Canada, as disclosed in Note 14 to the 2006 annual consolidated financial statements. During the first quarter of 2006, we made a payment to fund the annual 2006 current and past service obligation of $7.6 million. This included a special past service contribution of $4.1 million. We expect to contribute approximately $5.5 million to these plans during 2007.

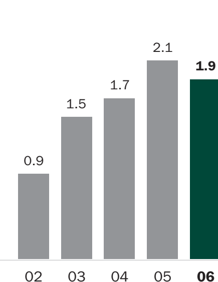
Book Value per Common Share
$ per share



Market Capitalization
$ millions



Market Capitalization to Book Value
Times



Vision and Strategy

The metals distribution business is a segment of a mature, cyclical industry. The use of service centers and steel distributors by both manufacturers and end users of steel continues to grow. This is evidenced by the growth in the percentage of total steel shipments from steel producers to service centers. As the distribution segment's share of steel industry shipments continues to grow, service centers such as ours can grow their business over the course of a cycle.

We strive to deal with the cyclical nature of the business by operating with the lowest possible net assets throughout the course of a cycle. In order to achieve this, management emphasizes profitability rather than revenue growth. This intensive asset management reduces borrowings and therefore interest expense in declining periods in the economic cycle. This in turn creates higher, more stable returns on net assets over the course of the cycle. Our conservative management approach creates relatively stronger trough earnings but could cause potential peak earnings to be somewhat muted. Management strongly believes that it is more prudent to be profitable throughout a cycle, without the spikes in earnings caused by less emphasis on asset management, and have average earnings over the full range of the cycle in the top deciles of the industry.

Growth from selective acquisitions is also a core strategy. We focus on investment opportunities in businesses that have strong market niches or provide mass to our existing operations.

In both the energy tubular products and steel distributors segments, all of the business units have significant operations in the market niche that they service. Consistent with our acquisition philosophy, any new acquisitions in these areas could likely be either major stand-alone operations or those that complement our existing operations.

In the future, we believe that the length of the steel-based economic cycle will continue to shorten and a management structure and philosophy that allows the fastest reaction to the changes that affect the industry will be the most successful. We will continue to invest in business systems to enable faster reaction times to changing business conditions. In addition, management believes the high level of service and flexibility provided by service centers will enable this distribution channel to capture an increasing percentage of total steel revenues to end users, allowing for increased growth within the sector.

Risk

The timing and extent of future price changes from the steel producers and their impact on us can not be predicted with any certainty due to the inherent cyclical nature of the steel industry.

Accounting Policies and Estimates

a) Change in Accounting Policies in 2006

During the first quarter of 2006, as required by Canadian accounting standards, we adopted EIC-156, Accounting by a Vendor for Consideration Given to a Customer (including a Reseller for the Vendor's Product). This standard requires us to reduce revenues for amounts paid to our customers as rebates. As a result, we restated our 2005 income statement, which resulted in a reduction in revenues and cost of sales of $1.2 million for 2005 and $1.1 million for 2004. This change had no impact on earnings.

During the third quarter of 2006, we adopted EIC-162, Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date. The adoption of this standard required us to shorten the amortization period for three employees who will attain the age of 65 prior to the four year vesting period related to stock options issued in 2006 and prior years. This restatement changed stock-based compensation expense and net income as follows.

(millions)	**2006**	2005	2004
Increase in stock-based compensation expense	**$ 0.9**	$ 0.2	$ –
Decrease in net income	**$ 0.9**	$ 0.2	$ –

b) Future Accounting and Reporting Changes

The CICA has issued three new accounting standards: Financial Instruments – Recognition and Measurement, Hedges and Comprehensive Income, which we are adopting effective January 1, 2007. The principal impacts of the standards are:

(i) Other comprehensive income will be a new component of shareholders' equity and a new statement entitled Statement of Comprehensive Income will be added to our consolidated financial statements.

(ii) Financial assets and liabilities will be required to be classified as available for sale, held to maturity, trading, other liabilities or loans and receivables.

(iii) Items classified as held-for-trading will be measured at fair value with gains and losses recognized in net income. Assets classified as available-for-sale will be measured at fair value with gains and losses recognized in other comprehensive income until the item is sold. Other assets and liabilities will be measured at amortized cost using the effective interest method.

(iv) Derivative instruments including hedges will be recorded on the balance sheet at fair value.

(v) This new hedging standard will replace our current policy and the hedge on the US$100 million of our Senior Notes will be recorded at fair value on the balance sheet with any gains or losses recorded in other comprehensive income until the hedged items are recognized in the consolidated statement of income.

We do not believe these new standards will have a material impact on our consolidated net income.

c) Accounting Estimates

The preparation of our financial statements requires management to make estimates and judgements that affect the reported amounts. On an ongoing basis, we evaluate our estimates, including those related to bad debts, inventory obsolescence, useful lives of fixed assets, asset retirement obligations, income taxes, restructuring costs, pensions and other post-retirement benefits, fair values, guarantees, environmental obligations, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Our most significant assets are accounts receivable and inventory.

Accounts Receivable

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Assessments are based on aging of receivables, legal issues (bankruptcy status), past collection experience, current financials or credit agency reports and the experience of our credit personnel. Accounts receivable, which we determined to be uncollectible, are reserved in the period in which the determination is made. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. During the first quarter of 2006, we experienced increased bad debts in central Canada resulting in a higher than normal bad debt expense. Our bad debt experience returned to normal levels for the remainder of 2006.

Inventories

We review our inventory for obsolescence, slow moving product and to ensure that the cost of inventory is not in excess of its estimated market value. Inventory reserves or write-downs are recorded when cost exceeds the market value and when product is determined to be slow moving or obsolete. Significant reductions in market value could result in additional write-downs. The inventory reserve level at December 31, 2006 is consistent with the level at December 31, 2005.

Other areas involving significant estimates and judgements include:

Income Taxes

We believe that we have adequately provided for income taxes based on all of the information that is currently available. The calculation of income taxes in many cases requires significant judgement in interpreting tax rules and regulations, which are constantly changing. Our tax filings are also subject to audits, which could materially change the amount of current and future income tax assets and liabilities. Any change would be recorded as a charge or a credit to income tax expense.

Employee Benefit Plans

We perform a valuation, at least every three years, for each plan to determine the actuarial present value of the accrued pension and other retirement benefits. The valuation uses management's assumptions for the discount rate, expected long-term rate of return on plan assets, rate of compensation increase, health care cost trend and expected average remaining years of service of employees.

While we believe that these assumptions are reasonable, differences in actual results or changes in assumptions could materially affect employee benefit obligations and future net benefit plans costs. We account for differences between actual and assumed results by recognizing differences in benefit obligations and plan performance over the working lives of the employees who benefit from the plans.

Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

As of December 31, 2006, an evaluation was carried out, under the supervision of and with the participation of management, including the President and Chief Executive Officer, and the Executive Vice President and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined under Canadian Securities Administrators Multilateral Instrument 52-109. Based on that evaluation, the President and Chief Executive Officer, and the Executive Vice President and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

The purpose of internal controls over financial reporting as defined by the Canadian Securities Administrators is to provide reasonable assurance that:

(i) financial statements prepared for external purposes are in accordance with the Company's generally accepted accounting principles;

(ii) transactions are recorded as necessary to permit the preparation of financial statements, and records are maintained in reasonable detail;

(iii) receipts and expenditures of the Company are made only in accordance with authorizations of the Company's management and directors; and

(iv) unauthorized acquisitions, uses or dispositions of the Company's assets that could have a material effect on the financial statements will be prevented or detected in order to prevent material error in financial statements.

The President and Chief Executive Officer, and the Executive Vice President and Chief Financial Officer have caused management and other employees to design and document our internal controls over financial reporting. No material weaknesses in the design effectiveness were identified during the documentation of these internal controls.

No changes were made in our internal control over financial reporting during the year ended December 31, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Fourth Quarter Results

Our sales volumes have declined in all segments for the fourth quarter of 2006 compared to 2005. Revenues for the fourth quarter of 2006 have decreased 8% compared to the fourth quarter of 2005. Volume declines relate to excess inventory that needs to work its way through the service centers and a slow down in activity in Alberta and British Columbia related to a pause in the busy oil and gas industry. The decline in activity in the energy sector relates to lower gas pricing and warmer weather affecting rig activity.

This decline in volumes resulted in lower operating profits in all segments compared to the fourth quarter of 2005. Our basic earnings per share of $0.49 for the fourth quarter of 2006 compares to that reported for the fourth quarter of 2005 of $0.82.

Outlook

As mentioned earlier, we noticed softness in demand in both the metals service centers and the energy tubular products segments in the last quarter of 2006. The metals service centers were negatively impacted by the strength of the Canadian dollar. We believe that this affected our customers who sell manufactured products into the U.S.

We have just finished three years of record earnings, pay one of the highest yielding dividends on the TSX, have more cash than long-term debt, and are poised to grow the Company both organically and through external acquisitions. Entering 2007, North American steel prices appear to be stabilizing. The service center industry inventory overhang is shrinking, steel imports are declining as steel prices outside of North America increase, and demand is improving over the fourth quarter of 2006. We are, however, far from complacent as we live in a competitive, highly cyclical industry. We are well positioned to capitalize on any eventualities that may present themselves.

February 19, 2007

> management’s report to the shareholders

The accompanying consolidated financial statements, management’s discussion and analysis and all information in the Annual Report have been prepared by management and approved by the Audit Committee and the Board of Directors of the Company.

These consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management’s best estimates and judgements. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements and management’s discussion and analysis within reasonable limits of materiality and for the consistency of financial data included in the text of the Annual Report with that contained in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company has developed, documented and maintained a system of internal controls in order to provide reasonable assurance that its assets are safeguarded; that only valid and authorized transactions are executed; and that accurate, timely and comprehensive financial information is prepared in accordance with Canadian generally accepted accounting principles. In addition, the Company has developed and maintained a system of disclosure controls in order to provide reasonable assurance that the financial information is relevant, reliable and accurate. The Company has evaluated its disclosure controls for the year ended December 31, 2006, and has concluded that they are effective.

The Company’s Audit Committee is appointed annually by the Board of Directors. The Audit Committee, which is composed entirely of outside directors, meets with management to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements, the management’s discussion and analysis and the report to shareholders. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements, the management’s discussion and analysis and the report to shareholders for presentation to the shareholders.

The consolidated financial statements have been audited on behalf of the shareholders by the external auditors, Deloitte & Touche LLP, in accordance with Canadian generally accepted auditing standards. Deloitte & Touche LLP has full and free access to the Audit Committee.

February 19, 2007

E.M. Siegel, Jr.
President and
Chief Executive Officer

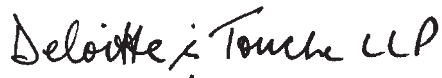
B.R. Hedges
Executive Vice President and
Chief Financial Officer

To the Shareholders of Russel Metals Inc.

We have audited the consolidated balance sheets of Russel Metals Inc. as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles.



Deloitte & Touche LLP
Chartered Accountants

Toronto, Ontario
February 5, 2007

> consolidated balance sheets

At December 31 (millions)		**2006**		2005
ASSETS				
Current				
Cash and cash equivalents	**$**	**209.9**	$	47.1
Accounts receivable		**329.0**		359.6
Inventories		**664.0**		474.0
Prepaid expenses and other assets		**7.4**		7.0
Income taxes		**2.1**		0.3
		1,212.4		888.0
Property, Plant and Equipment (Note 6)		**189.5**		181.8
Assets Held For Sale (Note 4)		**–**		5.1
Deferred Financing Charges		**6.8**		7.3
Future Income Tax Assets (Note 10)		**0.4**		1.0
Other Assets		**3.9**		2.8
Goodwill (Note 4)		**9.2**		9.2
	$	**1,422.2**	$	1,095.2
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current				
Bank indebtedness	**$**	**–**	$	2.1
Accounts payable and accrued liabilities		**283.9**		315.3
Income taxes payable		**15.0**		5.6
		298.9		323.0
Other Accrued Liabilities (Note 12)		**15.4**		15.3
Long-Term Debt (Note 8)		**203.9**		204.0
Pensions and Benefits (Note 14 b))		**2.6**		8.9
Future Income Tax Liabilities (Note 10)		**6.8**		5.3
		527.6		556.5
Shareholders' Equity (Note 11)		**894.6**		538.7
	$	**1,422.2**	$	1,095.2

On behalf of the Board,

C.R. Fiora
Director

A. Benedetti
Director

> consolidated statements of earnings

For the years ended December 31 (millions, except per share data)	**2006**	2005	2004
Revenues	**$ 2,692.1**	$ 2,614.1	$ 2,411.4
Cost of sales and operating expenses	**2,443.1**	2,412.7	2,088.3
Earnings before the following	**249.0**	201.4	323.1
Restructuring (Note 4)	**(1.2)**	(1.1)	3.7
Debt restructuring costs (Note 8)	**–**	–	13.7
Interest expense, net (Note 9)	**6.7**	17.5	20.0
Earnings before income taxes	**243.5**	185.0	285.7
Provision for income taxes (Note 10)	**(84.8)**	(60.4)	(105.3)
Earnings from continuing operations	**158.7**	124.6	180.4
Loss from discontinued operations (Note 5)	**–**	(0.1)	(2.6)
Net earnings for the year	**$ 158.7**	$ 124.5	$ 177.8
Basic earnings per common share – continuing operations (Note 11)	**$ 2.65**	$ 2.47	$ 3.70
Basic earnings per common share	**$ 2.65**	$ 2.47	$ 3.64
Diluted earnings per common share – continuing operations	**$ 2.63**	$ 2.44	$ 3.63
Diluted earnings per common share	**$ 2.63**	$ 2.44	$ 3.57

> consolidated statements of retained earnings

For the years ended December 31 (millions)	**2006**	2005	2004
Retained earnings, beginning of the year	**$ 341.8**	$ 262.7	$ 110.5
Net earnings	**158.7**	124.5	177.8
Dividends on common shares	**(89.4)**	(45.4)	(25.0)
Dividends on preferred shares	**–**	–	(0.6)
Retained earnings, end of the year (Note 11)	**$ 411.1**	$ 341.8	$ 262.7

> consolidated cash flow statements

For the years ended December 31 (millions)		**2006**		2005		2004
Operating activities						
Earnings from continuing operations	**$**	**158.7**	$	124.6	$	180.4
Depreciation and amortization		**20.0**		19.2		18.6
Future income taxes		**3.9**		6.3		5.0
(Gain) loss on sale of fixed assets and assets held for sale		**(1.3)**		(2.0)		0.3
Stock-based compensation		**3.4**		1.5		0.9
Pension expense (funding) (Note 14)		**(6.2)**		–		–
Restructuring and debt redemption costs		**–**		–		5.1
Cash from operating activities before working capital		**178.5**		149.6		210.3
Changes in non-cash working capital items						
Accounts receivable		**30.3**		(2.4)		(122.8)
Inventories		**(188.2)**		76.5		(260.9)
Accounts payable and accrued liabilities		**(30.9)**		(32.2)		128.5
Current income taxes		**9.2**		(55.6)		54.7
Other		**(0.4)**		–		(2.1)
Change in non-cash working capital		**(180.0)**		(13.7)		(202.6)
Cash (used in) from operating activities		**(1.5)**		135.9		7.7
Financing activities						
Decrease in bank borrowing		**(2.1)**		(31.2)		(44.9)
Issue of common shares (Note 11)		**277.9**		4.4		54.4
Dividends		**(89.4)**		(45.4)		(25.6)
Deferred financing costs		**(1.1)**		(0.3)		(9.1)
Issuance of long-term debt		**–**		–		235.2
Repurchase of long-term debt		**–**		–		(184.7)
Redemption of preferred shares		**–**		–		(30.0)
Cash from (used in) financing activities		**185.3**		(72.5)		(4.7)
Investing activities						
Purchase of fixed assets		**(27.6)**		(26.5)		(25.4)
Proceeds on sale of fixed assets		**1.7**		1.6		0.8
Proceeds from assets held for sale and sale of businesses (Note 4)		**6.2**		5.9		3.7
Other		**(0.9)**		(4.4)		0.3
Cash used in investing activities		**(20.6)**		(23.4)		(20.6)
Discontinued operations						
Operating activities		**–**		–		(1.2)
Investing activities		**–**		6.5		0.4
Cash from (used in) discontinued operations		**–**		6.5		(0.8)
Effect of exchange rates on cash		**(0.4)**		–		–
Increase (decrease) in cash		**162.8**		46.5		(18.4)
Cash and cash equivalents, beginning of the year		**47.1**		0.6		19.0
Cash and cash equivalents, end of the year	**$**	**209.9**	$	47.1	$	0.6

1. Summary of Significant Accounting Policies

a) Basis of presentation

The consolidated financial statements include the accounts of Russel Metals Inc. and its subsidiary companies herein referred to as the Company. The reporting currency is Canadian dollars unless otherwise noted. All inter-company balances, transactions and profits have been eliminated.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

b) Cash and cash equivalents

Cash and cash equivalents includes demand deposits, bank term deposits, and investment-grade short-term investments with a maturity of less than three months at time of purchase. At December 31, 2006, short-term investments were $200.2 million (2005: $42.7 million). Cash and cash equivalents are recorded at cost, which approximates market value.

c) Inventories

Inventories are recorded at the lower of cost and net realizable value. Cost is determined on either an average cost basis or an actual cost basis depending on the business unit.

d) Property, plant, equipment and depreciation

Property, plant, equipment and leasehold improvements are recorded at cost. Depreciation is provided on a straight-line basis at rates that charge the original cost of such assets to operations over their estimated useful lives. The rates used are 20 to 40 years for buildings, 10 years for machinery and equipment, 2 to 5 years for computer equipment, and over the lease term for leasehold improvements. Depreciation expense was $18.4 million in 2006 (2005: $17.7 million; 2004: $17.3 million).

e) Deferred financing charges and amortization

Eligible costs incurred relating to financing are deferred and amortized on a straight-line basis over the period of the related financing. Deferred financing charges are recorded at cost less accumulated amortization. Amortization of deferred financing charges was $1.6 million in 2006 (2005: $1.5 million; 2004: $1.3 million).

f) Goodwill

Goodwill represents the excess purchase price paid on acquisitions over the value assigned to identifiable net assets acquired. The Company reviews goodwill for impairment annually and whenever facts and circumstances indicate that carrying amounts may not be recoverable. As part of the evaluation, the estimated future undiscounted cash flows associated with the underlying business operation are compared to the carrying amount of goodwill to determine if a write-down is required. If such an assessment indicates that the undiscounted future cash flows will not be recovered, the carrying amount is reduced to the estimated fair value (Note 4).

g) Pensions and other benefit plans

The cost of pension benefits earned by employees covered under defined benefit plans is determined using the projected benefit method prorated on service and is charged to expense as services are rendered. Actuarial gains and losses and past service costs are amortized on a straight-line basis over the estimated average remaining service lives of the employee groups utilizing the corridor approach. The corridor approach amortizes the excess of the net accumulated actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets. The cost of post-retirement benefits other than pensions is recognized on an accrual basis.

h) Income taxes

The Company uses the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the financial accounting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future income tax assets are recognized to the extent that their realization is more likely than not.

i) Foreign currency translation

The accounts of self-sustaining foreign subsidiaries are translated from U.S. dollars to Canadian dollars at the noon spot rate in effect at the balance sheet date, which was 1.1653 at December 31, 2006 (2005: 1.1659). Revenues and expenses are translated at the average rate of exchange during the year. For 2006, the U.S. dollar published average exchange rate was 1.1343 (2005: 1.2114; 2004: 1.3013). The resulting gains or losses are included in the cumulative translation adjustment line of shareholders' equity.

Exchange gains or losses on long-term debt denominated in foreign currencies not designated as a hedge are expensed as incurred. Exchange gains or losses on the translation of long-term debt denominated in a foreign currency designated as a hedge of the Company's net investment in foreign subsidiaries are included in the cumulative translation adjustment line of shareholders' equity.

j) Revenue recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, selling price is fixed and collection is reasonably assured. Revenue on certain sales within the energy tubular products segment, where the Company acts as an agent, is presented on a net basis. Freight and shipping billed to customers are included in revenue.

k) Stock-based compensation

The Company uses the fair value-based approach to account for stock-based compensation granted to employees subsequent to January 1, 2003. Compensation expense is recognized for stock options over their vesting period based on their estimated fair values on the date of grant with the related credit charged to contributed surplus except for employees who are eligible to retire during the vesting period (Note 2 a)). Fair value is determined by the Black-Scholes option-pricing model. Compensation expense is also recognized for deferred share units when issued with changes in the quoted market price from the issue date to the reporting period date being charged to compensation expense until exercised.

l) Earnings per share

Basic earnings per common share are calculated using the weighted daily average number of common shares outstanding. The weighted average number of common shares for 2006 was 59,887,382 (2005: 50,461,330; 2004: 48,671,915). Diluted earnings per share is calculated using the treasury stock method.

m) Derivative financial instruments

The Company uses foreign exchange contracts to manage foreign exchange risk on certain committed cash outflows, primarily inventory purchases. When the derivative instruments have been designated and are highly effective at offsetting risks, hedge accounting is applied. Hedge accounting requires that gains and losses on the hedge instrument are recognized through income in the same period or manner as the item being hedged. Realized and unrealized foreign exchange gains and losses not designated as a hedge are included in income. Derivatives are not entered into for speculative purposes and the use of derivative contracts is governed by documented risk management policies.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific firm commitments or forecasted transactions. The Company assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in the cash flows of hedged items.

n) Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. In particular, inventories, accounts receivable, asset retirement obligations, fair values, pension and benefit obligations, other contingencies, and assigned values on net assets acquired represent management's best estimates. Actual results could differ from these estimates.

2. Changes in Accounting Policies

a) On September 30, 2006, the Company adopted EIC-162, Stock-Based Compensation for Employees Eligible to Retire Before the Vesting Date. This standard requires that the compensation cost attributable to stock options be recognized over the period from grant date to the date the employee becomes eligible to retire. The impact of adopting this standard was an increase to the 2006 compensation expense of $0.9 million. The standard requires retroactive restatement of prior periods, and accordingly, income was reduced and contributed surplus was increased by $0.2 million for the year ended December 31, 2005. The adoption of this standard also resulted in a change to the diluted shares outstanding due to the restatement of the unamortized compensation expense for stock compensation (Note 11 g)).

b) On January 1, 2006, the Company adopted EIC-156, Accounting by a Vendor for Consideration Given to a Customer (including a Reseller of the Vendor's Products). This standard requires that the consideration given to a customer be recorded as a reduction of revenues, not as cost of sales or as an operating expense. The standard requires retroactive restatement of prior periods, and accordingly, revenues and cost of sales for the year ended December 31, 2005 were reduced by $1.2 million (2004: $1.1 million) but had no impact on net earnings.

c) Effective January 1, 2004, the Company adopted the new accounting guideline, AcG-13, Hedging Relationships, which establishes certain conditions when hedge accounting may be applied. The guideline sets out the requirements for the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting. The adoption of this standard did not have a material effect on the Company's results of operations, financial position or cash flows. The Company has applied this standard to the fixed for fixed cross currency swaps entered into on February 20, 2004, in order to hedge the last US$100 million of its US$175 million U.S. Senior Notes (Note 8). In addition, this standard has been applied to the Company's other hedging relationships, namely foreign exchange contracts used to manage certain committed cash flows and the hedge of the net investment in U.S. subsidiaries.

d) Effective January 1, 2004, the Company adopted the new CICA (Canadian Institute of Chartered Accountants) Handbook section 3110, Asset Retirement Obligations. This section established standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. The adoption of this standard did not have a material effect on the Company's results of operations, financial position or cash flows.

e) Effective January 1, 2004, the Company prospectively adopted the new CICA Handbook section 1100, Generally Accepted Accounting Principles (GAAP). This standard establishes what constitutes Canadian generally accepted accounting standards and provides guidance on the GAAP hierarchy. The adoption of this standard did not have a material effect on the Company's results of operations, financial position or cash flows.

f) Effective October 1, 2004, the Company prospectively adopted the new accounting guideline AcG-15, Variable Interest Entities. The adoption of this standard did not have a material effect on the Company's results of operations, financial position or cash flows.

3. Future Accounting Changes

During 2005, the CICA issued three new accounting standards: CICA Handbook section 1530, Comprehensive Income; CICA Handbook section 3855, Financial Instruments – Recognition and Measurement; and CICA Handbook section 3865, Hedges. These standards, which must be adopted together, are effective for fiscal years beginning on or after October 1, 2006. The Company is adopting these standards effective January 1, 2007. In accordance with the standards, prior periods will not be restated.

a) Comprehensive Income

This standard provides guidance on the presentation of comprehensive income, which is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income is comprised of net income and other comprehensive income (OCI). OCI includes certain gains and losses that are recognized outside of net income. The major components of the Company's OCI are the cumulative translation adjustment (Note 11) and the effective portion of cash flow hedges including the fixed for fixed cross currency swaps which are designated as a cash flow hedge of US$100 million of our Senior Notes. Our consolidated financial statements will include a new Statement of Comprehensive Income. The accumulated OCI, which includes the Company's cumulative translation adjustment, will be presented as a new category of Shareholders' Equity in our Consolidated Balance Sheets.

b) Financial Instruments – Recognition and Measurement

This standard provides guidance for recognizing and measuring financial assets, financial liabilities and non-financial derivatives which are to be classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities. Financial assets and financial liabilities classified as held-for-trading will be measured at fair value with gains and losses recognized in net income. Financial assets classified as held-to-maturity, loans and receivables, and financial liabilities not classified as held-for-sale will be measured at amortized cost using the effective interest method.

Derivative instruments, including embedded derivatives, must be recorded on the balance sheet at fair value. Changes in fair value will be recognized in net income, except for derivatives designated as cash flow hedges, for which the related fair value change will be recognized in OCI.

Available-for-sale financial assets will be measured at fair value. Unrealized gains and losses on available-for-sale financial assets and derivatives designated as cash flow hedges will be recorded through OCI.

The standard provides an accounting policy choice on the treatment of transactions costs. The Company's accounting policy for transaction costs will be to net them with the associated debt and to amortize them using the effective interest method.

c) Hedges

This standard replaces existing hedge accounting guidance in CICA Handbook section 1650, Foreign Currency Translation, and accounting guideline AcG-13, Hedging Relationships, and provides requirements for the designation, documentation and disclosure of qualifying hedge relationships. The Company's cash flow hedges on the first US$100 million of its US$175 million Senior Notes will be recorded at fair value on the balance sheet with gains and losses recorded through OCI until realized. The adoption of the hedging standard is not expected to have a material effect of the Company's results of operations or cash flows; however, the effective portion of the cash flow hedges will be recorded as a component of OCI.

d) Transitional Adjustment

The transitional adjustments relating to financial instruments, including embedded derivatives, will be recorded in opening retained earnings as at January 1, 2007. These adjustments will include (i) financial instruments classified as held-for-trading that were not previously recorded at fair value, and (ii) deferred gains and losses on discontinued hedging relationships that do not qualify for hedge accounting under the new standards.

Adjustments arising as a result of re-measuring hedging instruments designated as cash flow hedges are recognized in the opening balance of accumulated OCI.

4. Restructuring and Goodwill

a) Restructuring

Restructuring of the Company's metals service center segment's operations as a result of acquisitions is charged to income as incurred. Under certain conditions, restructuring relating to the acquired operation is included in the net assets acquired.

Restructuring charged to income is summarized as follows:

(millions)	**2006**	2005	2004
Gain on Assets Held for Sale	**$ (1.2)**	$ (2.9)	$ –
Impairment loss – Ontario branch	**–**	1.3	–
Ontario branch severance and other employee termination costs	**–**	0.5	–
Acier Leroux restructuring and unutilized acquisition	**–**	–	3.7
Restructuring	**$ (1.2)**	$ (1.1)	$ 3.7

During 2005, the Company announced the closure of its Milton, Ontario branch. The Company determined, based on a valuation, that the carrying amount of the property and equipment was greater than the fair value and recorded an impairment loss in 2005 of $1.3 million. On December 31, 2005, the Company vacated the property, and accordingly, classified its carrying value of $5.1 million as an Asset Held for Sale. On May 18, 2006, the Company sold the Milton, Ontario location for $6.2 million. The resulting gain of $1.2 million was recorded in restructuring. Previously, the Company provided for contractual termination costs of $0.5 million relating to the employees terminated at this location in 2005.

During 2004, the Company incurred a restructuring charge of $3.7 million related to the restructuring of the Russel Metals' locations as a result of its acquisition of Acier Leroux in July 2003. These costs primarily related to the restructuring of the Ontario region and ongoing costs associated with the Company's Lachine property which was closed on December 31, 2003 as part of the rationalization of operations due to the Acier Leroux acquisition and classified as an Asset Held for Sale. On May 2, 2005, the Company sold its Lachine property for net proceeds of $5.8 million. The resulting before tax gain of $2.9 million was recorded in restructuring.

The Company recorded restructuring expenses of $0.3 million in 2005, relating to the costs of the Lachine property prior to sale. Also in 2005, the Company recorded restructuring income of $0.3 million relating to costs accrued as part of the fair value of Acier Leroux net assets acquired that were not required. These costs primarily related to the resolution of matters relating to Poutrelles Delta (Note 5).

b) Goodwill impairment

The Company completed its annual goodwill impairment tests, using projected discounted cash flows during the fourth quarter of 2006 and 2005, resulting in no impairment charge.

5. Discontinued Operations and Divestitures

During 2005, the Company disposed of two operations acquired in 2003 as part of the Acier Leroux acquisition.

On May 10, 2005, the Company sold its investment in Armabec Inc., a metals service center, for book value less selling costs. In the second quarter of 2005, as a result of this divestiture, the Company classified Armabec Inc. as discontinued, and the revenue and results of operations for the period from January 1, 2005 to the date of sale and the comparative year ended December 31, 2004 were reclassified to discontinued operations accordingly.

On December 23, 2004, the Company received an offer pursuant to the Shareholders Agreement whereby the minority shareholders would purchase the Company's holdings of Poutrelles Delta Inc. For the year ended December 31, 2004, the Company classified Poutrelles Delta as discontinued and recorded a loss to fair value of $0.6 million. On February 23, 2005, the Company sold its investment in Poutrelles Delta, for $4.1 million in cash. The write-down to fair value at December 31, 2004 resulted in no additional gain or loss upon sale. The revenue and results of operations for Poutrelles Delta for 2005 and prior periods were reclassified as discontinued.

During 2004, the Company disposed of two asset groups acquired in 2003 with the Acier Leroux acquisition.

On May 14, 2004, the Company sold the inventory and certain fixed assets of the Dollard Steel operation for book value of $1.5 million, and on July 30, 2004, the Company sold the inventory and fixed assets of its Plattsburgh, New York operation for its book value of US$0.4 million. As part of the acquisition of Acier Leroux, the Company had adopted a formal plan to dispose of the Acier Leroux U.S. operations and classified them as discontinued, all of which were divested. The Company has certain residual obligations relating to these operations. At December 31, 2006, the remaining liability was $1.8 million (2005: $2.4 million).

During the year ended December 31, 2004, the Company incurred an additional charge of $3.2 million, net of tax, relating to long-term lease obligations and other environmental cleanup costs for operations classified as discontinued in 1995.

Basic and fully diluted loss per share from discontinued operations was $nil (2005: $nil; 2004: $0.06).

6. Property, Plant and Equipment

(millions)		**2006**		2005
	Cost	**Net**	Cost	Net
Land and buildings	**$ 144.0**	**$ 103.3**	$ 132.8	$ 96.5
Machinery and equipment	**207.8**	**76.2**	193.5	75.3
Leasehold improvements	**26.1**	**10.0**	25.6	10.0
	$ 377.9	**$ 189.5**	$ 351.9	$ 181.8

The Company has certain significant asset retirement obligations relating to the land lease for its Thunder Bay Terminal operations whose lease term expires in 2017. The landlord has the option to retain the facilities or to require the Company to remove them. In addition, the Company has certain end-of-lease obligations in six of its service center operations.

During the year ended December 31, 2006, the Company increased its probability-weighted undiscounted expected cash flow relating to its asset retirement obligations by $0.1 million (2005: $1.3 million) and the probability-weighted discounted expected cash flow by $nil (2005: $0.3 million) primarily as a result of an increase in forecasted costs. The probability range is 50% – 99% and the discount rate used was 9%. The asset retirement obligation, including applicable accretion at December 31, 2006, was $0.5 million (2005: $0.4 million) and the undiscounted expected cash flow relating to its asset retirement obligation was $1.6 million (2005: $1.5 million).

7. Revolving Credit Facilities

On October 6, 2006, the Company extended its credit facility for an additional one-year period to October 29, 2009. This facility was originally entered into with a syndicate of banks on October 29, 2004. This facility provides a line of credit to a maximum of $200 million, including letters of credit. This three-year facility provides for annual extensions. Borrowings under this facility are restricted by certain financial covenants which the Company was in compliance with at December 31, 2006. The obligations of the Company under this agreement are secured by a pledge of trade accounts receivable and inventories of a significant portion of the Company's operations. At December 31, 2006 and 2005, the Company had no borrowings and letters of credit of $54.8 million and $46.1 million, respectively. Deferred charges relating to the previous bank facility of $0.5 million were charged to income in 2004.

In addition, a U.S. subsidiary has its own credit facility. The maximum borrowing under this facility is US$50.0 million. At December 31, 2006 and 2005, this subsidiary had no borrowings and letters of credit of US$36.1 million and US$30.6 million, respectively.

8. Long-Term Debt

The long-term debt is comprised of the following:

(millions)		**2006**		2005
6.375% US$175 million Senior Notes due March 1, 2014	**$**	**203.9**	$	204.0

On February 20, 2004, the Company issued US$175 million Senior Notes due March 1, 2014, bearing interest at 6.375%. The proceeds of this issue were used to redeem US$95.5 million of the 10% Senior Notes due June 1, 2009, including a call premium for 1.0725; the $30 million 8% Subordinated Debentures due June 15, 2006; and the $30 million Class II preferred shares during the first quarter of 2004. The remaining US$20.1 million of 10% Senior Notes were redeemed on June 1, 2004, including a call premium of 1.05. The call premiums and deferred charges of $2.5 million relating to the redeemed debt were charged to income in 2004.

The Company entered into fixed for fixed cross currency swaps with major banks to manage the foreign currency exposure on the last US$100 million of the 6.375% Senior Notes. On the swaps, the Company receives U.S. denominated interest at 6.375% on a notional US$100 million and pays Canadian dollar interest at 7.12% on a notional $131.8 million. As part of the swaps, the Company exchanged US$100 million for $131.8 million on February 20, 2004 and will receive US$100 million for $131.8 million on March 1, 2014. Both the swap counterparties and the Company have the right to early terminate the swaps in the first quarter of 2009. On a monthly basis, the Senior Notes are recorded at month-end exchange rates, and the difference between the swap rate of $1.3180 and the month-end rate on the US$100 million relating to the swap is recorded separately in Other Assets or Other Accrued Liabilities.

The US$175 million Senior Notes are redeemable, in whole or in part, at the option of the Company on or after March 1, 2009 at 103.188% of the principal amount declining rateably to 100% of the principal amount on or after March 1, 2012. In addition, the Senior Notes are also redeemable, in whole, at the option of the Company at any time at 100% of the principal amount in the event of certain changes affecting Canadian withholding taxes. The Senior Notes contain certain restrictions on the payment of common share dividends in excess of $0.08 per share per quarter. On May 17, 2006, the Company completed a consent solicitation with its bondholders to amend the provisions of the indenture for its Senior Notes. In return for the payment of a consent fee of $5.00 per $1,000, the Company's reporting obligations were amended to require the Company to file annual reports, quarterly reports and other continuous disclosure documents only with Canadian provincial regulators. The total consent fee of US$0.8 million has been recorded as a deferred charge and is being amortized on a straight-line basis over the remaining term of the debt. Other costs relating to the consent solicitation were expensed in the second quarter. The Company was in compliance with all debt covenants at December 31, 2006.

9. Interest Expense

(millions)		**2006**		2005		2004
Interest on long-term debt	**$**	**14.8**	$	15.2	$	16.9
Other interest expense		**0.4**		2.3		3.1
Other interest income		**(8.5)**		–		–
	$	**6.7**	$	17.5	$	20.0

Total interest paid by the Company in 2006 was $14.8 million (2005: $17.7 million; 2004: $20.1 million).

10. Income taxes

a) The non-current future income tax balances consist of:

(millions)		**2006**		2005
Future income tax assets				
Tax benefits of loss carryforwards	**$**	**0.2**	$	0.8
Plant and equipment		**0.4**		(0.5)
Pensions and benefits		**0.9**		1.0
Other timing		**0.2**		1.6
Gross future income tax assets		**1.7**		2.9
Valuation allowance		**(1.3)**		(1.9)
Total future income tax assets		**0.4**		1.0
Future income tax liabilities				
Plant and equipment		**(7.7)**		(6.2)
Pensions and benefits		**(0.1)**		2.1
Other timing		**(0.8)**		1.1
Items charged to equity		**1.8**		(2.3)
Total future income tax liabilities		**(6.8)**		(5.3)
Net future income taxes	**$**	**(6.4)**	$	(4.3)

b) The Company's effective income tax rate is derived as follows:

	2006	2005	2004
Average combined statutory rate	**34.5%**	35.5%	36.0%
Rate difference of U.S. companies	**1.1%**	0.7%	0.9%
Recognition of previously unrecorded tax benefits	**(0.5%)**	(1.3%)	–
Statutory tax rate changes	**(0.2%)**	–	–
Stock compensation not deductible	**0.5%**	0.3%	–
Other	**(0.6%)**	(2.6%)	(0.1%)
Average effective tax rate	**34.8%**	32.6%	36.8%

c) The details of the income tax provision are as follows:

(millions)		**2006**		2005		2004
Current provision	**$**	**80.9**	$	54.1	$	100.2
Future provision		**4.3**		6.3		5.1
Statutory rate adjustments		**(0.4)**		–		–
	$	**84.8**	$	60.4	$	105.3

d) Income taxes paid in 2006 were $71.0 million (2005: $110.4 million; 2004: $47.3 million).

e) The Company has Canadian net operating losses carried forward for tax purposes, for which a valuation allowance has been recorded, that expire as follows: 2007: $0.3 million; 2008: $0.5 million and thereafter: $0.3 million.

11. Shareholders' Equity

a) The components of shareholders' equity are as follows:

(millions)		**2006**		2005
Common shares	**$**	**491.2**	$	208.1
Retained earnings		**411.1**		341.8
Contributed surplus (related to stock-based compensation)		**3.5**		1.3
Cumulative translation adjustment		**(11.2)**		(12.5)
	$	**894.6**	$	538.7

b) At December 31, 2006, the authorized share capital of the Company consists of:

(i) an unlimited number of common shares without nominal or par value;

(ii) an unlimited number of Class I preferred shares without nominal or par value, issuable in series; and

(iii) an unlimited number of Class II preferred shares without nominal or par value, issuable in series.

The directors have the authority to issue the Class I and Class II preferred shares in series and fix the designation, rights, privileges and conditions to be attached to each series, except that the Class I shares shall be entitled to preference over the Class II shares with respect to the payment of dividends and the distribution of assets in the event of liquidation, dissolution or winding-up of the Company.

The Company redeemed 1,200,000 cumulative, redeemable Class II preferred shares on March 22, 2004 (Note 8).

c) The number of common shares issued and outstanding at December 31 was as follows:

	Number of Shares		Amount (millions)
Balance, December 31, 2004	49,887,659	$	203.1
Stock options exercised	768,350		5.0
Balance, December 31, 2005	50,656,009		208.1
Common share issue	11,000,000		275.3
Stock options exercised	710,833		7.8
Balance, December 31, 2006	**62,366,842**	**$**	**491.2**

On March 16, 2006, the Company closed its public offering of 10,000,000 common shares at a price of $25.75 per share and received net proceeds of $246.7 million. The Company granted the underwriters an option, exercisable, in whole or in part, and at any time up to 30 days following March 16, 2006 to purchase up to an additional 1,000,000 common shares on the same terms as the issue. These additional shares were issued on March 30, 2006 for net proceeds of $24.7 million. In addition to the underwriters' fees, expenses of $0.5 million have also been netted from the proceeds of this offering and the tax benefits of $3.9 million associated with the share issue costs have been recorded in share capital.

d) The Company has a shareholder-approved share option plan, the purpose of which is to provide the employees of the Company and its subsidiaries with the opportunity to participate in the growth and development of the Company. The number of common shares that may be issued under the share option plan is 5% of the current issued and outstanding common shares. The options are exercisable on a cumulative basis to the extent of 20% per year of total options granted, except that under certain specified conditions the options become exercisable immediately. The consideration paid by employees for purchase of common shares is added to share capital.

The following is a continuity of options outstanding:

	Number of Options		Weighted Average Exercise Price	
	2006	2005	**2006**	2005
Balance, beginning of the year	**1,869,466**	1,793,816	**$ 11.12**	$ 6.52
Granted	**865,000**	856,000	**25.88**	15.85
Exercised	**(710,833)**	(768,350)	**9.23**	5.71
Expired and forfeited	**(9,600)**	(12,000)	**19.20**	6.75
Balance, end of the year	**2,014,033**	1,869,466	**$ 18.09**	$ 11.12
Exercisable	**326,233**	275,666	**$ 20.29**	$ 11.87

The outstanding options have an exercise price range as follows:

(number of options)	**2006**	2005
$25.75 – $26.30	**858,500**	–
$15.85	**633,600**	852,800
$5.50 – $9.15	**371,400**	553,600
$3.00 – $5.49	**150,533**	463,066
Options outstanding	**2,014,033**	1,869,466

The options expire in the years 2007 to 2016 and have a weighted average remaining contractual life of 7.5 years (2005: 8.2 years).

The Black-Scholes option-pricing model assumptions used to compute compensation expense under the fair value-based method are as follows:

	2006	2005	2004
Dividend yield	**5%**	5%	5%
Expected volatility	**29%**	25%	29%
Expected life	**5 yrs**	7 yrs	7 yrs
Risk-free rate of return	**5%**	5%	5%
Weighted average fair value of options granted	**$ 5.05**	$ 2.93	$ 1.89

e) The Company has established a Deferred Share Unit (DSU) plan for its directors. A DSU entitles the holder to receive, upon redemption, a cash payment equivalent to the market value of a common share at the redemption date. DSUs are credited to the director accounts on a quarterly basis and vest immediately. At December 31, 2006, there were 20,981 DSUs outstanding (2005: 18,024).

f) Total compensation cost for stock-based compensation is as follows:

(millions)	**2006**	2005	2004
Stock options	**$ 3.4**	$ 1.5	$ 0.8
Deferred share units	**0.2**	0.3	0.1
	$ 3.6	$ 1.8	$ 0.9

g) Diluted share amounts as restated were computed as follows:

(number of shares)	**2006**	2005	2004
Weighted average shares outstanding	**59,887,382**	50,461,330	48,671,915
Dilution impact of stock options	**562,688**	591,797	912,714
Diluted weighted average shares outstanding	**60,450,070**	51,053,127	49,584,629

12. Financial Instruments

a) Fair value

The fair value of long-term debt as at December 31, 2006 and 2005 is estimated based on the last quoted trade price, where it exists, or on the current rates available to the Company for similar debt of the same remaining maturities. The fair value of the Company's debt at December 31, 2006 was $194.5 million (2005: $197.9 million).

Concurrent with the issue of the Senior Notes, the Company entered into fixed for fixed cross currency swaps with major banks (Note 8). At December 31, 2006, the fair value of the liability relating to these swaps was $29.4 million (2005: $29.8 million). The change in the spot foreign exchange rate on the swaps of $15.4 million (2005: $15.3 million) is recorded as an Other Accrued Liability. At December 31, 2006, the Company had forward exchange contracts outstanding (Note 12 d)) whose fair value was $0.8 million. At December 31, 2005, the fair value of forward contracts approximated their contract value.

As at December 31, 2006 and 2005, the estimated fair value of other financial assets, liabilities and off-balance sheet instruments approximates their carrying value.

b) Credit risk

The Company, in the normal course of business, is exposed to credit risk relating to accounts receivable from its customers. This risk is mitigated by the fact that its customer base is geographically diverse and in different industries. The Company is also exposed to credit risk from the potential default by any of its counterparties on its foreign exchange forward contracts and the fixed for fixed cross currency swaps. The Company mitigates this risk by entering into forward contracts and swaps with members of the credit facility syndicate.

c) Interest rate risk

The Company is not exposed to significant interest rate risk. The Company's long-term debt is at fixed rates. The Company's bank debt, if any, that is used to finance working capital, which is short-term in nature, is at floating interest rates.

d) Foreign exchange risk

The Company uses foreign exchange contracts with maturities of less than a year to manage foreign exchange risk on certain future committed cash outflows. As at December 31, 2006, the Company had outstanding forward foreign exchange contracts in the amounts of US$16.5 million and €nil, maturing in the first half of 2007 (2005: US$58.7 million and €2.9 million). The foreign exchange gain on U.S. denominated financial assets and liabilities included in 2006 operating earnings from continuing operations was $1.7 million (2005: $1.6 million; 2004: $2.3 million).

The Company has designated US$75 million of the Senior Notes as a hedge of its net investment in foreign subsidiaries.

13. Segmented Information

The Company conducts business primarily in three metals business segments.

i) ***Metals service centers***
The Company's network of metals service centers provides processing and distribution services on a broad line of metal products in a wide range of sizes, shapes and specifications, including carbon hot rolled and cold finished steel, pipe and tubular products, stainless steel and aluminum. The Company services all major geographic regions of Canada and certain regions in the Midwest region of the United States.

ii) ***Energy tubular products***
The Company's energy tubular products operations distribute oil country tubular products, line pipe, tubes, valves and fittings, primarily to the energy sector in western Canada and the western United States.

iii) ***Steel distributors***
The Company's steel distributors act as master distributors selling steel to customers in large volumes, mainly on an "as is" basis. The steel distributors source their steel domestically and offshore.

The Company has segmented its operations on the basis of type of customer, management reporting and geographic segments in which it operates. The inter-segment sales from steel distributors to metals service centers were $85.1 million (2005: $57.4 million; 2004: $54.4 million). These sales, which are at market rates, are eliminated in the following table.

a) Results by business segment:

(millions)	**2006**	2005	2004
Segment Revenues			
Metals service centers	**$ 1,507.9**	$ 1,538.5	$ 1,530.9
Energy tubular products	**614.3**	595.2	395.3
Steel distributors	**559.4**	468.7	471.2
	2,681.6	2,602.4	2,397.4
Other	**10.5**	11.7	14.0
	$ 2,692.1	$ 2,614.1	$ 2,411.4
Segment Operating Profits			
Metals service centers	**$ 126.4**	$ 115.2	$ 209.4
Energy tubular products	**62.2**	54.0	47.2
Steel distributors	**76.7**	46.6	78.2
	265.3	215.8	334.8
Other income	**1.9**	2.4	4.6
Corporate expenses	**(18.2)**	(16.8)	(16.3)
	$ 249.0	$ 201.4	$ 323.1
Capital Expenditures			
Metals service centers	**$ 24.4**	$ 23.6	$ 24.4
Energy tubular products	**2.8**	1.5	0.8
Steel distributors	**0.3**	0.2	–
Other	**0.1**	1.2	0.2
	$ 27.6	$ 26.5	$ 25.4
Depreciation Expense			
Metals service centers	**$ 15.8**	$ 15.1	$ 14.8
Energy tubular products	**1.1**	1.0	1.1
Steel distributors	**0.4**	0.4	0.5
Other	**1.1**	1.2	0.9
	$ 18.4	$ 17.7	$ 17.3
Identifiable Assets			
Metals service centers	**$ 618.7**	$ 583.8	$ 662.4
Energy tubular products	**359.3**	281.0	228.3
Steel distributors	**195.3**	138.1	192.4
Identifiable assets by segment	**1,173.3**	1,002.9	1,083.1
Assets not included in segments			
Cash	**209.9**	47.1	0.6
Income tax assets	**2.5**	1.3	7.6
Deferred financing charges	**6.8**	7.3	8.4
Other assets	**3.2**	2.8	2.6
Corporate and other operating assets	**26.5**	33.8	44.2
Total assets	**$ 1,422.2**	$ 1,095.2	$ 1,146.5

b) Results by geographic segment:

(millions)		**2006**		2005		2004
Segment Revenues						
Canada	**$**	**1,999.8**	$	1,983.8	$	1,769.2
United States		**681.8**		618.6		628.2
	$	**2,681.6**	$	2,602.4	$	2,397.4
Segment Operating Profits						
Canada	**$**	**190.8**	$	161.3	$	232.5
United States		**74.5**		54.5		102.3
	$	**265.3**	$	215.8	$	334.8
Identifiable Assets						
Canada	**$**	**946.4**	$	839.4	$	903.0
United States		**226.9**		163.5		180.1
	$	**1,173.3**	$	1,002.9	$	1,083.1

14. Pensions and Benefits

a) The Company maintains defined benefit pension plans, post-retirement benefit plans and defined contribution pension plans in Canada and 401(k) defined contribution pension plans in the United States. Actuarial valuations are performed on defined benefit plans every three years or earlier if required. The most recent valuations for the Company's defined benefit pension plans are as follows:

Number of Plans	Valuation Date
3	January 1, 2004
1	November 1, 2004
1	January 1, 2005
2	December 31, 2005
1	January 1, 2006

All of the Company's pension plans had a measurement date of December 31, 2006.

The components of the Company's pension and benefit expense include the following:

(millions)		**2006**		2005		2004
Defined benefit pension plans						
Benefits earned during the year	**$**	**2.3**	$	1.8	$	1.5
Interest cost on benefit obligation		**4.4**		4.5		4.2
Expected return on plan assets		**(4.8)**		(4.2)		(3.9)
Curtailment loss		**–**		–		0.1
Settlement loss		**–**		–		0.2
Other		**0.7**		0.3		0.3
		2.6		2.4		2.4
Post-retirement benefits		**0.4**		0.4		–
Defined contribution plans paid during the year		**0.6**		0.8		0.8
		3.6		3.6		3.2
Related to discontinued operations		**(0.2)**		(0.3)		(0.2)
Pension and benefit expense	**$**	**3.4**	$	3.3	$	3.0

The actuarial determinations were based on the following assumptions in each year:

	2006	2005	2004
Assumed discount rate – year end	**5.0%**	5.0%	6.0%
Expected long-term rate of return on plan assets	**7.0%**	7.0%	7.0%
Rate of increase in future compensation	**4.0%**	4.0%	4.0%
Rate of increase in future government benefits	**3.5%**	3.5%	3.5%

The health care cost trend rates used were 5% for dental and 10% (2005: 10%; 2004: 8%) graded out for medical, which is reduced 0.5% per year until 5% and 5% thereafter. A 1% change in trend rates would result in either an increase in the accrued benefit obligation for post-retirement benefits of $0.8 million or a decrease of $0.7 million and either an increase in net periodic cost of $38,000 or a decrease of $31,000.

b) The following information pertains to the Company's defined benefit pension and other benefit plans, excluding those which are in the process of being wound up.

	Pension Plans		Other Benefit Plans	
(millions)	**2006**	2005	**2006**	2005
Reconciliation of accrued benefit obligation				
Balance, beginning of the year	**$ 87.9**	$ 74.2	**$ 6.9**	$ 6.4
Current service cost	**2.3**	1.8	**–**	–
Participant contribution	**0.3**	0.3	**–**	–
Interest cost	**4.4**	4.5	**0.3**	0.4
Benefits paid	**(4.1)**	(5.4)	**(0.4)**	(0.4)
Plan amendments	**–**	0.6	**–**	–
Actuarial (gain) loss	**(0.2)**	11.9	**–**	0.5
Balance, end of the year	**$ 90.6**	$ 87.9	**$ 6.8**	$ 6.9
Reconciliation of fair value of plan assets				
Balance, beginning of the year	**$ 66.3**	$ 59.9	**$ –**	$ –
Actual return of plan assets	**6.7**	8.0	**–**	–
Employer contributions	**8.9**	3.5	**0.4**	0.4
Employee contributions	**0.3**	0.3	**–**	–
Benefits paid	**(4.1)**	(5.4)	**(0.4)**	(0.4)
Balance, end of the year	**$ 78.1**	$ 66.3	**$ –**	$ –
Unamortized amounts				
Funded status – (deficit)	**$ (12.5)**	$ (21.6)	**$ (6.8)**	$ (6.9)
Unrecognized prior service cost	**0.8**	0.9	**–**	–
Unamortized net actuarial loss	**14.8**	17.5	**1.1**	1.2
Accrued benefit asset (liability)	**$ 3.1**	$ (3.2)	**$ (5.7)**	$ (5.7)

As at December 31, 2006 and 2005, all the plans in the above table had an unfunded obligation. In the first quarter of 2006, the Company contributed $7.6 million, which represented the minimum required annual contributions and $4.1 million for prior service costs.

The other benefit plans represent obligations to retired employees of sold or closed businesses. No active employees are entitled to post-retirement benefits.

(millions)		**2006**		2005
Defined contribution plans				
Fair value of plan assets				
Canadian plans	**$**	**6.3**	$	6.5
401(k) U.S. plans		**23.6**		22.9
	$	**29.9**	$	29.4

The Company has a number of plans in the process of being wound up that relate to previously discontinued operations with no further benefit obligation. The resolution of the surplus may result in sharing arrangements with employees of those operations. The fair value of the plan assets and surplus at December 31, 2006 is $2.0 million (2005: $2.8 million).

c) As at December 31, 2006, approximately 40% of all pension plan assets were invested in equities, 40% in fixed income securities, and 20% in cash and cash equivalents. The expected return on plan assets is based on the fair value of plan assets. Management endeavours to have an asset mix of approximately 55% in equities, 40% in fixed income securities and 5% in cash and cash equivalents. The investment policy allows up to 30% in cash and cash equivalents. The volatility of the markets has caused management to invest a correspondingly greater percentage of the pension plan assets in cash and cash equivalents. The plan assets are not invested in either derivatives or real estate assets.

The expected annual benefits to be paid from the plans are as follows:

(millions)		Pension Plans		Other Benefit Plans		Total
2007	$	3.5	$	0.4	$	3.9
2008		3.6		0.4		4.0
2009		3.8		0.4		4.2
2010		4.1		0.4		4.5
2011		4.2		0.5		4.7
2012 – 2016		26.7		2.5		29.2

As a result of a recent court decision, the Company may be subject to a surplus sharing arrangement on one of its pension plans as a result of a partial plan windup. The timing and the amount of surplus subject to sharing is currently being reviewed by the Company.

The elements of defined benefit costs recognized in the year are as follows:

		2006		2005
Current service costs	**$**	**2.3**	$	1.8
Interest on accrued benefit obligation		**4.8**		4.8
Actual return on assets		**(6.7)**		(8.0)
Actuarial (gain) loss on accrued benefit obligation		**(0.2)**		12.4
Prior service costs		**–**		0.6
Elements of future benefit costs		**0.2**		11.6
Adjustments to recognize the long-term nature of employee benefit costs:				
Difference between expected and actual return on assets		**1.9**		3.8
Difference between actuarial losses recognized and actuarial losses incurred		**0.8**		(12.1)
Difference between prior service costs recognized and prior service costs incurred		**0.1**		(0.5)
Defined benefit cost recognized	**$**	**3.0**	$	2.8

15. Contingencies, Guarantees and Commitments

a) The Company and certain of its subsidiaries have been named defendants in a number of legal actions. Although the outcome of these claims cannot be determined, management intends to defend all claims and has recorded provisions based on its best estimate of the potential losses. In the opinion of management, the resolution of these matters is not expected to have a materially adverse effect on the Company's financial position, cash flows or operations.

b) The Company and its subsidiary companies have operating lease commitments, with varying terms, requiring approximate annual payments as follows: 2007: $10.8 million; 2008: $9.0 million; 2009: $8.5 million; 2010: $7.8 million; 2011: $6.1 million; 2012 and beyond: $11.9 million. Rental expense on operating leases was as follows: 2006: $11.8 million; 2005: $11.1 million; and 2004: $13.6 million.

c) The Company is incurring site cleanup and restoration costs related to properties not utilized in current operations. Remedial actions are currently underway at three sites. The estimated costs of these cleanups have been provided for based on management's best estimates. Additional costs may be incurred at these or other sites as site cleanup and restoration progress, but the amounts cannot be quantified at this time.

d) The Company has also entered into other agreements that provide indemnifications to counterparties in certain transactions including underwriting agreements. These indemnifications generally require the Company to indemnify the counterparties for costs incurred as a result of losses from litigation that may be suffered by counterparties arising from those transactions. The Company does not expect to make a payment on these indemnifications and, accordingly, no liability has been accrued.

Operating under the name Russel Metals, unless otherwise noted.

CANADA

BRITISH COLUMBIA

Operating under the name A.J. Forsyth throughout BC

Delta (Vancouver) – Regional Office
830 Carlisle Road, V3M 5P4
Tel: (604) 525-0544

Campbell River
2710 Vigar Road, V9W 6A3
Tel: (250) 287-8841

Fort Nelson
4850 44th Avenue, V0C 1R0
Tel: (250) 774-7553

Fort St. John
Mile 49 1/2 Alaska Highway, V1J 4M6
Tel: (250) 785-5641

Kelowna
8955 Grigg Road, V4V 2N5
Tel: (250) 766-6050

Kitimat
815 Enterprise Avenue, V8C 2P1
Tel: (250) 632-4702

Nanaimo
1950 East Wellington Road, V9S 5V2
Tel: (250) 753-1555

Prince George
1154 Pacific Street, V2N 5S3
Tel: (250) 563-1274

990 Industrial Way, V2N 5S1
Tel: (250) 563-1274

ALBERTA

Calgary
5724 40th Street SE, T2C 2A1
Tel: (403) 279-6600

Edmonton
7016 99th Street NW, T6E 3R3
Tel: (780) 439-2051

5730 72A Avenue NW, T6B 3L1
(Specializing in plate processing)
Tel: (780) 439-2051

2471 76th Avenue NW, T6P 1P6
(Specializing in non-ferrous sales)
Tel: (780) 440-0779

Grande Prairie
11035 89th Avenue, T8V 5B9
Tel: (780) 539-3193

Red Deer
6724 Golden West Avenue, T4P 1A8
Tel: (403) 346-2096

SASKATCHEWAN

Regina
445 1st Avenue E, S4N 4Z3
Tel: (306) 721-6411

475 1st Avenue E, S4N 4Z3
Tel: (306) 721-9355

Saskatoon
922 51st Street E, S7K 5C7
Tel: (306) 931-3338

MANITOBA

Winnipeg
1359 St. James Street, R3H 0K9
Tel: (204) 772-0321

1510 Clarence Avenue, R3T 1T6
Tel: (204) 475-8584

ONTARIO

Mississauga (Toronto) – Regional Office
1900 Minnesota Court, Suite 210, L5N 3C9
(Ontario general line sales)
Tel: (800) 268-0750

Aberfoyle (Guelph)
24 Nicholas Beaver Road, N1H 6H9
(Specializing in plate processing)
Tel: (519) 767-3800

Burlington
Milspec Industries
5036 South Service Road, L7L 5Y7
(Specializing in strapping)
Tel: (905) 333-0646

Cambridge
15 Cherry Blossom Road, N3H 4R7
Tel: (519) 650-1666

Hamilton
175 Shaw Street, L8N 3S2
(Specializing in non-ferrous sales)
Tel: (905) 522-5930
(Specializing in chain)
Tel: (905) 522-1130

Kingston
191 Dalton Avenue, K7K 6C2
Tel: (613) 546-1281

London
685 Hale Street, N5W 1J1
Tel: (519) 451-1140

Oldcastle (Windsor)
4051 Delduca Drive, N0R 1L0
Tel: (519) 737-1549

Ottawa
2420 Stevenage Drive, K1G 3W3
Tel: (613) 738-2961

Port Robinson
York – Ennis
200 South Street North, L0S 1K0
Tel: (905) 384-9794

Stoney Creek (Hamilton)
Russel Metals – B&T Steel
1052 South Service Road, L8E 6G3
(Specializing in flat rolled)
Tel: (905) 643-3008

McCabe Steel
687 Arvin Avenue, L8E 5R2
Tel: (905) 643-8284

Thunder Bay
620 Norah Crescent, P7C 5V8
Tel: (807) 622-8898

QUEBEC

Boucherville – Regional Office
Acier Leroux
1331, rue Graham-Bell, J4B 6A1
Tel: (450) 641-4360

Acier Richler
1330, rue Graham-Bell, J4B 6H5
(Specializing in non-ferrous sales)
Tel: (450) 449-5112

Amos
Acier Leroux
1675, route de l'Aéroport, J9T 3A8
Tel: (819) 732-8381

Baie-Comeau
Acier Leroux
55, avenue William-Dobell, G4Z 1T8
Tel: (418) 296-8626

Chicoutimi
Acier Leroux
2149, rue de la Fonderie, G7H 8C1
Tel: (418) 545-8881

Jonquière
Métaux Russel
2420, rue Bauman, G7S 4S4
Tel: (418) 548-3103

Quebec
Acier Loubier
5225, rue John Molson, G1X 3X4
Tel: (418) 656-9911

Rimouski
Acier Leroux
221, rue des Négociants, G5M 1B7
Tel: (418) 724-4937

Saint-Augustin-de-Desmaures
Acier Leroux
167, rue de Rotterdam, G3A 2K2
Tel: (418) 878-5737

Sept-Îles
Acier Leroux
533, boulevard Laure Est, G4R 4K2
Tel: (418) 962-6374

Terrebonne
Acier Leroux
1025, boulevard des Entreprises, J6Y 1V2
(Specializing in structurals)
Tel: (450) 622-2060

Thetford Mines
Mégantic Métal
1400, boulevard Frontenac Est, G6G 5R9
Tel: (418) 338-3188

NEW BRUNSWICK

Edmundston
25, rue Richards, E3V 4H4
Tel: (506) 739-9561

Sackville
141 Crescent Street, E4L 3V2
Tel: (506) 364-1234

Saint John
37 McIlveen Drive, McAllister Industrial Park, E2L 4B3
Tel: (506) 635-0005

NOVA SCOTIA

Halifax – Regional Office
28 Lakeside Park Drive, B3T 1A3
Tel: (902) 876-7861

NEWFOUNDLAND

Mount Pearl
11 Panther Place, Donovans Industrial Estates, A1N 5B7
Tel: (709) 364-3300

UNITED STATES

Russel Metals Williams Bahcall
Appleton, Wisconsin
975 North Meade Street, 54912 – 1054
Tel: (920) 734-9271

Green Bay, Wisconsin
895 Hinkle Street, 54303
Tel: (920) 497-1020

Milwaukee, Wisconsin
999 West Armour Avenue, 53221
Tel: (414) 481-7100

Baldwin International
Solon, Ohio
30403 Bruce Industrial Parkway, 44139
Tel: (440) 248-9500

> energy tubular products directory

CANADA

Comco Pipe and Supply Company
Edmonton, Alberta
5910 17th Street NW, T6P 1S5
Tel: (780) 440-2000

Calgary, Alberta
9307 48th Street SE, T2C 2R1
Tel: (403) 203-0766

Stonewall, Manitoba
116 4th Street E, R0C 2Z0
Tel: (204) 467-8797

Guelph, Ontario
Kerr Industrial Park, N1H 6H9
Tel: (519) 763-1114

Sarnia, Ontario
1018 Prescot Drive
N7T 7H3
Tel: (519) 332-6666

Fedmet Tubulars
Calgary, Alberta
700 9th Avenue SW,
Suite 2200, T2P 3V4
Tel: (403) 237-0955

Triumph Tubular & Supply
Calgary, Alberta
441 5th Avenue SW,
Suite 875, T2P 2V1
Tel: (403) 262-3777

UNITED STATES

Pioneer Pipe
Denver, Colorado
1660 Lincoln Street,
Suite 2300, 80264
Tel: (303) 289-3201

Aurora, Colorado
2401 Picadilly Road, 80019
Tel: (303) 307-9021

Lindon, Utah (Provo)
1610 West 200 South, 84042
Tel: (801) 224-8739

Houston, Texas
2203 Timberloch Place,
Suite 125-1,
The Woodlands, 77380
Tel: (281) 292-2875

Spartan Steel Products
Evergreen, Colorado
2942 Evergreen Parkway,
Suite 207, 80439
Tel: (303) 670-9048

> steel distributors directory

CANADA

Wirth Steel
Montreal, Quebec
1 Westmount Square,
Suite 200, H3Z 2P9
Tel: (514) 939-5555

Burnaby, British Columbia
4603 Kingsway,
Suite 308, V5H 4M4
Tel: (604) 436-1741

UNITED STATES

Sunbelt Group L.P.
Houston, Texas
1990 Post Oak Boulevard,
Suite 950, 77056-3817
Tel: (713) 840-0550

Overland Park, Kansas
8717 W. 110th Street,
Suite 240, 66210
Tel: (913) 491-6660

Arrow Steel Processors
Houston, Texas
8710 Clinton Drive, 77029
Tel: (713) 673-0666

> other

Thunder Bay Terminals Ltd.
Thunder Bay, Ontario
Station F, McKellar Island,
P7C 5J7, Canada
Tel: (807) 625-7800

Book value per share
Equity value divided by ending shares outstanding.

Debt as % of capitalization
Total net interest bearing debt excluding cash on hand divided by common shareholders' equity plus interest bearing debt excluding cash on hand.

Debt to EBITDA
Total interest bearing debt excluding cash on hand divided by EBITDA.

Dividend per share
The December 15th quarterly dividend annualized.

Dividend yield
The dividend per share divided by the year end common share price.

EBIT
Earnings from continuing operations before deduction of interest and income taxes.

EBITDA
Earnings from continuing operations before deduction of interest, income taxes, depreciation and amortization.

Earnings multiple
Period ending common share price divided by basic earnings per common share.

Free cash flow
Cash from operating activities before change in working capital less capital expenditures plus proceeds on sale of assets.

Market capitalization
Outstanding common shares times market price of a common share at December 31.

Return on capital employed
EBIT over net assets employed.

Head Office

1900 Minnesota Court, Suite 210, Mississauga, Ontario, Canada, L5N 3C9
Main Tel: (905) 819-7777 Fax: (905) 819-7409 Investor Relations: (905) 816-5178
E-mail: info@russelmetals.com Internet: www.russelmetals.com

Shareholder Information

Stock Symbol:
The Toronto Stock Exchange – RUS

Transfer Agent and Registrar

CIBC Mellon Trust Company
P.O. Box 7010, Adelaide Street Postal Stn.,
Toronto, Ontario, Canada, M5G 2W9
Answer line: Toronto (416) 643-5500
Toll free: 1-800-387-0825
E-mail: inquiries@cibcmellon.ca Internet: www.cibcmellon.ca

Board of Directors

Alain Benedetti
Corporate Director

James F. Dinning
Chairman of the Board,
Western Financial Group Inc.

Carl R. Fiora
Corporate Director,
steel industry executive

Anthony F. Griffiths
Corporate Director,
Chairman of the Board,
Russel Metals Inc.

Robbert Hartog
President,
Robhar Investments Ltd.

Lise Lachapelle
Corporate Director

John W. Robinson
Corporate Director,
steel industry executive

Edward M. Siegel, Jr.
President and Chief Executive Officer,
Russel Metals Inc.

Officers

Anthony F. Griffiths
Chairman of the Board
Toronto

Edward M. Siegel, Jr.
President and
Chief Executive Officer
Mississauga

Brian R. Hedges
Executive Vice President
and Chief Financial Officer
Mississauga

Marion E. Britton
Vice President, Chief Accounting
Officer and Assistant Secretary
Mississauga

Lesley M.S. Coleman
Vice President and Controller
Mississauga

William M. O'Reilly
Secretary
Davies Ward Phillips & Vineberg, LLP
Toronto

Elaine G. Toomey
Assistant Secretary
Mississauga

Management Team

Edward M. Siegel, Jr.
President and
Chief Executive Officer

Brian R. Hedges
Executive Vice President and
Chief Financial Officer

Marion E. Britton
Vice President,
Chief Accounting Officer and
Assistant Secretary

David J. Halcrow
Vice President, Purchasing and
Inventory Management

Maureen A. Kelly
Vice President, Information
Systems

Corporate Governance

Detailed disclosure concerning the Company's governance practices may be found in the Management Proxy Circular.

Russel Metals Inc.

metals service centers

Operating as:

- Russel Metals
- Métaux Russel
- A.J. Forsyth
- Acier Leroux
- Acier Loubier
- Acier Richler
- B&T Steel
- Leroux Steel
- Mégantic Métal
- McCabe Steel
- York-Ennis
- Russel Metals Williams Bahcall
- Baldwin International

energy tubular products

Operating as:

- Comco Pipe and Supply Company
- Fedmet Tubulars
- Triumph Tubular & Supply
- Pioneer Pipe
- Spartan Steel Products

steel distributors

Operating as:

- Wirth Steel
- Sunbelt Group
- Arrow Steel

www.russelmetals.com