MANAGEMENT'S DISCUSSION & ANALYSIS

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. and shall include its independent operating subsidiaries.

This MD&A and the Company's audited consolidated financial statements were approved by the Board of Directors on March 14, 2019. The MD&A provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2018 compared with the fiscal year ended December 31, 2017. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2018 and 2017 and the notes thereto.

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. 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.

The Company's audited consolidated financial statements are reported in Canadian dollars and are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Chartered Professional Accountants ("CPA Canada") Handbook Part I - Accounting. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

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 railroad operators with railway ties and timbers, and the continent's electrical utilities and telecommunication companies with utility poles. 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 14, 2019, the Company operated thirty-nine 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 December 31, 2018, the Company's workforce numbered approximately 2,110 employees.

Stella-Jones enjoys a number of key attributes which should further 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.

2018 HIGHLIGHTS

Selected Key Indicators (in millions of dollars, except earnings per share ("EPS") and key indicators)	**2018**	**2017**	**2016**
Operating results			
Sales	2,123.9	1,886.1	1,838.4
Gross profit(1)	314.2	299.9	333.7
EBITDA(1)	244.4	243.1	264.8
Operating income(1)	206.3	207.4	233.2
Net income	137.6	167.9	153.9
EPS – basic & diluted	1.98	2.42	2.22
Cash Flows			
Cash flows from operating activities	128.1	301.1	181.8
Cash flows from financing activities	(26.0)	(239.9)	(9.5)
Cash flows from investing activities	(108.5)	(58.5)	(175.6)
Financial Position			
Current assets	1,068.4	908.4	1,050.4
Inventories	838.6	718.5	854.6
Total assets	2,062.2	1,786.0	1,960.9
Long-term debt(2)	513.5	455.6	694.0
Total liabilities	780.8	670.4	934.5
Shareholders' equity	1,281.4	1,115.5	1,026.4
Key Performance Indicators			
EBITDA margin(1)	11.5%	12.9%	14.4%
Operating margin(1)	9.7%	11.0%	12.7%
Return on average equity(1)	11.5%	15.7%	15.9%
Working capital ratio(1)	6.70	7.04	8.58
Long-term debt(2) to total capitalization(1)	0.29:1	0.29:1	0.40:1
Long-term debt(2) to EBITDA(1)	2.10	1.87	2.62
Dividend per share	0.48	0.44	0.40

(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. Refer to the Non-IFRS financial measures section of this MD&A.
(2) Including current portion of long-term debt.
Note: Numbers are rounded.

- On December 18, 2018, Stella-Jones announced that the Toronto Stock Exchange had accepted its Notice of Intention to Make a Normal Course Issuer Bid. Shareholders may obtain a copy of the Notice of Intention upon request to the Company. Pursuant to the Notice, Stella-Jones may, during the twelve-month period commencing December 20, 2018 and ending December 19, 2019, purchase for cancellation, up to 3,000,000 common shares, representing approximately 4.3% of its outstanding common shares.

- On November 19, 2018, Stella-Jones announced the appointment of Ms. Karen Laflamme to its Board of Directors. Ms. Laflamme is Executive Vice-President and Chief Financial Officer, Retail, of Ivanhoé Cambridge, an investor and developer of superior quality real estate properties, projects and companies around the world. Ms. Laflamme's appointment was effective December 1, 2018.

- On September 25, 2018, Stella-Jones announced the appointment of Ms. Katherine A. Lehman as Chair of the Board, the establishment of a Governance and Nomination Committee and the implementation of additional governance initiatives.

- On August 14, 2018, Stella Jones International S.A. sold its remaining share ownership in Stella-Jones Inc. through a bought deal public offering of 8,445,911 common shares and a concurrent private placement of an aggregate of 13,126,925 common shares.

- On April 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of Wood Preservers Incorporated ("WP"), located at its wood treating facility in Warsaw, Virginia. WP manufactures, sells and distributes marine and foundation pilings and treated wood utility poles.

- On February 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of Prairie Forest Products ("PFP"), a division of Prendiville Industries Ltd., located at its wood treating facility in Neepawa, Manitoba, as well as at its peeling facility in Birch River, Manitoba. PFP manufactures treated wood utility poles as well as treated residential lumber.

NON-IFRS FINANCIAL MEASURES

This MD&A 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 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 margins**: 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 EBITDA
- **Return on average equity**: Net income divided by the mathematical average of the current and prior year's shareholders' equity
- **Working capital ratio**: Total current assets divided by total current liabilities
- **Long-term debt to total capitalization**: Long-term debt (including the current portion) divided by the sum of shareholders' equity and long-term debt (including the current portion)

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

Reconciliation of EBITDA and operating income to net income (millions of dollars)	Three-month periods ended		Fiscal years ended	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
Net income for the period	20.6	51.1	137.6	167.9
Plus:				
Provision for (recovery of) income taxes	6.4	(26.0)	49.6	20.5
Financial expenses	4.8	3.9	19.1	19.0
Operating income	31.8	29.0	206.3	207.4
Depreciation and amortization	10.0	9.0	38.1	35.7
EBITDA	41.8	38.0	244.4	243.1

Note: Numbers may not add exactly due to rounding.

FOREIGN EXCHANGE

The table below shows average and closing exchange rates applicable to Stella-Jones' quarters for the years 2018 and 2017. 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.

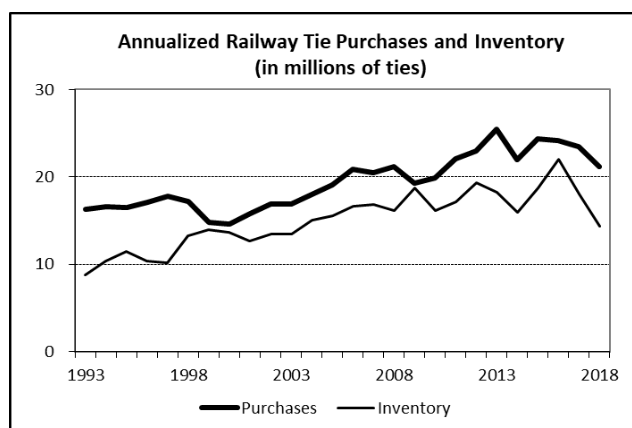
Cdn$/US$ rate	2018		2017	
	Average	Closing	Average	Closing
First Quarter	1.2549	1.2894	1.3240	1.3310
Second Quarter	1.2893	1.3168	1.3491	1.2977
Third Quarter	1.3080	1.2945	1.2664	1.2480
Fourth Quarter	1.3129	1.3642	1.2754	1.2545
Fiscal Year	1.2913	1.3642	1.3038	1.2545

- Average rate: The depreciation of the U.S. dollar relative to the Canadian dollar during 2018 compared to 2017 resulted in a negative impact on sales while benefitting cost of sales.
- Closing rate: The appreciation of the U.S. dollar relative to the Canadian dollar as at December 31, 2018, compared to December 31, 2017 resulted in a higher value of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

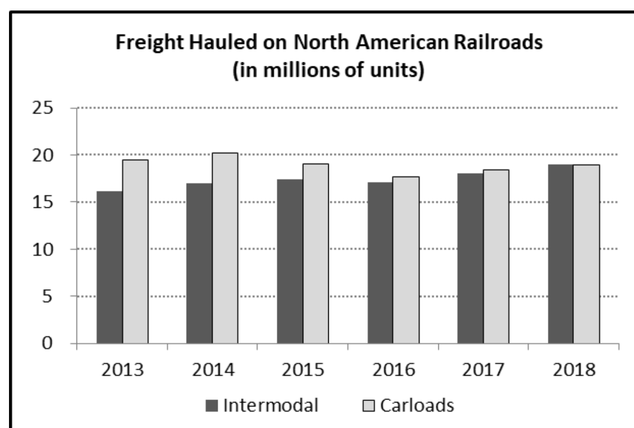
RAILWAY TIE INDUSTRY OVERVIEW

As reported by the Railway Tie Association ("RTA"), purchases for 2018 were 21.2 million ties, versus 23.4 million ties for 2017. The RTA calculates purchases based on the difference between monthly production and the change in inventory, as reported by its members. Inventory levels are lower at 14.4 million as at December 31, 2018, as purchases are outpacing production. As a result, the inventory-to-sales ratio was 0.68:1 as at December 31, 2018, beneath the previous ten-year average ratio of 0.78:1.

In the last decade, volatile fuel prices and persistent highway congestion have increasingly caused shippers to favour rail, a more fuel-efficient transportation mode, over trucks. The resulting increase in rail transportation volume, combined with an aging infrastructure, yielded greater demand for products and services related to the modernization and extension of the North American rail network, including railway ties.



Source: Railway Tie Association



Source: Association of American Railroads

Total traffic on North American railroads increased 3.4% in 2018, according to data released by the Association of American Railroads. Carload volume grew by 2.0%, mainly due to increased shipments of petroleum and petroleum products, chemicals and metallic ores and metals, whereas the volume of intermodal trailers and containers rose 4.8% from 2017 levels.

OPERATING RESULTS

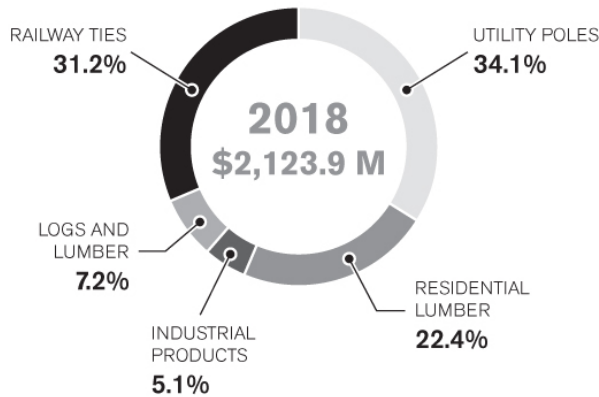
Sales

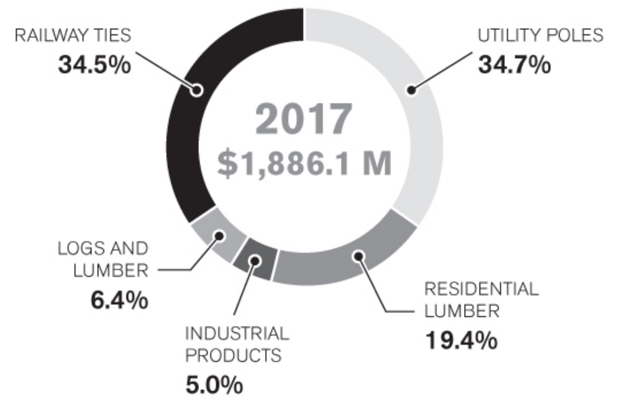
Sales for the year ended December 31, 2018 reached $2,123.9 million, up 12.6% versus last year's sales of $1,886.1 million. Acquisitions contributed sales of approximately $60.5 million, while the conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, had a negative impact of $12.9 million on the value of U.S. dollar denominated sales when compared with the previous year. Excluding these factors, sales increased approximately $190.2 million, or 10.1%, as detailed below.

Sales (in millions of dollars, except percentages)	**Railway Ties**	**Utility Poles**	**Residential Lumber**	**Industrial Products**	**Logs & Lumber**	**Consolidated Sales**
2017	**651.5**	**654.0**	**366.2**	**94.5**	**119.9**	**1,886.1**
Acquisitions	-	1.4	43.9	14.4	0.8	60.5
FX impact	(6.9)	(3.4)	(1.7)	(0.9)	-	(12.9)
Organic growth	17.8	73.0	66.3	1.0	32.1	190.2
2018	**662.4**	**725.0**	**474.7**	**109.0**	**152.8**	**2,123.9**
Organic growth %	2.7%	11.2%	18.1%	1.1%	26.8%	10.1%

Note: Numbers may not add exactly due to rounding.

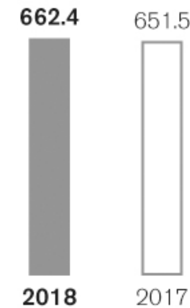
SALES BY PRODUCT CATEGORY
(% of sales)





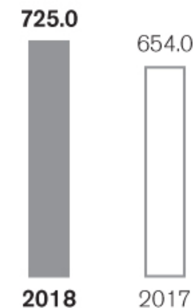
Railway ties

Railway tie sales for 2018 amounted to $662.4 million, representing an increase of 1.7%, from sales of $651.5 in 2017. The currency conversion effect decreased the value of U.S. dollar denominated sales by about $6.9 million. Excluding the currency conversion effect, railway tie sales increased approximately $17.8 million, or 2.7%, primarily as a result of price increases in the second half of the year, partially offset by the Company supporting the transition of a Class 1 railroad customer from a "treating services only" program to a full service "black-tie" program in the first half of the year. Railway tie sales accounted for 31.2% of the Company's total sales in 2018.



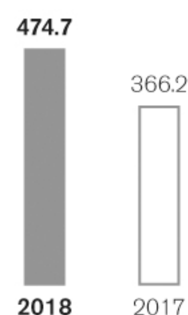
Utility poles

Utility pole sales reached $725.0 million in 2018, up 10.9% from sales of $654.0 million in 2017. Acquisitions contributed sales of $1.4 million, while the currency conversion effect decreased the value of U.S. dollar denominated sales by about $3.4 million. Excluding the contribution from acquisitions and the currency conversion effect, utility pole sales increased approximately $73.0 million, or 11.2%, primarily driven by increased sales in the U.S. Southeast, increased projects related to transmission poles, healthy demand for replacement programs and increased sales prices. Utility pole sales accounted for 34.1% of the Company's total sales in 2018.



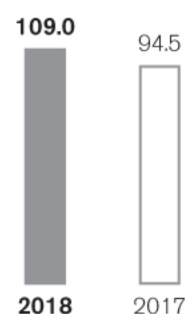
Residential lumber

Sales in the residential lumber category totalled $474.7 million in 2018, up 29.6% from sales of $366.2 million in 2017. Acquisitions contributed sales of approximately $43.9 million, while the currency conversion effect decreased the value of U.S. dollar denominated sales by about $1.7 million when compared with 2017. Excluding these factors, residential lumber sales increased approximately $66.3 million, or 18.1%. This favourable variance is primarily explained by higher selling prices as a result of higher lumber costs passed through to customers and to increased volume due to the Company's expanding market presence. Residential lumber accounted for 22.4% of the Company's total sales in 2018.



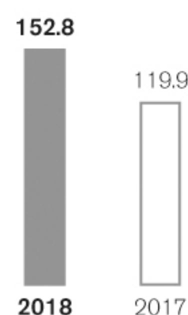
Industrial products

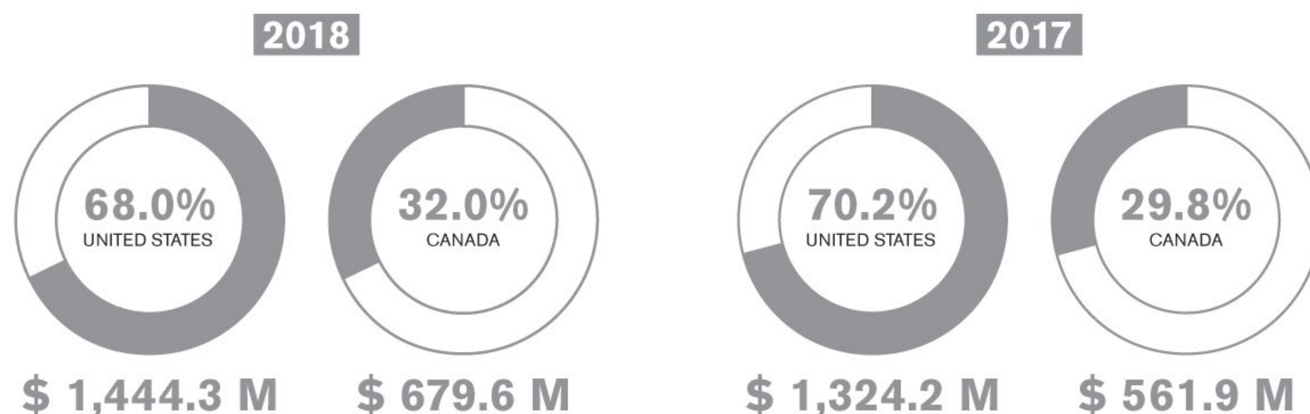
Industrial product sales reached $109.0 million in 2018, compared with $94.5 million last year. Acquisitions contributed sales of approximately $14.4 million, while the currency conversion effect decreased the value of U.S. dollar denominated sales by about $0.9 million when compared with 2017. Excluding the contribution from acquisitions and the currency conversion effect, sales increased 1.1%, explained in most part by demand for rail-related products and projects requiring laminated products, partially offset by lower demand for bridges and timbers. Industrial products represented 5.1% of the Company's total sales in 2018.



Logs and lumber

Sales in the logs and lumber product category totalled $152.8 million in 2018, compared with $119.9 million in 2017. Excluding the contribution from acquisitions, sales for this product category increased 26.8%. This significant variance reflects higher selling prices due to higher lumber costs coupled with increased harvesting activities to procure raw material to support strong pole sales. Logs and lumber sales represented 7.2% of the Company's total sales in 2018.





Sales in the United States amounted to $1,444.3 million, or 68.0% of sales in 2018, representing an increase of $120.0 million, or 9.1%, over sales of $1,324.2 million in 2017. This year-over-year increase is mainly attributable to higher sales across all product categories, coupled with the contribution of the WP acquisition, partially offset by the negative effect of local currency translation on U.S.-dollar denominated sales.

Sales in Canada amounted to $679.6 million, or 32.0% of sales in 2018, representing an increase of $117.7 million, or 20.9%, over sales of $561.9 million in 2017. This year-over-year increase primarily reflects higher sales in the residential lumber product category driven by volume as well as increased selling prices due to higher lumber costs and the contribution of the PFP acquisition. Moreover, the increase was also impacted by higher sales in the utility pole and logs and lumber product categories.

Cost of sales

Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $1,809.7 million, or 85.2% of sales, in 2018. This compares with $1,586.3 million, or 84.1% of sales, in 2017. The cost of sales increase is explained by the Company supporting the transition of a Class 1 railroad customer from a "treating services only" program to a full service "black-tie" program in the first half of the year. To accelerate this transition, the Company acquired untreated railway ties from the Class 1 railroad customer which increased cost of sales once these ties were treated and sold. Moreover, cost of sales was also impacted by the increasing cost of untreated railway ties and certain untreated species of poles. In addition, the higher lumber costs for the year, which were passed through to the customers via higher selling prices, have contributed to increased cost of sales in the residential product category but have also put downward pressure on margins as a percentage of sales. These cost increases were partially offset by the effect of currency translation.

Depreciation and amortization charges reached $38.1 million in 2018, up from $35.7 million in 2017. As a result, gross profit reached $314.2 million, or 14.8% of sales, in 2018, compared with $299.9 million, or 15.9% of sales, in 2017.

Selling and administrative

Selling and administrative expenses for 2018 were $99.0 million, compared with expenses of $93.8 million in 2017. This variation is primarily explained by higher taxable tax credits of $2.6 million recognized in 2017, coupled with higher salaries and benefits as well as greater stock-based compensation expenses in 2018, partially offset by the effect of currency translation. As a percentage of sales, selling and administrative expenses represented 4.7% of sales in 2018, slightly down from 5.0% in 2017.

Other losses (gains), net
Stella-Jones' other net losses of $8.9 million for 2018, included a $7.9 million non-cash loss related to the mark-to-market effect of diesel and petroleum derivative commodity contracts. In 2017, other net gains of $1.3 million mainly consisted of a $4.1 million foreign exchange gain and a $2.1 million reversal of a provision for site remediation, partially offset by a $3.2 million expense on freight and distribution accruals and a $1.3 million loss on asset disposal.

The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to its sales and purchases in U.S. dollars by its Canadian-based operations and to U.S. dollar denominated long-term debt held by its Canadian company. Stella-Jones U.S. Holding Corporation, the Company's wholly-owned U.S. subsidiary, is a foreign operation that has a different functional currency from that of the Company and foreign exchange gains and losses on translating its financial statements are deferred in shareholders' equity. The Company monitors its transactions in U.S. dollars generated by Canadian-based operations. Its basic hedging activity for economic purposes consists of entering into foreign exchange forward contracts for the sale of U.S. dollars and purchasing certain goods and services in U.S. dollars. The Company will also consider foreign exchange forward contracts for the purchase of U.S. dollars for significant purchases of goods and services that are not covered by natural hedges.

Financial expenses
Financial expenses reached $19.1 million in 2018, in line with $19.0 million in 2017, as higher year-over-year borrowings, resulting mainly from financing for the acquisitions, were partially offset by the effect of local currency conversion on financial expenses related to the Company's U.S. dollar denominated borrowings.

Income before income taxes and income tax expense
Stella-Jones generated income before income taxes of $187.2 million, or 8.8% of sales, in 2018, in line with income before income taxes of $188.4 million, or 10.0% of sales, in 2017.

Stella-Jones' income tax expense totalled $49.6 million in 2018, representing an effective tax rate of 26.5%. In 2017, the income tax expense stood at $20.5 million, equivalent to an effective tax rate of 10.9%. The lower effective tax rate in 2017 reflects changes to the U.S. Federal Corporate income tax rate following the enactment of the Tax Cuts and Jobs Act (the "Act") on December 22, 2017. The Act favourably affected the Company's U.S. subsidiaries, specifically by reducing the top federal corporate income tax rate from 35.0% to 21.0%, starting January 1, 2018. Although the Act only came into effect on January 1, 2018, changes to the tax rates required the remeasurement of the deferred income tax liability as at December 31, 2017. As a result of the reduction in tax rates, a one-off non-cash deferred tax benefit of $30.0 million was recognized in the statement of income for the fourth quarter ended December 31, 2017 which explains the lower effective tax rate for 2017.

Net income
Net income for 2018 reached $137.6 million, or $1.98 per diluted share, versus net income of $167.9 million, or $2.42 per diluted share, in 2017. This decrease is primarily explained by the lower income tax expense in 2017.

BUSINESS ACQUISITIONS

Wood Preservers Incorporated

On April 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of WP, located at its wood treating facility in Warsaw, Virginia. WP manufactures, sells and distributes marine and foundation pilings and treated wood utility poles.

Total cash outlay associated with the acquisition was approximately $27.5 million (US$21.6 million), excluding acquisition costs of approximately $423,000 recognized in the consolidated statement of income under selling and administrative expenses. The Company financed the acquisition through its existing syndicated credit facilities. The consideration transferred is also comprised of an unsecured promissory note bearing no interest and payable annually on the anniversary of the transaction in six instalments of US$500,000. This unsecured promissory note was recorded at a fair value of $3.3 million (US$2.6 million), using an effective interest rate of 4.17%.

The following table is a final summary of the assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. No significant adjustments were made to the preliminary fair value determination. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

(Tabular information presented in millions of dollars)	
Assets acquired	
Accounts receivable	3.9
Inventories	8.5
Property, plant and equipment	18.2
Customer relationships	0.2
Goodwill	1.1
Total assets acquired	**31.9**
Liabilities assumed	
Deferred income tax liabilities	0.4
Total net assets acquired and liabilities assumed	**31.5**
Consideration transferred	
Cash	27.5
Consideration payable	0.7
Unsecured promissory note	3.3
Consideration transferred	**31.5**

Prairie Forest Products

On February 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of PFP, a division of Prendiville Industries Ltd., located at its wood treating facility in Neepawa, Manitoba, as well as at its peeling facility in Birch River, Manitoba. PFP manufactures treated wood utility poles as well as treated residential lumber.

Total cash outlay associated with the acquisition was approximately $27.0 million excluding acquisition costs of approximately $425,000 of which $159,000 and $266,000 were recognized respectively in the 2017 and 2018 consolidated statements of income under selling and administrative expenses. The Company financed the acquisition through its existing syndicated credit facilities.

The following table is a final summary of the assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. No significant adjustments were made to the preliminary fair value determination.

(Tabular information presented in millions of dollars)	
Assets acquired	
Inventories	10.5
Property, plant and equipment	7.8
Customer relationships	5.9
Goodwill	4.0
Deferred income tax assets	0.2
Total assets acquired	**28.4**
Liabilities assumed	
Site remediation provision	1.4
Total net assets acquired and liabilities assumed	**27.0**
Consideration transferred	
Cash	27.0
Consideration transferred	**27.0**

QUARTERLY RESULTS

The Company's sales follow a seasonal pattern, with railway tie, utility pole and industrial product shipments strongest 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; thus 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 eight quarters, ending with the most recently completed financial year:

2018

For the quarters ended (millions of dollars, except EPS)	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
	$	$	$	$	$
Sales	398.8	662.3	630.0	432.8	2,123.9
EBITDA	44.0	80.1	78.5	41.8	244.4
Operating income	35.5	71.0	67.9	31.8	206.3
Net income for the period	23.1	48.1	45.8	20.6	137.6
EPS - basic and diluted	0.33	0.69	0.66	0.30	1.98

2017

For the quarters ended (millions of dollars, except EPS)	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
	$	$	$	$	$
Sales	396.9	594.2	517.6	377.4	1,886.1
EBITDA	49.7	83.6	71.8	38.0	243.1
Operating income	40.8	74.5	63.1	29.0	207.4
Net income for the period	25.9	48.9	42.0	51.1	167.9
EPS - basic and diluted	0.37	0.71	0.61	0.74	2.42

Note: Due to rounding, the sum of results for the quarters may differ slightly from the total shown for the full year.

FOURTH QUARTER RESULTS

Highlights

Selected Key Indicators (in millions of dollars, except margins and EPS)	Q4-2018	Q4-2017	Variation ($)	Variation (%)
Operating results				
Sales	432.8	377.4	55.4	14.7%
Gross profit	67.0	53.5	13.5	25.2%
EBITDA	41.8	38.0	3.8	10.0%
EBITDA margin	9.7%	10.1%	n/a	n/a
Operating income	31.8	29.0	2.8	9.7%
Net income	20.6	51.1	(30.5)	(59.7%)
EPS – basic & diluted	0.30	0.74	(0.44)	(59.5%)

Note: Numbers are rounded.

Operating Results

Sales for the fourth quarter of 2018 amounted to $432.8 million, up 14.7% from sales of $377.4 million for the same period in 2017. Acquisitions contributed sales of approximately $11.4 million, while the conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, had a positive impact of $9.0 million on the value of U.S. dollar denominated sales when compared with the corresponding period last year. Excluding these factors, sales increased approximately $35.0 million, or 9.3%, as detailed below.

Sales (in millions of dollars, except percentages)	Railway Ties	Utility Poles	Residential Lumber	Industrial Products	Logs & Lumber	Consolidated Sales
Q4-2017	**118.0**	**162.9**	**48.6**	**20.0**	**27.9**	**377.4**
Acquisitions	-	0.3	7.2	3.9	-	11.4
FX impact	3.3	4.4	0.6	0.4	0.3	9.0
Organic growth	5.7	24.4	3.9	(1.2)	2.2	35.0
Q4-2018	**127.0**	**192.0**	**60.3**	**23.1**	**30.4**	**432.8**
Organic growth %	4.8%	15.0%	8.0%	(6.0%)	7.9%	9.3%

Note: Numbers may not add exactly due to rounding.

Sales of railway ties reached $127.0 million, versus $118.0 million last year. Excluding the currency conversion effect, railway tie sales rose 4.8%, driven by price increases. Utility pole sales amounted to $192.0 million, up 17.9% from $162.9 million last year. Excluding the contribution from acquisitions and the currency conversion effect, sales grew 15.0% as a result of greater market reach in the U.S. Southeast, increased project activity requiring transmission poles, healthy demand for replacement programs and requirements following the California wildfires in late 2018. Residential lumber sales reached $60.3 million, up from $48.6 million last year. Excluding the contribution from acquisitions and the currency conversion effect, sales grew 8.0%, reflecting stronger volume in Canada, partially offset by lower selling prices in the U.S. Industrial product sales amounted to $23.1 million, up from $20.0 million a year ago. Excluding acquisitions and the currency conversion effect, sales decreased 6.0% as a result of lower bridge and timber demand. Finally, logs and lumber sales stood at $30.4 million, versus $27.9 million last year. Excluding the currency conversion effect, sales grew 7.9%, driven, in most part, by heightened pole procurement efforts which resulted in more log sales, partially offset by lower selling prices on lumber.

Gross profit amounted to $67.0 million, or 15.5% of sales, in the fourth quarter of 2018, versus $53.5 million, or 14.2% of sales, in the fourth quarter of 2017. The increase as a percentage of sales mainly reflects better year-over-year overhead absorption driven by greater production activity while product margins were comparable to the previous year. Operating income totalled $31.8 million, or 7.4% of sales, in the fourth quarter of 2018, versus $29.0 million, or 7.7% of sales, last year.

Net income for the period reached $20.6 million, or $0.30 per diluted share, compared with $51.1 million, or $0.74 per diluted share, in the prior year. The year-over-year decrease is attributable to a one-off non-cash tax benefit of $30.0 million recognized in the fourth quarter of 2017, stemming from the remeasurement of deferred tax liabilities following a reduction in the U.S. top federal corporate income tax rate. Fourth quarter results were also impacted by a non-cash loss of $7.9 million related to the mark-to-market fair value of diesel and petroleum derivative commodity contracts.

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 December 31, 2018, compared to December 31, 2017 (see "Foreign Exchange" on page 4), results in a higher value of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

Assets

As at December 31, 2018, total assets reached $2.06 billion, versus $1.79 billion as at December 31, 2017. The higher balance of total assets mostly reflects an increase in current assets, as detailed below.

Assets (in millions of dollars)	**As at December 31, 2018**	**As at December 31, 2017**	**Variance**
Accounts Receivable	192.4	163.5	28.9
Inventories	838.6	718.5	120.1
Other current assets	37.4	26.4	11.0
Total current assets	**1,068.4**	**908.4**	**160.0**
Property, plant and equipment	551.8	466.1	85.7
Intangible assets	131.7	130.3	1.4
Goodwill	298.3	270.3	28.0
Other non-current assets	12.1	10.9	1.2
Total non-current assets	**993.9**	**877.6**	**116.3**
Total assets	**2,062.2**	**1,786.0**	**276.2**

Note: Numbers may not add exactly due to rounding.

The value of accounts receivable, which is net of a credit loss provision of $2.2 million, was $192.4 million as at December 31, 2018, compared with $163.5 million as at December 31, 2017. The increase is attributable to higher sales in the fourth quarter of 2018, when compared to the fourth quarter of 2017, coupled with the effect of local currency translation on U.S.-based accounts receivable. Management considers that all recorded receivables in the statement of financial position are collectible as major customers, mainly Class 1 railroad operators, large retailers and large-scale utility service providers, have good credit standing and limited history of default.

Inventories stood at $838.6 million as at December 31, 2018, up from $718.5 million as at December 31, 2017. This increase reflects the effect of local currency translation on U.S. dollar denominated inventories and the inventories pertaining to the PFP and WP acquisitions as well as higher inventory levels in preparation for deliveries in the first half of 2019.

Because of 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. As such, inventory turnover has historically been relatively low. In addition, important raw material and finished goods inventory are required at certain times of the year to support the residential lumber product category. However, solid relationships and long-term contracts with customers enable the Company 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. The Company believes that its cash flow from operations and available syndicated credit facilities are adequate to meet its working capital requirements for the foreseeable future.

The value of property, plant and equipment stood at $551.8 million as at December 31, 2018, compared with $466.1 million as at December 31, 2017. This increase is mainly related to the purchase of property, plant and equipment of $51.6 million during 2018, the additional property, plant and equipment from the PFP and WP acquisitions totalling $26.0 million and the effect of local currency translation on U.S-based property, plant and equipment, partially offset by depreciation of $21.1 million for the period.

The value of intangible assets and goodwill reached $131.7 million and $298.3 million, respectively, as at December 31, 2018. Intangible assets include customer relationships, the discounted value of non-compete agreements, a creosote registration, cutting rights, standing timber, software and a favourable lease agreement. As at December 31, 2017, intangible assets and goodwill were $130.3 million and $270.3 million, respectively. The slight increase in the value of intangible assets stems primarily from customer relationships from acquisitions and the effect of local currency translation on U.S.-based intangible assets, partially offset by an amortization charge of $17.0 million in 2018. The increase in goodwill is primarily explained by acquisitions and the effect of local currency translation on U.S. dollar denominated goodwill.

Liabilities

As at December 31, 2018, Stella-Jones' total liabilities stood at $780.8 million, up from $670.4 million as at December 31, 2017. This variation reflects an increase in non-current liabilities as well as current liabilities, as detailed below.

Liabilities (in millions of dollars)	**As at December 31, 2018**	**As at December 31, 2017**	**Variance**
Accounts payable and accrued liabilities	133.3	111.2	22.1
Current portion of long-term debt	9.7	5.7	4.0
Other current liabilities	16.4	12.1	4.3
Total current liabilities	**159.4**	**129.0**	**30.4**
Long-term debt	503.8	449.9	53.9
Other non-current liabilities	117.6	91.5	26.1
Total non-current liabilities	**621.4**	**541.4**	**80.0**
Total liabilities	**780.8**	**670.4**	**110.4**

Note: Numbers may not add exactly due to rounding.

The value of current liabilities was $159.4 million as at December 31, 2018, versus $129.0 million as at December 31, 2017. This variation is primarily attributable to a $22.1 million increase in accounts payable and accrued liabilities related to higher business activity in the fourth quarter of 2018, compared to the same period last year. It is also explained by 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 $513.5 million as at December 31, 2018, versus $455.6 million as at December 31, 2017. The increase mainly reflects higher working capital requirements, financing required for the acquisitions of PFP and WP, as well as the effect of local currency translation on U.S. dollar denominated long-term debt. As at December 31, 2018, an amount of $291.6 million was available against the Company's syndicated credit facilities of $579.8 million (US$425.0 million). The Company's syndicated credit facilities are made available for a five-year term until February 2024 and thus considered long-term debt.

As at December 31, 2018, the Company was in full compliance with its debt covenants and contractual obligations.

On January 14, 2019, the Company obtained a one-year extension of its unsecured revolving facility to February 27, 2024. This extension was granted through an amendment to the fifth amended and restated credit agreement dated as of February 26, 2016, as amended on May 18, 2016 and March 15, 2018.

Shareholders' equity

Shareholders' equity reached $1.28 billion as at December 31, 2018 compared with $1.12 billion as at December 31, 2017. This variation reflects an increase in retained earnings and accumulated other comprehensive income, as detailed below.

Shareholders' Equity (in millions of dollars)	**As at December 31, 2018**	**As at December 31, 2017**	**Variance**
Capital Stock	221.3	220.4	0.9
Contributed surplus	0.3	0.3	-
Retained earnings	909.1	809.0	100.1
Accumulated other comprehensive income	150.7	85.8	64.9
Total shareholders' equity	**1,281.4**	**1,115.5**	**165.9**

Note: Numbers may not add exactly due to rounding.

The increase is attributable to net income of $137.6 million during 2018 and a $64.9 million favourable variation in the value of accumulated other comprehensive income resulting from the effect of currency fluctuations, partially offset by dividends of $33.3 million.

As part of its Normal Course Issuer Bid, the Company repurchased, as at December 31, 2018, 105,000 common shares for cancellation in consideration of $4.0 million. As at December 31, 2018, the Company had unsettled transactions to repurchase 42,000 common shares for a cash consideration of $1.6 million. The settlement of these transactions occurred in early January 2019 and the cancellation of the corresponding common shares was done at the same time.

LIQUIDITY AND CAPITAL RESOURCES

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

Summary of cash flows (millions of dollars)	**Years ended**	
	December 31, 2018	**December 31, 2017**
Operating activities	128.1	301.1
Financing activities	(26.0)	(239.9)
Investing activities	(108.5)	(58.5)
Net change in cash and cash equivalents during the year	(6.4)	2.7
Cash and cash equivalents - beginning	6.4	3.7
Cash and cash equivalents - end	**-**	**6.4**

Note: Numbers may not add exactly due to rounding.

The Company's activities, acquisitions and purchases of property, plant and equipment are primarily financed by cash flows from operating activities, available cash and long-term debt. The Company plans a similar level of capital expenditures in 2019 as compared to 2018 ($51.6 million in 2018), which will include a plant expansion in Cameron, Wisconsin.

Cash flows from operating activities

Cash flows provided by operating activities in 2018 were $128.1 million, versus $301.1 million for the corresponding period last year. This variation mainly reflects changes in non-cash working capital components, as detailed below.

Cash flows from operating activities (in millions of dollars)	**December 31, 2018**	**December 31, 2017**
Net income	137.6	167.9
Loss on derivative financial instruments	8.6	0.8
Deferred income taxes	10.6	(21.1)
Others	105.5	100.6
Cash flows from operating activities before changes in non-cash working capital components and interest and income taxes paid	**262.3**	**248.2**
Inventories	(56.7)	100.7
Other current assets	(15.3)	4.4
Other	(4.1)	(2.0)
Changes in non-cash working capital components	**(76.1)**	**103.1**
Interest paid	(18.7)	(15.8)
Income taxes paid	(39.4)	(34.5)
Cash flows from operating activities	**128.1**	**301.1**

Note: Numbers may not add exactly due to rounding.

Cash flows from operating activities before changes in non-cash working capital components and interest and income taxes paid was $262.3 million in 2018, compared with $248.2 million in 2017. This increase mostly reflects higher deferred income taxes and a loss on derivative financial instruments, partially offset by lower net income.

Changes in non-cash working capital components decreased liquidity by $76.1 million in 2018. This was mainly due to an increase in inventory levels and cost. In 2017, changes in non-cash working capital components had increased liquidity by $103.1 million, driven by lower inventory cost and volume of railway ties.

Interest and income taxes paid reduced liquidity by $18.7 million and $39.4 million, respectively, in 2018. This compares with interest paid of $15.8 million and income taxes paid of $34.5 million in 2017.

As a result, cash flows from operating activities generated $128.1 million in 2018, versus $301.1 million in 2017.

Cash flows from financing activities

Financing activities for 2018 reduced liquidity by $26.0 million, primarily related to dividend payments of $33.3 million and the repurchase of common shares totalling $4.0 million. In 2017, financing activities reduced liquidity by $239.9 million explained by a $207.4 million net decrease in debt financing.

Cash flows from financing activities (in millions of dollars)	**December 31, 2018**	**December 31, 2017**
Net change in syndicated credit facilities	18.7	(391.8)
Increase in long-term debt	-	195.9
Repayment of long-term debt	(6.7)	(11.5)
Dividends on common shares	(33.3)	(30.5)
Repurchase of common shares	(4.0)	-
Other	(0.7)	(2.0)
Cash flows from financing activities	**(26.0)**	**(239.9)**

Note: Numbers may not add exactly due to rounding.

Cash flows from investing activities

Investing activities used $108.5 million in liquidity in 2018, as compared to $58.5 million in 2017. The PFP and WP acquisitions required an investment of $54.5 million, while the purchase of property, plant and equipment required $51.6 million of liquidity, as detailed below.

Cash flows from investing activities (in millions of dollars)	**December 31, 2018**	**December 31, 2017**
Business acquisitions	(54.5)	(5.8)
Purchase of property, plant and equipment	(51.6)	(50.6)
Other	(2.4)	(2.1)
Cash flows from investing activities	**(108.5)**	**(58.5)**

Note: Numbers may not add exactly due to rounding.

Financial Obligations

The following table details the maturities of the financial obligations as at December 31, 2018:

Financial obligations (in millions of dollars)	**Carrying Amount**	**Contractual Cash flows**	**Less than 1 year**	**1 – 3 years**	**4 – 5 years**	**After 5 years**
Accounts payable and accrued liabilities	133.3	133.3	133.3	-	-	-
Long-term debt obligations	513.5	601.8	25.5	51.7	303.1	221.5
Minimum payments under operating lease obligations	-	132.8	30.2	46.9	26.2	29.5
Derivative commodity agreements	8.1	8.3	4.1	4.2	-	-
Non-compete agreements	4.3	4.6	1.6	3.0	-	-
Financial obligations	**659.2**	**880.8**	**194.7**	**105.8**	**329.3**	**251.0**

SHARE AND STOCK OPTION INFORMATION

As at December 31, 2018, the capital stock issued and outstanding of the Company consisted of 69,267,732 common shares (69,342,095 as at December 31, 2017). The following table presents the outstanding capital stock activity for the year ended December 31, 2018:

Number of shares (in thousands)	**Year Ended December 31, 2018**
Balance – Beginning of year	69,342
Repurchase of common shares	(105)
Employee share purchase plans	31
Balance – End of year	**69,268**

As at March 14, 2019, the capital stock issued and outstanding consisted of 69,125,146 common shares.

As at December 31, 2018, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 45,000 (December 31, 2017 – 45,000) of which 39,000 (December 31, 2017 – 33,000) were exercisable. As at March 14, 2019, the number of outstanding options was 45,000, of which 39,000 were exercisable.

DIVIDENDS

In 2018, the Board of Directors of Stella-Jones declared the following quarterly dividends:

Declared	Record Date	Payable Date	Dividend
March 13, 2018	April 6, 2018	April 27, 2018	$0.12
May 2, 2018	June 6, 2018	June 27, 2018	$0.12
August 7, 2018	September 3, 2018	September 21, 2018	$0.12
November 1, 2018	December 3, 2018	December 20, 2018	$0.12

Subsequent to year end, on March 14, 2019, the Board of Directors declared a quarterly dividend of $0.14 per common share payable on April 26, 2019 to shareholders of record at the close of business on April 5, 2019. 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 upon and subject to the Company's covenants in its loan documentation as well as its financial performance and cash requirements. There can be no assurance as to the amount or timing of such dividends in the future.

COMMITMENTS AND CONTINGENCIES

The Company is from time to time involved in various claims and legal proceedings arising in the ordinary course of business. It is the opinion of Management that a final determination of these proceedings cannot be made at this time but should not materially affect the Company's financial position or results of operations.

The Company has issued guarantees amounting to $29.7 million in 2018 (2017 – $19.0 million) under letters of credit and various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on and, as such, no provisions have been recorded in the consolidated financial statements.

The Company's operations are subject to Canadian federal and provincial as well as U.S. federal and state environmental laws and regulations governing, among other matters, air emissions, waste management and wastewater effluent discharges. The Company takes measures to comply with such laws and regulations. However, the measures taken are subject to the uncertainties of changing legal requirements, enforcement practices and developing technological processes.

RISKS AND UNCERTAINTIES

Economic Conditions

A negative change in economic conditions may affect most or all of the markets the Company serves, reducing demand for its products and adversely affecting its operating results. These economic conditions may also impact the financial condition of one or more of the Company's key suppliers, which could affect its ability to secure raw materials and components to meet its customers' demand for its products.

Dependence on Major Customers

The Company is dependent on major customers for a significant portion of its sales, and the loss of one or more of its major customers could result in a significant reduction in its profitability. For the year ended December 31, 2018, the Company's top ten customers accounted for approximately 44.2% of its sales. During this same period, the Company's largest customer accounted for approximately 16.6%, of its total sales and is associated to the residential lumber product category while the second largest customer accounted for approximately 9.3% of total sales and is associated to the railway tie product category.

Availability and Cost of Raw Materials

Management considers that the Company may be affected by potential fluctuations in wood prices. While the Company has entered into long-term cutting licenses and benefits from long-standing relationships with private woodland owners and other suppliers, there can be no assurance that such licenses will be respected or renewed on expiry, or that its suppliers will continue to provide adequate timber to the Company.

In addition, there are a limited number of suppliers for certain preservatives that the Company employs in its production process, which lessens the availability of alternate sources of supply in the event of unforeseen shortages or disruptions of production. While the Company is mitigating this risk by researching and identifying alternate suppliers outside of its traditional sources of supply, there can be no assurance that it will be able to secure the supply of all materials required to manufacture its products. The Company may also enter into certain commodity hedges, where available, for a percentage of forecasted needs in order to help ensure stable production costs.

Environmental Risk

The Company is subject to a variety of environmental laws and regulations, including those relating to emissions to the air, discharges into water, releases of hazardous and toxic substances, and remediation of contaminated sites. These environmental laws and regulations require the Company to obtain various environmental registrations, licenses, permits and other approvals, as well as carry out inspections, compliance testing and meet timely reporting requirements in order to operate its manufacturing and operating facilities.

Compliance with these environmental laws and regulations will continue to affect the Company's operations by imposing operating and maintenance costs and capital expenditures. Failure to comply could result in civil or criminal enforcement actions, which could result, among others, in the payment of substantial fines, often calculated on a daily basis, or in extreme cases, the disruption or suspension of operations at the affected facility.

Under various federal, provincial, state and local laws and regulations, the Company could, as the owner, lessor or operator, be liable for the costs of removal or remediation of contamination at its sites. The remediation costs and other costs required to clean up or treat contaminated sites could be substantial. However, in certain cases, the Company benefits from indemnities from the former owners of its sites. Contamination on and from the Company's sites may subject it to liability to third parties or governmental authorities for injuries to persons, property or the environment and could adversely affect the Company's ability to sell or rent its properties or to borrow money using such properties as collateral.

The possibility of major changes in environmental laws and regulations is another risk faced by the Company. While it is not possible to predict the outcome and nature of these changes, they could substantially increase the Company's capital expenditures and compliance costs at the facilities affected.

While the Company has been party to environmental litigation which has included, among others, claims for adverse physical effects and diminution of property value, the outcomes and associated costs have not been material. There is, however, no guarantee that this will continue to be the case in the future, as the result of disputes regarding environmental matters and conclusions of environmental litigation cannot be predicted.

The Company's business has grown and its image strengthened, in large part by its consistent production and delivery of high quality products, while maintaining as well, a high level of environmental responsibility. Claims of irresponsible practices by regulatory authorities, communities or customers could harm the reputation of the Company. Adverse publicity resulting from actual or perceived violations of environmental laws, regulations or industry practices could negatively impact customer loyalty, reduce demand, lead to a weakening of confidence in the marketplace and ultimately, a reduction in the Company's share price. These effects could materialize even if the allegations are not valid and the Company is not found liable.

Risk Related to Acquisitions
As part of its growth strategy, the Company intends to acquire additional complementary businesses where such transactions are economically and strategically justified. There can be no assurance that the Company will succeed in effectively managing the integration of other businesses which it might acquire. If the expected synergies do not materialize, or if the Company fails to successfully integrate such new businesses into its existing operations, this could have a material adverse effect on the Company's business, operating results, profitability and financial position. The Company may also incur costs and direct Management's attention to potential acquisitions which may never be consummated.

In addition, although the Company performs due diligence investigations in connection with its acquisitions, an acquired business could have liabilities that the Company fails or is unable to uncover prior to acquisition and for which the Company may be responsible. Such liabilities could have a material adverse effect on the Company's business operating results, profitability and financial position.

Litigation Risk
The Company is subject to the risk of litigation in the ordinary course of business by employees, customers, suppliers, competitors, shareholders, government agencies, or others, through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The outcome of litigation is difficult to assess or quantify. Claimants in these types of lawsuits or claims may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to these lawsuits or claims may remain unknown for substantial periods of time. Regardless of outcome, litigation could result in substantial costs to the Company. In addition, litigation could divert Management's attention and resources away from the day-to-day operations of the Company's business.

Insurance Coverage Risk
The Company maintains property, casualty, general liability and workers' compensation insurance, but such insurance may not cover all risks associated with the hazards of its business and is subject to limitations, including deductibles and maximum liabilities covered. The Company may incur losses beyond the limits, or outside the coverage, of its insurance policies, including liabilities for environmental compliance and remediation. In addition, from time to time, various types of insurance coverage for companies in the Company's industry have not been available on commercially acceptable terms or, in some cases, have not been available at all. In the future, the Company may not be able to obtain coverage at current levels, and its premiums may increase significantly on coverage that it maintains.

Currency Risk
The Company is exposed to currency risks due to its export of certain goods manufactured in Canada. The Company strives to mitigate such risks by purchases of raw materials denominated in U.S. dollars for use in its Canadian manufacturing process. The Company may also use foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars. The use of such currency hedges involves specific risks including the possible default by the other party to the transaction or illiquidity. Given these risks, there is a possibility that the use of hedges may result in losses greater than if hedging had not been used.

Interest Rate Fluctuation Risk
As at December 31, 2018, 96.0% of the Company's long-term debt was at fixed interest rates, therefore reducing the Company's exposure to interest rate risk. The Company enters into interest rate swap agreements in order to reduce the impact of fluctuating interest rates on its long-term debt, subject to floating interest rates. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as cash flow hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swap agreements. However, if interest rates increase, the debt service obligations on the variable rate indebtedness of the Company would increase even though the amount borrowed remained the same, and this could have adverse effect on the Company's business operating results, profitability and financial position.

Customers' Credit Risk
The Company carries a substantial level of trade accounts receivable on its statement of financial position. This value is spread amongst numerous contracts and clients. Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. Although the Company reduces this risk by dealing primarily with Class 1 railroad operators, large retailers and large-scale utility providers, there can be no assurance that outstanding accounts receivable will be paid on a timely basis or at all.

Cyber and Information Technology Risk
The Company relies on information technology to process, transmit and store electronic data in its daily business activities. Despite its security design and controls, and those of third-party providers, the Company's information technology and infrastructure may be vulnerable to cyber-attacks by hackers or breach due to employee error, malfeasance or other disruptions. Any such breach could result in operational disruption and increased costs or the misappropriation of sensitive data that could disrupt operations, subject the Company to litigation and have a negative impact on its reputation. To limit exposure to incidents that may affect confidentiality, integrity and availability of information, the Company has invested in data privacy controls, threat protections as well as detection and mitigation policies, procedures and controls. In addition, the Company relies on information technology systems to operate, and any disruption to such systems could cause a disruption to daily operations while the systems are being repaired or updated.

Corporate Tax Risk
In estimating the Company's income tax payable, Management uses accounting principles to determine income tax positions that are likely to be sustained by applicable tax authorities. However, there is no assurance that tax benefits or tax liability will not materially differ from estimates or expectations. The tax legislation, regulation and interpretation that apply to the Company's operations are continually changing. In addition, future tax benefits and liabilities are dependent on factors that are inherently uncertain and subject to change, including future earnings, future tax rates, and anticipated business in the various jurisdictions in which Stella-Jones operates. Moreover, the Company's tax returns are continually subject to review by applicable tax authorities. These tax authorities determine the actual amounts of taxes payable or receivable, any future tax benefits or liabilities and the income tax expense that Stella-Jones may ultimately recognize. Such determinations may become final and binding on the Company. Any of the above factors could have a material adverse effect on net income or cash flow.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company uses derivative instruments to provide economic hedges to mitigate various risks. The fair values of these instruments represent the amount of the consideration that could be exchanged in an arm's length transaction between willing parties who are under no compulsion to act. The fair value of these derivatives is determined using prices in active markets, where available. When no such market is available, valuation techniques are applied such as discounted cash flow analysis. The valuation technique incorporates all factors that would be considered in setting a price, including the Company's own credit risk, as well as the credit risk of the counterparty.

Interest Rate Risk Management
Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company enters into both fixed and floating rate debt. The risk management objective is to minimize the potential for changes in interest rates to cause adverse changes in cash flows to the Company. The Company enters into interest rate swap agreements in order to reduce the impact of fluctuating interest rates on its short-and long-term debt. As at December 31, 2018, the Company had two interest rate swap agreements hedging $252.4 million in debts and having maturity dates ranging from April 2021 to December 2021. These instruments are presented at fair value and designated as cash flow hedges. The ratio as at December 31, 2018, of fixed and floating debt was 96.0% and 4.0%, respectively, including the effects of interest rate swap positions (100.0% and 0.0%, respectively, as at December 31, 2017).

Foreign Exchange Risk Management
The Company's financial results are reported in Canadian dollars, while a portion of its Canadian-based operations are in U.S. dollars. Foreign exchange risk is the risk that fluctuations in foreign exchange rates may have on operating results and cash flows. The Company's risk management objective is to reduce cash flow risk related to foreign denominated cash flows. When the natural hedge of sales and purchases does not match, the Company considers foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars. As at December 31, 2018, the Company had no foreign exchange forward contract agreements in place.

Diesel and Petroleum Price Risk Management
Diesel and petroleum price risk is the risk that future cash flows will fluctuate because of changes in price of diesel and petroleum. In order to manage its exposure to diesel and petroleum prices and to help mitigate volatility in operating cash flow, the Company uses derivative commodity contracts based on the New York Harbor Ultra Low Sulfur Diesel Heating Oil to reduce the risk of fluctuating prices on these commodities. As at December 31, 2018, the Company had commodity hedges for 12.0 million gallons (1.2 million in 2017) of diesel and petroleum covering requirements for 2019 and 2020. These instruments are presented at fair value and were not designated for hedge accounting purposes.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the December 31, 2018 and 2017 audited consolidated financial statements as well as in the impact of new accounting pronouncements MD&A section that follows with regards to accounting policy changes for revenue recognition and financial instruments.

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

The preparation of 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 the estimated useful life of assets, impairment of goodwill, determination of the fair value of the assets acquired and liabilities assumed in the context of an acquisition and impairment of long-lived assets. 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.

Impact of new accounting pronouncements

IFRS 15 – *Revenue from Contracts with Customers*
In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, to specify how and when to recognize revenue as well as requiring the provision of more informative and relevant disclosures. IFRS 15 supersedes IAS 18, *Revenue*, IAS 11, *Construction Contracts*, and other revenue related interpretations. The retrospective adoption of this new standard had no significant impact on the Company's consolidated financial statements and the new accounting policy was defined as follows:

The Company sells treated and untreated wood products (the "Products"), as well as treating services. Revenue from the sale of Products is recognized when the Company satisfies a performance obligation by transferring a promised Product to a customer. Products are considered to be transferred once the customer takes control of them, being either at the Company's manufacturing site or at the customer's location. Control of the Products refers to the ability to direct its use and obtain substantially all of the remaining benefits from the Product.

The Company offers to treat wood products owned by third parties. Revenue from these treating services is recognized using the point in time criteria since there is a short manufacturing timeframe to treat wood products.

Product sales can be subject to retrospective volume discounts based on aggregate sales over a twelve-month period per certain contractual conditions. Revenue from these sales is recognized based on the price specified in the contract, net of the estimated volume discounts. Accumulated experience is used to estimate and provide for the discounts, using the expected value method, and revenue is only recognized to the extent that it is highly probable that a significant reversal will not occur. A liability is recognized for expected volume discounts payable to customers in relation to sales made until the end of the reporting period.

Products sales may also be subject to retrospective price discounts based on aggregate sales over a twelve-month period, according to certain contractual conditions. Revenue from these sales is recognized based on the expected average sales price over the specified period. Accumulated experience is used to estimate and provide for the price discounts, using the expected value method, and revenue is only recognized to the extent that it is highly probable that specified contractual conditions will be met. The customer is invoiced at the contract price and a liability is recognized to adjust to the average price.

A receivable is recognized when control of the Product is transferred to the customer because it is at this point in time that the consideration becomes unconditional since only the passage of time remains before payment is due.

IFRS 9 – *Financial Instruments*

The final version of IFRS 9, *Financial instruments*, was issued by the IASB in July 2014 and replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces a model for classification and measurement, a single, forward-looking expected loss impairment model and a substantially reformed approach to hedge accounting. The new single, principle-based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of an entity's own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. The retrospective adoption of this new standard had no significant impact on the Company's consolidated financial statements and the new accounting policy was defined as follows:

The Company recognizes a financial asset or a financial liability in its statement of financial position when it becomes party to the contractual provisions of the instrument. At initial recognition, the Company measures a financial asset or a financial liability at its fair value plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.

Financial assets

The Company will classify financial assets as subsequently measured at amortized cost, fair value through other comprehensive income or fair value through profit or loss, based on its business model for managing the financial asset and the financial asset's contractual cash flow characteristics. The three categories are defined as follows:

a) Amortized cost - a financial asset is measured at amortized cost if both of the following conditions are met:

   - the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
   - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

b) Fair value through other comprehensive income - financial assets are classified and measured at fair value through other comprehensive income if they are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

c) Fair value through profit or loss - any financial assets that are not held in one of the two business models mentioned in a) and b) are measured at fair value through profit or loss.

When, and only when, the Company changes its business model for managing financial assets it must reclassify all affected financial assets.

The Company's financial assets are comprised of cash, cash equivalents, accounts receivable and derivative financial instruments. Cash, cash equivalents and accounts receivable are measured at amortized cost. Derivative financial instruments that are not designated as hedging instruments are measured at fair value through profit or loss. Derivative financial instruments that are designated as hedging instruments are measured at fair value through other comprehensive income.

Financial liabilities

The Company's liabilities include accounts payable and accrued liabilities, bank indebtedness, long-term debt and derivative financial instruments. Accounts payable and accrued liabilities, bank indebtedness and long-term debt are measured at amortized cost. Derivative financial instruments that are not designated as hedging instruments are measured at fair value through profit or loss. Derivative financial instruments that are designated as hedging instruments are measured at fair value through other comprehensive income. After initial recognition, an entity cannot reclassify any financial liability.

Impairment

The Company assesses, on a forward-looking basis, the expected credit losses associated with its investment in debt securities carried at amortized cost and fair value through other comprehensive income. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, the Company applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognized from initial recognition of the receivables.

Hedging transactions

As part of its hedging strategy, the Company considers derivative financial instruments such as foreign exchange forward contracts to limit its exposure under contracted cash inflows of sales denominated in U.S. dollars from its Canadian-based operations. The Company also considers interest rate swap agreements in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These derivative financial instruments are treated as cash flow hedges for accounting purposes and are fair-valued through other comprehensive income.

The effective portion of changes in the fair value of derivative instruments that are designated and qualify as cash flow hedges is recognized in the cash flow hedge reserve within equity. The gain or loss relating to the ineffective portion is recognized immediately in profit or loss, within other income (expenses).

When forward contracts are used to hedge forecast transactions, the Company generally designates only the change in fair value of the forward contract related to the spot component as the hedging instrument. Gains or losses relating to the effective portion of the change in the spot component of the forward contracts are recognized in the cash flow hedge reserve within equity. The change in the forward element of the contract that relates to the hedged item is recognized within other comprehensive income in the costs of hedging reserve within equity. In some cases, the Company may designate the full change in fair value of the forward contract (including forward points) as the hedging instrument. In such cases, the gains or losses relating to the effective portion of the change in fair value of the entire forward contract are recognized in the cash flow hedge reserve within equity. Amounts accumulated in equity are reclassified in the periods when the hedged item affects profit or loss.

When a hedging instrument expires, or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative deferred gain or loss and deferred costs of hedging in equity at that time remains in equity until the forecast transaction occurs. When the forecast transaction is no longer expected to occur, the cumulative gain or loss and deferred costs of hedging that were reported in equity are immediately reclassified to profit or loss.

Impact of new accounting pronouncements not yet implemented

IFRS 16 - *Leases*
In January 2016, the IASB released IFRS 16, *Leases*, to set out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a lease agreement. The standard supersedes IAS 17, *Leases,* and the related interpretations on leases: IFRIC 4, *Determining whether an arrangement contains a lease*, SIC 15, *Operating Leases – Incentives* and SIC 27, *Evaluating the substance of transactions in the legal form of a lease*. The standard is effective for annual periods beginning on or after January 1, 2019.

Under the new standard, the Company will recognize, in the statement of financial position, assets (right to use the leased assets) totalling approximately $119.0 million, equivalent to the discounted cash flows of the future minimum payments, and corresponding financial liabilities. The assets will be depreciated over the duration of the lease agreements which has a weighted average of 78 months. The liabilities will be depleted upon contractual payment to the lessors and a corresponding financing expense will be recorded to the consolidated statements of income. The Company is currently assessing the impact of the new standard on its net income.

The following table outlines the key areas that will be impacted by the adoption of IFRS 16:

Impacted areas of the business	**Analysis**	**Conclusion**
Financial Reporting	The analysis includes determining which contracts will be in scope as well as the options available under the new standard and whether to apply the new standard on a full retrospective application in accordance with IAS 8 or retrospectively without restatement of comparative amounts.	The Company will adopt IFRS 16 for its fiscal year beginning January 1, 2019, retrospectively, without restatement of comparative amounts and shall use the exemptions for short-term leases and leases for which the underlying asset is of low value.
Information systems	The Company has analyzed the need to make changes within its information systems environment to optimize the management of close to 700 lease agreements that will fall within the scope of the new standard.	The Company has implemented an information technology solution to support recognition and measurement of leases in scope. The implementation was completed before the end of fiscal 2018.
Internal controls	The Company has performed a review and analysis of the changes to the control environment as a result of the adoption of IFRS 16.	New controls were implemented to enable monthly reconciliations of the assets and liabilities to detailed subledgers as well as reconciliations of the related financial and depreciation expenses. A roll forward analysis of these assets and liabilities will also be performed monthly. All lease agreements are approved by Head Office Management to ensure they are all captured for accounting purposes.
Stakeholders	The Company has performed an analysis of the impact on the disclosure to its stakeholders as a result of the adoption of IFRS 16.	The Company concluded that there will be no negative impact or breaches of agreement covenant as a result of the adoption of IFRS 16.

IFRIC 23 – *Uncertainty over Income Tax Treatments*
In June 2017, the IASB issued IFRIC 23, *Uncertainty over Income Tax Treatments*. This interpretation specifies that if an entity concludes it is probable that the taxation authority will accept an uncertain tax treatment, it shall determine the tax result consistently with the tax treatment used or planned to be used in its income tax filing. If it is not probable, the entity shall reflect the effect of uncertainty for each uncertain tax treatment by using either of the following methods, depending on which one the entity expects to better predict the resolution of the uncertainty:

- most likely amount: single most likely amount in a range of possible outcomes;
- expected value: sum of the probability-weighted amounts in a range of possible outcomes.

An entity shall apply IFRIC 23 for annual reporting periods beginning on or after January 1, 2019, with earlier application permitted. The Company will not early adopt IFRIC 23 and does not expect a significant impact.

IFRS 3 – *Business Combinations*
In October 2018, the IASB issued amendments to the definition of a business in IFRS 3, *Business Combinations*. The objective of the amendments is to assist entities in determining whether a transaction should be accounted for as a business combination or as an asset. The amendments apply prospectively to acquisitions that occur in annual periods beginning on or after January 1, 2020, with earlier application permitted.

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 and operating 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 December 31, 2018 and have concluded that such DC&P were designed and operating 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 and operating 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 appropriately designed and operating effectively, as at December 31, 2018.

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 October 1, 2018 to December 31, 2018 that have materially affected or are reasonably likely to materially affect the Company's ICFR.

OUTLOOK

The Company's railway tie and utility pole product categories are essential components of the North American basic transportation and utility infrastructure. Such infrastructure needs to be regularly maintained, which provides Stella-Jones with relatively steady demand for these products. In periods of economic growth, the Company may also benefit from additional demand stemming from expansions to the railway and telecommunication networks.

For 2019, based on current market conditions and assuming stable currencies and the current level of lumber prices, Management expects higher year-over-year sales for Stella-Jones, driven by stronger pricing for railway ties and utility poles as well as increased market reach for the residential lumber and the utility pole product categories. Management also expects improved year-over-year margins across all product categories. Higher margins will be primarily driven by increased pricing and volume for railway ties coupled with improved product mix for utility poles. Furthermore, it is important to note that the 2019 EBITDA will be positively impacted by the implementation of IFRS 16 while net income will be negatively impacted by higher financing expenses. The Company plans on spending a similar level of capital expenditures in 2019 as compared to 2018 ($51.6 million in 2018), which will include a plant expansion in Cameron, Wisconsin.

In the railway tie product category, North American railroads will continue to maintain their continental rail network, as operators constantly seek optimal line efficiency. Sales and margins for 2019 are expected to improve year-over-year, primarily driven by pricing. In fact, Management believes that the increasing costs of untreated railway ties, combined with a tighter supply market, will lead to continued upward selling price adjustments for the quarters ahead.

In the utility pole product category, demand for regular maintenance projects has historically been relatively steady. Sales and margins for 2019 are expected to increase year-over-year driven by both pricing and strong demand for replacement programs and increased project-based sales.

In the residential lumber product category, the Company expects to further benefit from continued demand for new construction and outdoor renovation projects in the North American residential and commercial markets. Sales for 2019 are expected to be stable, year-over-year, as higher market demand is expected to be offset by lower selling prices to customers, as a result of the lower lumber costs. Management closely monitors variations in these commodity prices, and adjusts its procurement practices accordingly, in order to maintain dollar margins on similar volume.

It is important to highlight that sales for the logs and lumber product category, an activity used to optimize procurement and which does not generate margin, is fairly tied to the price of lumber. Therefore, a decrease in the price of lumber will lead to lower sales but higher overall margins when taken as a whole with other product categories and vice versa.

As one of the leading providers of industrial treated wood products, Stella-Jones will leverage the strength of its continental network to capture more of its existing clients' business in its core railway tie and utility pole markets, while diligently seeking market opportunities in all product categories. The Company will also remain focused on improving operating efficiencies throughout the organization.

In the short-term, the Company will focus on optimizing operating capacity and minimizing costs throughout the organization. Cash generation and maintaining a prudent use of leverage remain priorities for Management. The cash flows provided from operating activities will be used to reduce debt, invest in working capital and in property, plant and equipment, buy back its own shares as well as maintain an optimal dividend policy to the benefit of shareholders.

Over the long-term, the Company's strategic vision, focused on continental expansion, remains intact, as Management believes that the fundamentals of each product category will remain strong. A solid financial position will allow Stella-Jones to continue to seek opportunities to further expand its presence in its core markets. These opportunities must meet its stringent investment requirements, provide synergies, and add value for shareholders.

March 14, 2019