# MANAGEMENT'S DISCUSSION & ANALYSIS

## Three-month period ended March 31, 2020 compared with the three-month period ended March 31, 2019

The following is Stella-Jones Inc.'s management discussion and analysis ("MD&A"). Throughout this MD&A, the terms "Company" and "Stella-Jones" shall mean Stella-Jones Inc. with its subsidiaries, either individually or collectively.

This MD&A and the Company's condensed interim unaudited consolidated financial statements were approved by the Audit Committee and the Board of Directors on May 6, 2020. The MD&A provides a review of the significant developments, results of operations, financial position and cashflows of the Company during the three-month period ended March 31, 2020 compared with the three-month period ended March 31, 2019. The MD&A should be read in conjunction with the Company's condensed interim unaudited consolidated financial statements for the periods ended March 31, 2020 and 2019 and the notes thereto, as well as the Company's annual audited consolidated financial statements and MD&A for the year ended December 31, 2019.

This MD&A contains statements that are forward-looking in nature. Forward-looking statements include, without limitation, the financial guidance and other statements contained in the "Outlook" section below, which are provided for the purposes of assisting the reader in understanding the Company's financial position, results of operations and cash flows and management's current expectations and plans (and may not be appropriate for other purposes). Such statements are based upon a number of assumptions and involve known and unknown risks and uncertainties that may cause the actual results of the Company to be materially different from those expressed or implied by such forward-looking statements. Such items include, among others: general economic and business conditions (including the impact of the global outbreak of the novel coronavirus [COVID-19 pandemic]), evolution in customer demand for the Company's products and services, product selling prices, availability and cost of raw materials, changes in foreign currency rates, the ability of the Company to raise capital and factors and assumptions referenced herein and, in the Company's most recent Annual MD&A and Annual Information Form. Unless required to do so under applicable securities legislation, the Company's management does not assume any obligation to update or revise forward-looking statements to reflect new information, future events or other changes after the date hereof.

The Company's condensed interim unaudited consolidated financial statements are reported in Canadian dollars and are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") and Chartered Professional Accountants ("CPA Canada") Handbook Part I – Accounting, applicable to the preparation of interim financial statements, including IAS 34, *Interim Financials Reporting*. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

This MD&A also contains financial measures which are not prescribed by IFRS and are not likely to be comparable to similar measures presented by other issuers. These measures are as follows:

- **Gross profit**: Sales less cost of sales
- **EBITDA**: Operating income before depreciation of property, plant and equipment, depreciation of right-of-use assets and amortization of intangible assets (also referred to as earnings before interest, taxes, depreciation and amortization)
- **EBITDA margin**: EBITDA divided by sales for the corresponding period
- **Operating income**
- **Operating margin**: Operating income divided by sales for the corresponding period
- **Cash flow from operating activities before changes in non-cash working capital components and interest and income taxes paid**
- **Long-term debt to EBITDA**: Long-term debt (including the current portion) divided by the trailing 12-month EBITDA

Management considers these non-IFRS measures to be useful information to assist knowledgeable investors understand the Company's operating results, financial condition and cash flows as they provide additional measures about its performance.

Additional information, including the Company's annual information form, quarterly and annual reports, and supplementary information is available on the SEDAR web site at www.sedar.com. Press releases and other information are also available in the Investor Relations section of the Company's web site at www.stella-jones.com.

## OUR BUSINESS

Stella-Jones Inc. is a leading producer and marketer of pressure-treated wood products. The Company supplies North America's electrical utilities and telecommunication companies with utility poles and the continent's railroad operators with railway ties and timbers. Stella-Jones also manufactures and distributes residential lumber and accessories to retailers for outdoor applications, as well as industrial products which include marine and foundation pilings, construction timbers, wood for bridges and coal tar-based products. The Company's common shares are listed on the Toronto Stock Exchange (TSX: SJ).

As at March 31, 2020, the Company operated forty wood treating plants, twelve pole peeling facilities and a coal tar distillery. These facilities are located in six Canadian provinces and nineteen American states and are complemented by an extensive distribution network across North America. As at March 31, 2020, the Company's workforce numbered approximately 2,230 employees.

Stella-Jones possesses a number of key attributes which should continue to enhance the Company's strategic positioning and competitive advantage in the wood treating industry. Among these are the ability to service clients from multiple plants, a solid financial position that allows the Company to stockpile and air-season green wood for major long-term contracts, a long-standing stable source of wood supply and a registration to produce and sell the wood preservative, creosote.

## OUR MISSION

Stella-Jones' objective is to be the performance leader in the wood preserving industry and a model corporate citizen, exercising environmental responsibility and integrity.

Stella-Jones will achieve these goals by focusing on customer satisfaction, core products, key markets, innovative work practices and the optimal use of its resources.

Stella-Jones is committed to providing a safe, respectful and productive environment for its employees, where problem solving, initiative and high standards of performance are rewarded.

## HIGHLIGHTS

### Overview – First Quarter of 2020

Sales in the first quarter of 2020 were up 14% to $503 million, due to higher sales in all product categories. Pressure-treated wood sales rose by $59 million while sales for logs and lumber increased by $3 million. The increase in pressure-treated wood sales is primarily explained by higher demand and sales prices for utility poles, increased volumes for residential lumber and industrial products as well as improved sales prices for railway ties. Despite the sales growth, EBITDA and operating income remained relatively unchanged compared to the same period last year, largely due to the $7 million mark-to-market loss recorded in the quarter for diesel derivative commodity contracts. Adjusting for the mark-to-market impact of diesel derivative contracts, EBITDA for the periods ending March 31, 2020 and 2019 were $70 million and $60 million, representing EBITDA margins of 13.9% and 13.6%, respectively.

During the period ended March 31, 2020, Stella-Jones used its liquidity to support seasonally higher working capital requirements and continued to invest in its property, plant and equipment. As at March 31, 2020, the Company maintained a strong financial position to pursue further growth opportunities with a long-term debt to trailing 12-month EBITDA ratio of 2.5x.

### Financial Highlights – First Quarter of 2020

| **Selected Key Indicators** (in millions of dollars except margins and earnings per share ("EPS")) | **Q1-20** | **Q1-19** | **Variation ($)** | **Variation (%)** |
|---|---|---|---|---|
| **Operating results** | | | | |
| Sales | 503 | 441 | 62 | 14% |
| Gross profit(1) | 83 | 70 | 13 | 19% |
| EBITDA(1) | 63 | 64 | (1) | (2%) |
| EBITDA margin(1) | 12.5% | 14.5% | n/a | (200 bps) |
| Operating income(1) | 45 | 46 | (1) | (2%) |
| Net income | 28 | 29 | (1) | (3%) |
| EPS – basic & diluted | 0.41 | 0.43 | (0.02) | (5%) |
| **Cash Flows** | | | | |
| Operating activities | (93) | (76) | | |
| Financing activities | 99 | 84 | | |
| Investing activities | (6) | (8) | | |
| **Financial position** | **As at March 31, 2020** | **As at December 31, 2019** | **Variation ($)** | |
| Inventories | 1,121 | 971 | 150 | |
| Long-term debt(2) | 766 | 605 | 161 | |
| Lease liabilities(3) | 130 | 118 | 12 | |

(1) This is a non-IFRS financial measure which does not have a standardized meaning prescribed by IFRS and may therefore not be comparable to similar measures presented by other issuers.
(2) Including current portion of long-term debt.
(3) Including current portion of lease liabilities.

### COVID-19 Pandemic Update

On March 25, 2020, Stella-Jones confirmed that its North American operations are considered critical to the integrity of the supply chains for utilities, railroads and the construction industry. It is committed to continue operations of its North American treating facilities and supporting distribution networks and support essential businesses. The Company responded by implementing rigorous hygiene practices and physical distancing policies throughout the organization to mitigate the health risks to its employees, business partners and communities where it operates and by putting in place a comprehensive business continuity plan. The Company continues to monitor the situation and to refine its work processes to adapt to this rapidly evolving environment. While first quarter

2020 results were strong and in line with previously disclosed guidance, the impact of the ongoing COVID-19 pandemic on the Company's operations and those of its suppliers and customers remains uncertain. The rapidly evolving COVID-19 pandemic could directly or indirectly disrupt the Company's operations and/or those of its suppliers or customers, which in turn could adversely impact the business, financial position, results of operations and cash flows of the Company. Please refer to the Outlook section for further details.

**RECONCILIATION OF NON-IFRS FINANCIAL MEASURES**

The following table presents the reconciliations of non-IFRS financial measures to their most comparable IFRS measures.

| **Reconciliation of net income to operating income and EBITDA** (in millions of dollars) | **Three-month periods ended March 31,** | |
|---|---|---|
| | **2020** | **2019** |
| Net income for the period | 28 | 29 |
| Plus: | | |
| Provision for income taxes | 10 | 11 |
| Financial expenses | 7 | 6 |
| Operating income | 45 | 46 |
| Depreciation and amortization | 18 | 18 |
| EBITDA | 63 | 64 |

Excluding the mark-to-market impacts of the diesel derivative contracts, operating income was $52 million and EBITDA was $70 million, compared to $42 million and $60 million, respectively in the first quarter of 2019.

**FOREIGN EXCHANGE**

The table below shows average and closing exchange rates applicable to Stella-Jones' quarters for the years 2020 and 2019. Average rates are used to translate sales and expenses for the periods mentioned, while closing rates translate assets and liabilities of foreign operations and monetary assets and liabilities of the Canadian operations denominated in U.S. dollars.

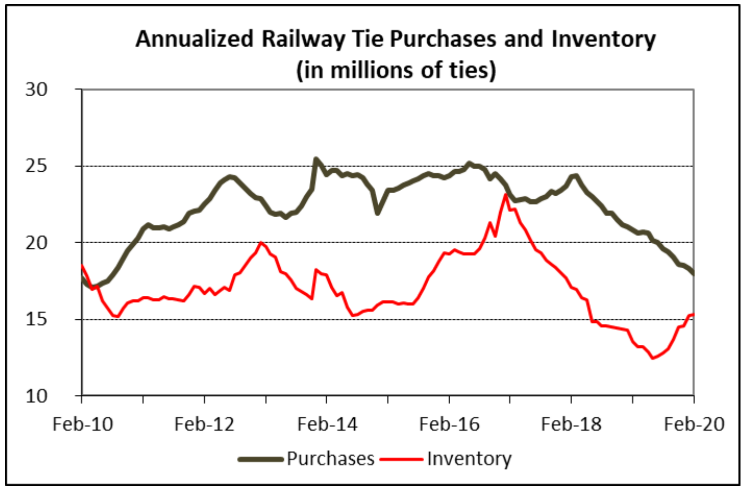
| **US$/Cdn$ rate** | **2020** | | **2019** | |
|---|---|---|---|---|
| | **Average** | **Closing** | **Average** | **Closing** |
| First Quarter | 1.34 | 1.42 | 1.33 | 1.34 |
| Second Quarter | | | 1.34 | 1.31 |
| Third Quarter | | | 1.32 | 1.32 |
| Fourth Quarter | | | 1.32 | 1.30 |
| Fiscal Year | | | 1.33 | 1.30 |

- Average rate: The appreciation of the U.S. dollar relative to the Canadian dollar during the first quarter of 2020 compared to the first quarter of 2019 resulted in a positive impact on sales and an unfavourable impact on cost of sales.

- Closing rate: The appreciation of the U.S. dollar relative to the Canadian dollar as at March 31, 2020, compared to December 31, 2019 resulted in a higher value of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

## RAILWAY TIE INDUSTRY OVERVIEW

As reported by the Railway Tie Association ("RTA"), purchases for the first two months of 2020 were 2.5 million ties, versus 3.0 million ties for the same period in 2019, resulting in industry purchases of 18.0 million ties for the 12-month period ended February 29, 2020. The RTA calculates purchases based on the difference between monthly production and the change in inventory, as reported by its members. Inventory levels increased slightly to 15.3 million ties as at February 29, 2020, when compared to the December 31, 2019 level. As a result, the inventory-to-sales ratio was 0.84:1 as at February 29, 2020, higher than the previous ten-year average ratio of 0.78:1.




Source: *Railway Tie Association*

## OPERATING RESULTS

### Sales

Sales for the first quarter reached $503 million, up $62 million, or 14%, versus sales of $441 million for the corresponding period last year. Excluding the positive impact of the currency conversion of $3 million, pressure-treated wood sales increased by $56 million, or 13%. This increase was primarily driven by higher demand and improved sales prices for utility poles, increased volumes for residential lumber and industrial products and higher sales prices for railway ties, as detailed below.

| **Sales** (in millions of dollars, except percentages) | **Utility Poles** | **Railway Ties** | **Residential Lumber** | **Industrial Products** | **Total Pressure-Treated Wood** | **Logs & Lumber** | **Consolidated Sales** |
|---|---|---|---|---|---|---|---|
| **Q1-2019** | **171** | **162** | **57** | **25** | **415** | **26** | **441** |
| FX impact | 2 | 1 | - | - | **3** | - | **3** |
| Organic growth | 29 | 9 | 14 | 4 | **56** | 3 | **59** |
| **Q1-2020** | **202** | **172** | **71** | **29** | **474** | **29** | **503** |
| **Organic growth** % | 17% | 6% | 25% | 16% | **13%** | 12% | **13%** |

### Utility poles

Utility pole sales rose to $202 million in the first quarter of 2020, up 18% from sales of $171 million in the corresponding period last year. Excluding the currency conversion effect, utility pole sales increased by $29 million, primarily driven by continued growth in replacement demand and improved pricing. Utility pole sales accounted for 40% of the Company's first-quarter sales.

### Railway ties

Railway tie sales were $172 million in the first quarter of 2020, an increase of 6% compared to sales of $162 million in the same period last year. Excluding the currency conversion, railway tie sales increased $9 million, mainly due to higher sales prices. Volume remained stable as higher shipments to Class 1 customers were offset by lower volume to non-Class 1 customers, largely related to the timing of projects. Railway tie sales accounted for 34% of the Company's first-quarter sales.

**Residential lumber**
Sales in the residential lumber category totalled $71 million in the first quarter of 2020, up 25% from sales of $57 million in the corresponding period last year. This increase is primarily attributable to increased demand, both in Canada and the U.S. Residential lumber sales accounted for 14% of the Company's first-quarter sales.

**Industrial products**
Industrial product sales increased to $29 million in the first quarter of 2020, up 16% compared to sales of $25 million in the first quarter last year, primarily as a result of stronger railway bridge sales. Industrial product sales represented 6% of the Company's first-quarter sales.

**Logs and lumber**
Sales in the logs and lumber product category were $29 million in the first quarter of 2020, compared with $26 million in the corresponding period last year. Sales increased mainly due to higher lumber market prices in North America for most of the first quarter compared to the same period last year, while volumes remained relatively unchanged. Logs and lumber sales represented 6% of the Company's first-quarter sales.

**Sales by Geographic Region**
Sales in the United States amounted to $385 million, or 77% of sales in the first quarter of 2020, representing an increase of $47 million, or 14%, compared to sales of $339 million in the corresponding period last year. This increase is mainly attributable to increased sales prices and strong demand for utility poles as well as higher sales for the residential lumber and industrial product categories.

Sales in Canada amounted to $118 million, or 23% of sales in the first quarter of 2020, an increase of $16 million, or 15%, compared to sales of $102 million in the first quarter last year. The increase is largely due to higher sales prices for railway ties and higher demand for residential lumber.

**Cost of sales**
Cost of sales, including depreciation of right-of-use assets, property, plant and equipment, as well as amortization of intangible assets, was $420 million, or 83% of sales, in the first quarter of 2020. This compares to cost of sales of $371 million, or 84% of sales, in the corresponding period last year. The increase in absolute dollars is largely explained by higher sales volume in all product categories, an increase in fibre procurement costs for utility poles, higher untreated tie costs, which are procured at least nine months before a sale is concluded, and higher market price of lumber compared to the same period last year.

Total depreciation and amortization was $18 million in the first quarter of 2020, of which $15 million was recorded under cost of sales, unchanged from the first quarter of 2019.

Gross profit grew to $83 million, or 17% of sales, in the first quarter of 2020, compared to $70 million, or 16% of sales, in the corresponding period last year. Despite higher fibre costs, gross profit improved due to higher sales.

**Selling and administrative**
Selling and administrative expenses for the first quarter of 2020 were $31 million, including depreciation and amortization of $3 million, compared to $28 million, including depreciation and amortization of $3 million, in the corresponding period in 2019. The increase is primarily explained by higher information technology expenses, mainly related to consulting fees associated with the implementation of a new enterprise resource planning system, higher project costs and an increase in compensation expense partially offset by lower stock-based compensation expense.

**Other losses and gains, net**
Other net losses of $7 million in the first quarter of 2020 mainly consisted of an unrealized loss related to the mark-to-market effect of diesel derivative commodity contracts. In the corresponding quarter of 2019, other net gains of $4 million was attributable to the mark-to-market valuation of the diesel derivative commodity contracts.

**Financial expenses**
Financial expenses amounted to $7 million in the first quarter of 2020, a slight increase compared to the $6 million expense recorded in the corresponding period last year, mainly due to additional borrowings to finance working capital requirements.

**Income before income taxes and income tax expense**
Income before income taxes was $38 million, or 8% of sales, in the first quarter of 2020, versus $40 million, or 9% of sales, in the corresponding period of 2019.

The provision for income taxes totalled $10 million in the first quarter of 2020, compared to $11 million in the same period last year, representing an effective tax rate of approximately 26%.

**Net income**
Net income for the first quarter of 2020 was $28 million, or $0.41 per diluted share, versus net income of $29 million, or $0.43 per share, in the corresponding period of 2019.

## QUARTERLY RESULTS

The Company's sales follow a seasonal pattern, with utility pole, railway tie, and industrial product shipments stronger in the second and third quarters to provide industrial end users with product for their summer maintenance projects. Residential lumber sales also follow a similar seasonal pattern. In the fall and winter seasons, there tends to be less activity; as a result, the first and fourth quarters are typically characterized by relatively lower sales. The table below sets forth selected financial information for the Company's last nine quarters:

**2020**

| **For the quarters ended** (in millions of dollars, except EPS) | **March 31** | **June 30** | **Sept. 30** | **Dec. 31** | **Total** |
|---|---|---|---|---|---|
| Sales | 503 | | | | |
| EBITDA | 63 | | | | |
| Operating income | 45 | | | | |
| Net income for the period | 28 | | | | |
| EPS - basic and diluted | 0.41 | | | | |

**2019**

| **For the quarters ended** (in millions of dollars, except EPS) | **March 31** | **June 30** | **Sept. 30** | **Dec. 31** | **Total** |
|---|---|---|---|---|---|
| Sales | 441 | 662 | 626 | 440 | 2,169 |
| EBITDA | 64 | 94 | 96 | 59 | 313 |
| Operating income | 46 | 77 | 78 | 41 | 242 |
| Net income for the period | 29 | 52 | 54 | 28 | 163 |
| EPS - basic and diluted | 0.43 | 0.76 | 0.77 | 0.41 | 2.37 |

**2018** (1)

| **For the quarters ended** (in millions of dollars, except EPS) | **March 31** | **June 30** | **Sept. 30** | **Dec. 31** | **Total** |
|---|---|---|---|---|---|
| Sales | 399 | 662 | 630 | 433 | 2,124 |
| EBITDA | 44 | 80 | 78 | 42 | 244 |
| Operating income | 35 | 71 | 68 | 32 | 206 |
| Net income for the period | 23 | 48 | 46 | 21 | 138 |
| EPS - basic and diluted | 0.33 | 0.69 | 0.66 | 0.30 | 1.98 |

(1) Comparative figures for 2018 were not restated as permitted by IFRS 16, *Leases*.

## STATEMENT OF FINANCIAL POSITION

As a majority of the Company's assets and liabilities are denominated in U.S. dollars, exchange rate variations may significantly affect their value. As such, the appreciation of the U.S. dollar relative to the Canadian dollar as at March 31, 2020, compared to December 31, 2019 (see "Foreign Exchange" on page 4), results in a higher amount of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

### Assets

As at March 31, 2020, total assets stood at $2,617 million versus $2,281 million as at December 31, 2019. The increase in total assets largely reflects higher current assets, as detailed below. Note that the following table provides information on assets using select line items from the consolidated statements of financial position.

| **Assets** (in millions of dollars) | **As at March 31, 2020** | **As at December 31, 2019** | **Variance** |
|---|---:|---:|---:|
| Accounts receivable | 289 | 179 | 110 |
| Inventories | 1,121 | 971 | 150 |
| Other current assets | 43 | 42 | 1 |
| **Total current assets** | **1,453** | **1,192** | **261** |
| Property, plant and equipment | 605 | 568 | 37 |
| Right-of-use assets | 128 | 116 | 12 |
| Intangible assets | 120 | 115 | 5 |
| Goodwill | 309 | 285 | 24 |
| Other non-current assets | 2 | 5 | (3) |
| **Total non-current assets** | **1,164** | **1,089** | **75** |
| **Total assets** | **2,617** | **2,281** | **336** |

Accounts receivable, net of a credit loss allowance of less than $1 million, was $289 million as at March 31, 2020, compared to $179 million as at December 31, 2019. The increase was mainly attributable to higher sales near the end of the quarter, as per normal seasonal demand patterns and the effect of currency translation of U.S. dollar denominated accounts receivable. In the normal course of business, the Company has a facility, to which it can sell, without credit recourse, eligible trade receivables. No receivables were outstanding under such facility as at March 31, 2020 and December 31, 2019.

Inventories stood at $1,121 million as at March 31, 2020, up from $971 million as at December 31, 2019. The increase is explained by the normal seasonal inventory build-up ahead of peak demand in the second and third quarters as well as the effect of currency translation of U.S. dollar denominated inventories.

Given the long periods required to air-season wood, which can occasionally exceed nine months before a sale is concluded, inventories are a significant component of working capital and the turnover is relatively low. In addition, significant raw material and finished goods inventory are required at certain times of the year to support the residential lumber product category. The Company maintains solid relationships and enters into long-term contracts with customers to better ascertain inventory requirements. Management continuously monitors the levels of inventory and market demand for its products. Production is adjusted accordingly to optimize efficiency and capacity utilization.

Property, plant and equipment stood at $605 million as at March 31, 2020, compared with $568 million as at December 31, 2019. The increase largely reflects the effect of currency translation of U.S. dollar denominated property, plant and equipment. The purchase of property, plant and equipment of $5 million during the first quarter of 2020 is offset by depreciation expense of $6 million for the period.

Right-of-use assets totalled $128 million as at March 31, 2020, compared to $116 million as at December 31, 2019. The increase is primarily due to the addition of right-of-use assets, the effect of currency translation on U.S. dollar denominated right-of-use assets, offset in part by depreciation expense of $9 million for the period.

Intangible assets and goodwill totalled $120 million and $309 million, respectively, as at March 31, 2020. Intangible assets include customer relationships, non-compete agreements, a creosote registration, cutting rights, standing timber and software. As at December 31, 2019, intangible assets and goodwill were $115 million and $285 million, respectively. The increase in intangible assets and goodwill is explained in large part by the effect of currency translation on U.S.-based intangible assets and goodwill.

**Liabilities**

As at March 31, 2020, Stella-Jones' total liabilities stood at $1,233 million, up from $993 million as at December 31, 2019. The increase in total liabilities mainly reflects the increase in long-term debt, as detailed below. Note that the following table provides information on liabilities using select line items from the consolidated statements of financial position.

| **Liabilities** (in millions of dollars) | **As at March 31, 2020** | **As at December 31, 2019** | **Variance** |
|---|---|---|---|
| Accounts payable and accrued liabilities | 180 | 136 | 44 |
| Current portion of long-term debt | 6 | 7 | (1) |
| Current portion of lease liabilities | 33 | 29 | 4 |
| Other current liabilities | 30 | 10 | 20 |
| **Total current liabilities** | **249** | **182** | **67** |
| Long-term debt | 760 | 598 | 162 |
| Lease liabilities | 97 | 89 | 8 |
| Other non-current liabilities | 127 | 124 | 3 |
| **Total non-current liabilities** | **984** | **811** | **173** |
| **Total liabilities** | **1,233** | **993** | **240** |

Current liabilities were $249 million as at March 31, 2020, versus $182 million as at December 31, 2019. This variation is primarily attributable to a $44 million increase in accounts payable and accrued liabilities, largely due to the seasonal inventory build-up in the latter part of the first quarter of 2020, as well as the effect of local currency translation on U.S. dollar denominated accounts payable and accrued liabilities.

The Company's long-term debt, including the current portion, was $766 million as at March 31, 2020, versus $605 million as at December 31, 2019. The increase reflects borrowings made to support seasonal working capital requirements and the currency translation effect of $54 million on U.S. dollar denominated long-term debt.

On February 24, 2020, the Company obtained a one-year extension of its unsecured revolving facility to February 27, 2025. This extension was granted through an amendment to the sixth amended and restated credit agreement dated as of May 3, 2019. All terms and conditions remain substantially unchanged.

As at March 31, 2020, an amount of $26 million (US$18 million) was available against the Company's syndicated credit facilities of $603 million (US$425 million). In addition, the Company had $34 million (US$24 million) of cash on hand, which is presented as a reduction of long-term debt, and a US$50 million undrawn demand loan facility with terms and conditions similar to those under the syndicated credit agreement.

The Company was in full compliance with its debt covenants, reporting requirements and financial ratios as at March 31, 2020.

**Shareholders' equity**

Shareholders' equity stood at $1,384 million as at March 31, 2020, compared to $1,288 million as at December 31, 2019.

| **Shareholders' Equity** (in millions of dollars) | **As at March 31, 2020** | **As at December 31, 2019** | **Variance** |
|---|---:|---:|---:|
| Capital Stock | 217 | 217 | - |
| Retained earnings | 986 | 968 | 18 |
| Accumulated other comprehensive income | 181 | 103 | 78 |
| **Total shareholders' equity** | **1,384** | **1,288** | **96** |

The increase in shareholders' equity in the first quarter of 2020 is attributable to net income of $28 million, a favourable variation of $78 million of other comprehensive income, mainly resulting from the currency translation of foreign operations, partially offset by $10 million of dividends declared in the quarter.

## LIQUIDITY AND CAPITAL RESOURCES

The following table sets forth summarized cash flow components for the periods indicated:

| **Summary of cash flows** (in millions of dollars) | **Three-month Periods Ended March 31,** | |
|---|---:|---:|
| | **2020** | **2019** |
| Operating activities | (93) | (76) |
| Financing activities | 99 | 84 |
| Investing activities | (6) | (8) |
| Net change in cash and cash equivalents during the period | - | - |
| Cash and cash equivalents - Beginning of period | - | - |
| **Cash and cash equivalents – End of period** | - | - |

The Company believes that its cash flow from operations and available credit facilities are adequate to finance its business plans, meet its working capital requirements and maintain its assets.

**Cash flows from operating activities**

Cash flows used by operating activities amounted to $93 million in the first quarter of 2020, compared to $76 million in the corresponding period in 2019 mainly due to an increase in non-cash working capital components, partially offset by improved profitability. Cash flows from operating activities before changes in non-cash working capital components and interest and income taxes paid was $69 million in the first quarter of 2020, compared to $60 million in the corresponding period in 2019. Changes in non-cash working capital components decreased liquidity by $153 million in the first quarter of 2020 as a result of the seasonal increase in inventories and account receivables.

The following table provides information on cash flows provided by operating activities using select line items from the consolidated statements of cash flows.

| **Cash flows from operating activities** (in millions of dollars) | **Three-month Periods Ended March 31,** | |
|---|---|---|
| | **2020** | **2019** |
| Net income | 28 | 29 |
| Loss (gain) on derivative financial instruments | 6 | (5) |
| Others | 35 | 36 |
| **Cash flows from operating activities before changes in non-cash working capital components and interest and income taxes paid** | **69** | **60** |
| Accounts receivable | (94) | (60) |
| Inventories | (86) | (78) |
| Accounts payable and accrued liabilities | 27 | 15 |
| Other current assets | - | 1 |
| **Changes in non-cash working capital components** | **(153)** | **(122)** |
| Interest paid | (8) | (7) |
| Income taxes paid | (1) | (7) |
| **Cash flows from operating activities** | **(93)** | **(76)** |

**Cash flows from financing activities**
Financing activities for the first quarter of 2020 increased liquidity by $99 million. During the quarter ended March 31, 2020, the Company borrowed $108 million under its syndicated credit facilities and repaid lease liabilities of $8 million. In the first quarter of 2019, financing activities increased liquidity by $84 million, primarily due to $98 million of borrowings under the syndicated credit facilities, $8 million repayment of lease liabilities and $6 million of repurchases of common shares.

The following table provides information on cash flows provided by financing activities using select line items from the consolidated statements of cash flows.

| **Cash flows from financing activities** (in millions of dollars) | **Three-month Periods Ended March 31,** | |
|---|---|---|
| | **2020** | **2019** |
| Net change in syndicated credit facilities | 108 | 98 |
| Repayment of long-term debt | (1) | **-** |
| Repayment of lease liabilities | (8) | (8) |
| Repurchase of common shares | - | (6) |
| **Cash flows from financing activities** | **99** | **84** |

**Cash flows from investing activities**
Investing activities used liquidity of $6 million in the first quarter of 2020, compared to $8 million in the first quarter of 2019, primarily due to the purchase of property, plant and equipment.

The following table provides information on cash flows used by investing activities using select line items from the consolidated statements of cash flows.

| **Cash flows from investing activities** (in millions of dollars) | **Three-month Periods Ended March 31,** | |
|---|---|---|
| | **2020** | **2019** |
| Purchase of property, plant and equipment | (5) | (8) |
| Other | (1) | **-** |
| **Cash flows from investing activities** | **(6)** | **(8)** |

**Financial obligations**
The following table details the maturities of the financial obligations as at March 31, 2020:

| **Financial obligations** (in millions of dollars) | **Carrying Amount** | **Contractual Cash flows** | **Less than 1 year** | **Years 2-3** | **Years 4-5** | **More than 5 years** |
|---|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 180 | 180 | 180 | - | - | - |
| Long-term debt obligations [(1)] | 766 | 887 | 31 | 63 | 676 | 117 |
| Minimum payments under lease liabilities | 130 | 142 | 36 | 57 | 26 | 23 |
| Derivative commodity contracts | 11 | 12 | 8 | 4 | - | - |
| Non-compete agreements | 3 | 3 | 2 | 1 | - | - |
| **Financial obligations** | **1,090** | **1,224** | **257** | **125** | **702** | **140** |

[(1)] Includes interest payments. Interest on variable interest debt is assumed to remain unchanged from the rates in effect as at March 31, 2020.

## SHARE AND STOCK OPTION INFORMATION

As at March 31, 2020, the capital stock issued and outstanding of the Company consisted of 67,476,516 common shares (67,466,709 as at December 31, 2019).

The following table presents the outstanding capital stock activity for the three-month period ended March 31, 2020:

| **Number of shares** | **Three-month Period Ended March 31, 2020** |
|---|---|
| Balance – Beginning of year | 67,466,709 |
| Employee share purchase plans | 9,807 |
| **Balance – End of period** | **67,476,516** |

As at May 6, 2020, the capital stock issued and outstanding consisted of 67,477,470 common shares.

As at March 31, 2020, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 45,000 (December 31, 2019 – 45,000) of which 45,000 (December 31, 2019 – 45,000) were exercisable. As at May 6, 2020, the number of outstanding options was 45,000, of which 45,000 were exercisable.

## DIVIDENDS

On May 6, 2020, the Board of Directors declared a quarterly dividend of $0.15 per common share payable on June 26, 2020 to shareholders of record at the close of business on June 5, 2020. This dividend is designated to be an eligible dividend.

The declaration, amount and date of any future dividends will continue to be considered by the Board of Directors of the Company based on the Company's balanced capital allocation strategy. There can be no assurance as to the amount or timing of such dividends in the future.

## COMMITMENTS AND CONTINGENCIES

The commitments and contingencies susceptible to affect the Company in the future remain substantially unchanged from those included in the Company's annual MD&A contained in its 2019 Annual Report.

## RISKS AND UNCERTAINTIES

Except as described in the COVID-19 pandemic update section herein, the risk and uncertainties affecting the Company in the future remain substantially unchanged from those included in the Company's annual MD&A contained in its 2019 Annual Report.

## SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the December 31, 2019 and 2018 audited consolidated financial statements.

The Company prepares its consolidated financial statements in accordance with IFRS as issued by the International Accounting Standards Board and CPA Canada Handbook Part I - Accounting.

The preparation of consolidated financial statements in conformity with IFRS requires Management to make estimates and assumptions that affect the reported amounts of 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 period. Significant items subject to estimates and assumptions include estimated useful life of assets, recoverability of long-lived assets and goodwill and determination of the fair value of the assets acquired and liabilities assumed in the context of an acquisition. It is possible that actual results could differ from those estimates, and such differences could be material. Estimates are reviewed periodically and, as adjustments become necessary, they are reported in the consolidated statement of income in the period in which they become known.

## DISCLOSURE CONTROLS AND PROCEDURES

The Company maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, accurate, reliable and timely. The disclosure controls and procedures ("DC&P") are designed to provide reasonable assurance that information required to be disclosed in the annual filings, interim filings or other reports filed under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to Management, including its certifying officers, as appropriate to allow timely decisions regarding required disclosure.

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company have evaluated, or caused the evaluation of, under their direct supervision, the design effectiveness of the Company's DC&P (as defined in Regulation 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) as at March 31, 2020 and have concluded that such DC&P were designed effectively.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal controls over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Management has evaluated the design effectiveness of its ICFR as defined in Regulation 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings. The evaluation was based on the criteria established in the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). This evaluation was performed by the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the President and Chief Executive

Officer and the Senior Vice-President and Chief Financial Officer concluded that the ICFR were effectively designed, as at March 31, 2020.

In spite of its evaluation, Management does recognize that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives.

## CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes were made to the design of ICFR during the period from January 1, 2020 to March 31, 2020 that have materially affected or are reasonably likely to materially affect the Company's ICFR.

## OUTLOOK

The financial outlook provided in the Company's MD&A for the year ended December 31, 2019 with respect to annual EBITDA for 2020 is hereby updated.

Management believes that the resiliency of the Company's utility poles, railway tie and residential lumber product categories as well as its solid balance sheet and liquidity, place the Company in a favourable position to navigate through the current challenging environment.

Given, however, the uncertain impact of the COVID-19 pandemic and the weaker economic conditions in North America on the demand for the Company's core product categories, the Company now expects EBITDA for 2020 to be in the range of $300 to $325 million, down $20 million from the previously disclosed range and EBITDA margin to be lower versus 2019. The Company's guidance is revised to reflect either no improvement or a slight decline in sales volume for utility pole, railway tie and industrial product categories and weaker demand for residential lumber compared to 2019.

Management has made a number of material assumptions in preparing the guidance and making the forward-looking statements contained herein. These assumptions include, but are not limited to the following:

- COVID-19-related government-imposed restrictions to be gradually lifted by the end of the second quarter of 2020 and North American economic activity, including residential construction, to gradually resume to normal levels;
- No significant disruption in the Company's manufacturing operations, supply chain and distribution networks, other than the measures already adopted by the Company to mitigate health risks to its employees, business partners and communities where it operates in response to the COVID-19 outbreak;
- No significant reduction in the replacement maintenance program of major railway and utility pole customers;
- Limited impact on the Company's cost of operations; and
- Canadian dollar will trade, on average, at C$1.40 per U.S. dollar for the last three quarters of 2020, with sales in the United States continuing to represent approximately 70% of total sales.

The guidance for capital asset expenditures remains unchanged, in the range of $45 to $55 million during 2020.

The Company's strategic vision, focused on continental expansion, remains intact, as it believes that the long-term fundamentals of each product category will remain strong. A healthy financial position will allow Stella-Jones to continue to seek opportunities to further expand its presence in the Company's core markets, both organically and through acquisitions to enhance shareholder value.

This outlook is fully qualified by the forward-looking statements described in this MD&A.

May 6, 2020