Management's Discussion & Analysis

Three-month period ended March 31, 2007 compared to three-month period ended March 31, 2006.

The following Management's Discussion and Analysis ("MD&A") dated May 3, 2007 should be read in conjunction with the MD&A for the year ended December 31, 2006, the audited consolidated financial statements for the year ended December 31, 2006, and the unaudited consolidated interim financial statements of the Company for the three months ended March 31, 2007 with the notes thereto. The interim financial results are prepared in accordance with Canadian Generally Accepted Accounting Principles and results are reported in Canadian dollars. The MD&A contains statements that are forward looking in nature. Such statements 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, product selling prices, raw material and operating costs, changes in foreign currency rates and other factors referenced herein and in the Company's continuous disclosure filings. Additional information, including the Company's annual information form, quarterly and annual reports, and supplementary information is available on SEDAR at www.sedar.com. Press releases and other information are also available in the Financial Information section of the Company's website at www.stella-jones.com.

Operating results

Sales for the first quarter ended March 31, 2007 reached $61.9 million, an increase of $17.1 million, or 38.1% over last year's first quarter sales of $44.9 million. Three of the Company's four product categories posted sales increases over last year's first quarter. The Carseland, Alberta facility, acquired on July 1st, 2006, was responsible for $10.3 million, or about 60% of the year-over-year gain. The Arlington, Washington facility, which was acquired during the first quarter, contributed a further $2.8 million in sales, or 16.4% of the sales increase for the quarter. Utility pole sales more than doubled to $30.6 million, up $15.3 million compared to the first three months of 2006, with the Carseland and Arlington facilities contributing most of the increase, with organic growth in utility poles sales also making a significant impact during the first quarter. Railway ties sales increased $3.3 million, or 15.7% to $24.6 million, driven by a strong contribution from the Bangor, Wisconsin facility. Residential lumber sales posted a gain of $1.9 million, or 104.9% over the same period last year. Industrial lumber sales were off to a slow start this year, with a $3.5 million, or 52.3% decline, as severe weather on the Eastern seaboard significantly slowed sales volumes during the quarter.

Gross margins improved markedly in the first three months of 2007, both in dollar terms and as a percentage of sales. Gross margins improved to $15.9 million or 25.7% of sales, from $9.3 million or 20.8% of sales in the same period in 2006, an increase of 70.0%. First quarter margins as a percentage of sales improved in every product category compared to the same period last year, with the exception of the residential lumber category. While a favourable product mix and improved product pricing were partly responsible for the increase in margins, economies of scale, operational efficiencies and better throughput were the main drivers of the continued margin improvement seen during the first quarter.

Selling and administrative expenses for the first quarter of 2007 were $3.5 million, an increase of $1.0 million or 41.5% when compared to the same period in 2006. The main explanation for this variation was an increase in personnel and related costs, and increases in consulting expenses related to the Company's internal controls certification project. It is worth noting that last year's first quarter selling and administrative expenses included a one-time gain of approximately $550,000 from the lease of certain cutting rights in the Company's British Columbia forestry operations. As a percentage of sales, selling and administrative expenses increased marginally, from 5.6% to 5.7%

Amortization of capital assets reached $1.1 million in the first quarter 2007, a 36.3% increase for the first quarter of 2007, compared to the $783,000 recorded in the corresponding period one year earlier. This increase reflects the growth of Stella-Jones' capital assets over the past year as a result of acquisitions and investments in new equipment.

Financial expenses for the first three months ended March 31, 2007 were $1.4 million compared to $730,000 for the same period in 2006. The rise in financial expenses is due to increases in short and long-term borrowings as a result of the acquisition of the Carseland, Alberta facility in July 2006, as well as the Arlington, Washington and Juliaetta, Idaho facilities on February 28, 2007, combined with increases in the Company's working capital requirements.

Income tax expenses amounted to $3.8 million for the first quarter of 2007, representing an effective tax rate of 38.1% compared to 34.9% for the same period in the prior year, reflecting a higher corporate tax rate in the United States, combined with a higher share of earnings before taxes stemming from the Company's growing U.S. asset base.

Net earnings were $6.1 million, or $0.50 per share, in the first quarter ended March 31, 2007 compared to $3.5 million, or $0.32 per share, in the corresponding period in 2006.

Business Acquisition

On February 28, 2007, the Company announced that its wholly-owned U.S. subsidiary, Stella-Jones Corporation, had completed the acquisition of the wood utility pole business of J.H. Baxter & Co. ("Baxter"). Assets acquired include the Baxter production plant located in Arlington, Washington, its pole peeling facility in Juliaetta, Idaho as well as all inventories and accounts receivable relating to its wood pole business.

The acquisition has been accounted for using the purchase method and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on Management's estimate of their fair value as of the acquisition date. The following fair value allocation is preliminary and is based on Management's best estimates and information known at the time of preparation of the March 31, 2007 interim unaudited consolidated financial statements. Subsequent revisions to this preliminary fair value allocation, if any, are expected to be accounted for by December 31, 2007. The results of operations of the acquired assets have been included in the consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired at fair values:

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Assets acquired	
Accounts receivable	3,792,494
Inventories	10,018,363
Prepaid expenses	143,523
Capital assets	12,605,534
	26,559,914
Liabilities assumed	
Obligation under capital lease	278,995
	26,280,919
Consideration	
Cash, including transaction costs of $348,276	16,937,350
Long-term subordinated note payable to vendor	9,285,600
Reserve amount for transaction costs, included in accounts payable	57,969
	26,280,919

Financing for the transaction was provided by a subordinated vendor note of US$8.0 million as well as additional debt funding under existing and new bank facilities. The new bank facilities comprise an increase of US$5.0 million in the operating line of credit of Stella-Jones Corporation, as well as a new 5-year term loan of US$4.0 million, both arranged with its existing U.S. banker.

Liquidity and capital resources

Cash flows from operating activities totaled $7.6 million for the first quarter of 2007, compared to $4.8 million in the corresponding period last year. After working capital requirements, notably the increases in accounts receivable and inventories, total operating activities used $4.0 million in the first three months of the year, compared to $8.1 million in the first quarter of 2006. The $4.0 million increase in accounts receivable since December 31, 2006, is directly related to the increase in sales volume. The $7.6 million increase in inventories since the beginning of the year is related to the regular seasonal build-up of inventories for summer shipments and anticipated future demand. Working capital increased $11.3 million to $91.2 million as at March 31, 2007, from the $80.0 million of working capital as at December 31, 2006.

Short-term bank indebtedness has increased by $12.8 million since December 31, 2006 and stood at $55.1 million as at March 31, 2007, reflecting the Company's increased working capital requirements and the additional bank borrowings related to the February 28, 2007 acquisition, as outlined above. The Company remains within its bank margining limits and was in compliance with all of its banking covenants throughout the three-month period.

Long-term debt and other long-term liabilities increased by $19.3 million compared to December 31st, 2006 levels, to stand at $51.2 million as at March 31, 2007. This increase was attributable to increased borrowings under the Company's term loans and a subordinated vendor note of US$8.0 million issued to Baxter, in conjunction with the aforementioned acquisition.

Shareholders' equity increased to $112.9 million as at March 31, 2007, and now represents a book value of $9.17 per share, up from $8.60 per share at the end of 2006. The Company's long-term debt to equity ratio was 0.45:1 as at March 31, 2007, compared to 0.30:1 as at December 31, 2006, as a result of the increased borrowings for the Baxter acquisition. As at May 2, 2007, the capital stock issued and outstanding consisted of 12,315,873 common shares (12,298,015 as at December 31, 2006).

Capital expenditures during the first quarter were $2.3 million. Of this amount, $1.4 million was related to the expansion of the Bangor, Wisconsin facility with, among other initiatives, the addition of a new treating cylinder. The remainder of the capital acquisitions were for equipment upgrades, renovations and repairs at the Company's other facilities.

Risks and Uncertainties

The risk and uncertainty factors affecting the Company in the future remain substantially unchanged from those included in the Company's annual MD&A contained in its 2006 Annual Report.

Changes in Accounting Policies

The Canadian Institute of Chartered Accountants ("CICA") has issued the following new Handbook Sections which are effective for the Company's interim periods beginning on January 1, 2007:

- Handbook Section 3855, "Financial Instruments – Recognition and Measurement", describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial assets, except for those classified as held-to-maturity or loans and receivables, and derivative financial instruments must be measured at their fair value. All financial liabilities must be measured at their fair value if they are classified as held for trading purposes. If not, they are measured at their carrying value.

The Company has implemented the following classification:

Cash and cash equivalents are classified as assets held for trading and are measured at fair value.

Accounts receivable and loans to certain suppliers are classified as loans and receivables. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, the measured amount generally corresponds to cost.

Bank loans, accounts payable, credit facilities, notes, loans payable, and obligations under capital leases are classified as other financial liabilities. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, the measured amount generally corresponds to cost.

- Handbook Section 1530, "Comprehensive Income", describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in equity of an enterprise during a period arising from transactions and other events and circumstances from non-owner sources. It includes items that would normally not be included in net income such as changes in the foreign currency translation adjustment relating to self-sustaining foreign operations and unrealized gains or losses on available for sale financial instruments. Upon adoption of this section, the consolidated interim financial statements now include a statement of comprehensive income.

- Section 3251, "Equity", replaces Section 3250, "Surplus", and describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530, "Comprehensive Income".

- Handbook Section 3865, "Hedges", describes when hedge accounting is appropriate. Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period.

  The Company enters into foreign exchange forward contracts to limit its exposure under contracted net cash inflows and outflows of US dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. The Company has documented its use of derivative financial instruments and has concluded that they qualify for hedge accounting.

The adoption of these new standards translated into the following changes as at January 1, 2007: a $568,785 increase in accumulated other comprehensive income, a $848,933 increase in short-term and long-term derivative financial instruments reported under assets and a $280,148 increase in future tax liabilities.

For the three-month period ended March 31, 2007, the Company recorded an increase of $148,784 in accumulated other comprehensive income, an increase of $222,065 in short-term and long-term derivative financial instruments reported under assets and an increase of $73,281 in future tax liabilities.

Contractual Obligations

In the normal course of business, the Company enters into certain contractual obligations and commercial commitments, such as operating leases, letters of credit and others. The summary of the Company's obligations and commitments as at December 31, 2006 can be found in its 2006 Annual Report and have not materially changed since December 31, 2006.

Outlook

Stella-Jones is enjoying a strong start to 2007 after having posted a solid performance in 2006. Management remains optimistic about further potential for growth in 2007. Firstly, end markets for the Company's products are continuing to enjoy strong fundamentals. Demand for utility poles is strong and the February 28th, 2007 acquisition in the Pacific Northwest will allow the Company to continue to leverage market opportunities and synergies for all of the Company's facilities. We are looking for the full-period contribution of these assets in coming quarters. In railway ties, the expansion of the Bangor, Wisconsin facility with and additional treating cylinder is proceeding on time, on budget and on schedule, and it should start to favourably impact results through higher production capacity. In residential lumber, we expect a solid performance going forward, while our industrial lumber sales should recover as the weather issues that had plagued the Eastern seaboard subside in coming quarters.

Secondly, Management remains focused on delivering strong bottom line performance to shareholders by integrating recently acquired assets, as well as leveraging the opportunities for external growth currently available to the Company. In this regard, the American market will likely continue to play a significant role in the Company's future expansion.

May 3, 2007