Stella-Jones 2007 Annual Report

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") dated March 12, 2008 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2007 compared with the fiscal year ended December 31, 2006. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2007 and the notes thereto. The audited consolidated financial statements and MD&A have been reviewed by the Company's Audit Committee and, upon its recommendation, have been approved by the Board of Directors.

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.

The Company's audited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and results are reported in Canadian dollars. 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 SEDAR at www.sedar.com. Press releases and other information are also available in the Financial Information section of the Company's Web site at www.stella-jones.com.

Our business

Stella-Jones is a leading North American producer and marketer of industrial pressure treated wood products and also provides treated consumer lumber products and customized services to lumber retailers and wholesalers for outdoor applications.

The Company specializes in four major product categories: treated wood utility poles for utility and telecommunication companies; railway ties for rail transportation companies; industrial lumber products for construction and maritime applications and treated consumer lumber products for the residential market.

As of March 12, 2008, the Company owns and operates ten wood treating plants, two distribution centres, two pole peeling facilities and has a 50% interest in a third pole peeling operation. These fifteen facilities are located in the Canadian provinces of British Columbia, Alberta, Ontario, Québec, Nova Scotia and Newfoundland as well as in the states of Wisconsin, Idaho and Washington, USA. The Company's workforce currently numbers approximately 450 employees.

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.

Major Achievements of 2007

Stella-Jones' financial results for the year ended December 31, 2007, marked the seventh consecutive year of uninterrupted growth. Revenues progressed by 20.5%, reflecting acquisitions completed in 2007 and 2006, while gross profit further increased, both on an absolute and on a percentage of sales basis, reflecting sustained operational improvements. As a result, net earnings grew by 23.3% to reach $25.7 million. The Company's two main product categories,

utility poles and railway ties, both posted solid sales growth, driven by acquisitions and robust demand.

On February 28th, 2007, the Company acquired through its wholly-owned U.S. subsidiary, Stella-Jones Corporation, the wood utility pole business of J.H. Baxter & Co. (“Baxter”). Assets acquired included a production plant located in Arlington, Washington, a pole peeling facility in Juliaetta, Idaho, as well as inventories and accounts receivables related to Baxter’s wood pole business. The acquisition was 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. See “Business acquisition” below.

Stella-Jones’ solid performance once again yielded a strong cash flow generation in 2007, with cash flow from operations (before changes in non-cash working capital components) reaching $32.9 million compared with $26.8 million in 2006. This growth was achieved while maintaining a solid balance sheet, with a total long-term debt to equity ratio of 0.37:1 and an average debt to operating earnings before amortization of capital assets ratio of 1.64:1.

Going forward, Management remains optimistic about market conditions and believes that the Company is well positioned to enjoy positive momentum in 2008 driven by a successful integration of the proposed acquisition of The Burke-Parsons-Bowlby Corporation (“BPB”), scheduled to be completed on April 1, 2008. Stella-Jones is also committed to grow organically by concentrating on its key markets and capturing more of its existing clients’ business in the railway ties and utility pole markets across North America.

Key Performance Indicators

For the years ended December 31	**2007**	2006	2005
(thousands of dollars, except per share data and ratios)	**$**	$	$
Sales	**269,714**	223,853	157,129
Gross profit	**66,288**	50,363	32,028
Net earnings	**25,700**	20,846	11,505
Net earnings per common share	**2.09**	1.81	1.10
Diluted net earnings per common share	**2.03**	1.76	1.08
Total assets	**244,856**	213,675	137,891
Total long-term debt*	**47,444**	31,893	26,466
Total long-term debt* to equity ratio	**0.37:1**	0.30:1	0.41:1
Dividend per share	**0.24**	0.14	0.10

*Including current portion

Foreign exchange

The table below shows the year-end and average exchange rates for the periods ended December 31, 2007 and 2006.

Canada/US exchange rate		**2007**	**2006**
Year-end rate to translate assets and liabilities	Cdn$/US$	0.9913	1.1654
Average rate to translate sales and expenses	Cdn$/US$	1.0782	1.1254

Operating results

Sales

Sales for the year ended December 31, 2007 reached $269.7 million, an increase of $45.9 million, or 20.5%, over last year’s sales of $223.9 million. The Baxter acquisition and the full-year contribution from the Bell Pole Company (“Bell Pole”) assets, acquired on July 1, 2006, accounted for essentially all of this gain. Organic growth was limited by the impact of a three-month forest industry strike in southern British Columbia that forced the closure of the Company’s New Westminster treating facility and its pole peeling joint venture in Maple Ridge. The appreciation of the Canadian dollar, Stella-Jones’ reporting currency, reduced the value of U.S. dollar denominated sales by nearly $5.0 million. All of the Company’s product categories, with the exception of industrial lumber, posted gains and its two main categories - utility poles and railway ties - accounted for most of the increase.

Sales by product group

Utility poles

Utility pole sales reached $129.8 million in 2007, an increase of $34.2 million or 35.7% over the 2006 sales of $95.6 million. The increase is, for the most part, due to the contribution of the Arlington, Washington facility, acquired from Baxter in February 2007, which contributed sales of $24.5 million over ten months, as well as to a full-year contribution from the Bell Pole facility in Carseland, Alberta. Organic growth was impacted by the labour conflict in British Columbia and unfavourable currency movements on utility pole sales to the United States. These factors offset solid demand for transmission poles. Utility pole sales accounted for 48.1% of the Company's total sales in 2007.

Railway ties

Railway tie sales for the year amounted to $94.4 million, a 3.6% increase over sales of $91.1 million achieved in 2006. These results reflect the solid performance of the rail transport sector, which continues to report near-record traffic levels and is investing considerable resources in the modernization of existing infrastructure. Demand for railway ties has been strong over the last few years, driven by maintenance requirements, installation of double-tracking and new siding construction. Railway tie sales accounted for 35.0% of the Company's total sales in fiscal 2007.

Stella-Jones enjoys a number of key attributes which should further enhance the Company's strategic positioning and competitive advantage in the railway tie market. 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, and a long-standing stable source of wood supply. Stella-Jones also operates dedicated production facilities which result in higher productivity and better efficiency, helping to preserve a competitive manufacturing cost structure. These attributes are allowing the Company to post solid growth not only with the Class 1 (major) railroads, but also with short-line customers and to operators of dedicated lines in the mining sector.

In response to continued strength in railway tie demand, the Company expanded its Bangor, Wisconsin facility during the year with an additional treating cylinder at a cost of $2.6 million. This cylinder, which entered production in May 2007, increased the capacity of the plant by over 50 percent.

Industrial lumber

Industrial lumber sales declined by 20.8% in 2007, to $15.9 million, from $20.1 million reported in 2006. Solid demand for the Company's products in Eastern Canada was not sufficient to offset weaker results on the West Coast due to the strike in British Columbia. The category represented 5.9% of overall sales in 2007.

Consumer lumber

Sales in the consumer lumber category totalled $29.6 million in 2007, up 74.2% from $17.0 million in 2006. The increase is attributable to a full-year's contribution from the Carseland, Alberta operations, and also reflects a robust renovation market in Canada. It should be noted that while the Company's other treating facilities provide treating services for customer-owned lumber, the Carseland, Alberta plant purchases the consumer lumber that it processes. This yields a higher sales figure that is not directly comparable to those of the Company's other plants on a per volume basis. Consumer lumber accounted for 11.0% of Stella-Jones' total sales in 2007.

Sales by destination

In 2007, sales in Canada grew 6.6% over 2006 levels, reaching $163.1 million, or 60.5% of the Company's total sales, whereas sales in the United States amounted to $106.6 million, or 39.5% of sales, a 50.4% increase over 2006. Sales of products exported to the United States from the Canadian-based facilities totalled $32.7 million in 2007, similar to what was recorded in 2006.

The strong increase in sales in the U.S. market came as a result of the contribution of the Arlington, Washington facility, acquired in February 2007 and increased sales from the Bangor, Wisconsin facility following its capacity expansion.

Management believes that the U.S. market presents additional growth opportunities, as the wood treatment industry remains highly fragmented. The potential acquisition of BPB would further

strengthen the Company's position in the U.S. railway tie market, making it the second largest player, with an estimated market share of 25% (see "Subsequent event" below). Organically, the Company's access to douglas fir and cedar - preferred species for a number of utilities - through its West Coast operations is a competitive advantage when bidding on transmission projects.

Gross profit

Gross profit reached $66.3 million or 24.6% of sales in 2007, up from $50.4 million or 22.5% of sales in 2006. The improvement in gross profit essentially stems from increased throughput owed to the integration and optimization of the Company's expanded production capacity. Overhead cost containment, plant specialization and economies of scale from increased overall volume in the Company's core markets also yielded greater efficiencies.

Expenses

Selling and administrative expenses for 2007 were $15.9 million, an increase of $3.4 million or 27.0% compared with a year earlier. This increase is the result of additional activities related to acquisitions and higher pay-outs from the Company's profit sharing plan. Of note, last year's 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 result, selling and administrative expenses represented 5.9% of sales in 2007, up marginally from 5.6% in the prior year.

The Company realized a foreign exchange loss of $1.5 million for the year, versus a foreign exchange gain of $0.2 million last year. 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. Stella-Jones Corporation, the Company's wholly-owned U.S. subsidiary, is a self-sustaining foreign operation and unrealized foreign exchange gains and losses are deferred in shareholders' equity. The Company monitors its transactions in U.S. dollars generated by Canadian based operations. Its basic hedging activity consists of entering into forward exchange contracts for the sale of U.S. dollars and purchasing certain goods and services in U.S. dollars. The Company will also consider forward exchange contracts for the purchase of U.S. dollars for significant purchases of goods and services that are not covered by natural hedges. On December 31, 2007, the Company had on hand foreign exchange contracts for the future sale of U.S. dollars totalling $5.8 million at rates averaging Cdn$1.1563/US$1.00 maturing up to December 2009. The unrealized net foreign exchange gain on these contracts totalled approximately $915,294 as at December 31, 2007.

Amortization of capital assets totalled $4.9 million in 2007, an increase of nearly $1.6 million over 2006. This increase is mainly attributable to the Baxter acquisition, early in 2007, as well as to the addition of a treatment cylinder at the Bangor, Wisconsin facility in May 2007. Amortization of the Bell Pole capital assets for the full-year in 2007, versus only six months in 2006, also explains the greater expense.

Financial expenses for 2007 amounted to $5.5 million, an increase of $1.9 million over financial expenses of $3.6 million incurred in 2006. The rise in financial expenses is owed to increases in short and long-term borrowings resulting from the Baxter acquisition in February 2007 and the Bell Pole acquisition in July 2006, increases in the Company's working capital requirements, as well as higher interest rates, on average, in 2007.

Stella-Jones' income tax expense increased by just over $2.5 million in 2007 to reach $12.9 million, compared with $10.3 million in 2006. The increase mirrors a 23.6% improvement in earnings before income taxes. The effective tax rate for 2007 was 33.3%, virtually unchanged from an effective tax rate of 33.3% in the prior year. Other non-income based corporate taxes represent a relatively small component of the Company's total tax burden.

Net earnings

Net earnings for the year totalled $25.7 million, or $2.03 per share, fully diluted, compared with $20.8 million, or $1.76 per share, fully diluted, in 2006. This represents a year-over-year increase in net earnings of $4.9 million, or 23.3%.

{Graphic}

Sales by product

(% of revenues)
• Utility Poles 48.1% (2006 – 42.7%)
• Railway Ties 35.0% (2006 – 40.7%)
• Industrial Lumber 5.9% (2006 – 9.0%)
• Consumer Lumber 11.0% (2006 – 7.6%)

Sales by geographic region
(% of revenues)
• Canada 60.5% (2006 – 68.3%)
• United States 39.5% (2006 – 31.7%)

Business Acquisition
On February 28th, 2007, the Company acquired through its wholly-owned U.S. subsidiary, Stella-Jones Corporation, the wood utility pole business of Baxter. Assets acquired included a production plant located in Arlington, Washington, a pole peeling facility in Juliaetta, Idaho, as well as inventories and accounts receivables related to the 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 detail of the assets acquired and the liabilities assumed can be found in Note 5 of the Company's audited consolidated financial statements for the year ended December 31, 2007. The results of operations of the acquired assets have been included in the consolidated financial statements from the acquisition date.

Financing for the transaction was provided by a subordinated vendor note of US$8.0 million (recognized at a fair value of US$7.0 million) as well as additional debt funding under existing and new bank facilities. The new bank facilities are comprised of 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.

Subsequent event
On January 7, 2008, the Company announced that it had entered into a letter of intent to acquire The Burke-Parsons-Bowlby Corporation ("BPB"). The acquisition is expected to be structured as a merger between a U.S.-based wholly-owned subsidiary of the Company, and BPB. The letter of intent contemplates a purchase price of US$33.0 million for the shares of BPB, to be paid through the conversion of each outstanding share of common stock of BPB into a right to receive approximately US$47.78 per share in cash, subject to adjustments in certain circumstances.

The acquisition is subject to customary conditions, including entry into a definitive merger agreement, approval of BPB shareholders and the completion of satisfactory due diligence. The definitive merger agreement was entered into by the Company and BPB on March 11, 2008. It is anticipated that the proposed transaction, if finalized, would close by April 1, 2008 with the right of Stella-Jones to extend the closing date by two 30-day increments. It is expected that financing for the transaction will be secured through existing and additional debt facilities.

BPB began operations in 1955 and is a producer of treated wood products, primarily for the railroad industry. It owns and operates five treatment plants located in DuBois, Pennsylvania; Goshen, Virginia; Spencer, West Virginia; and Stanton and Fulton, Kentucky. For the fiscal year ended March 31, 2007, BPB had sales of US$85 million. BPB shares are listed on the NASDAQ OTC Bulletin Board.

Quarterly results
In keeping with the Company's history, sales followed a seasonal pattern, with pole, tie and industrial lumber shipments strongest in the second and third quarters to provide industrial end users with product for their summer maintenance projects. Consumer lumber treatment 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 levels.

The Company posted sales gains and increases in net earnings in each of the first three quarters of 2007, compared with the corresponding periods in 2006. However, sales and earnings growth

in the fourth quarter were, for the most part, negatively impacted by the vigour of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, as it reduced the conversion rate applicable to the portion of the Company's revenue stream generated in U.S. dollars.

The table below sets forth selected financial information for the Company's last eight quarters ending with the most recently completed financial year:

Quarterly results
2007

For the quarters ended	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
(thousands of dollars, except per share data)	**$**	**$**	**$**	**$**	**$**
Sales	61,949	84,510	74,815	48,440	269,714
Operating earnings before amortization of capital assets [1]	12,301	14,725	13,254	8,720	49,000
Operating earnings [1]	11,235	13,424	11,864	7,537	44,060
Net earnings	6,097	8,078	7,085	4,440	25,700
Net earnings per common share	0.50	0.66	0.57	0.36	2.09
Diluted net earnings per common share	0.48	0.64	0.56	0.35	2.03

2006

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(thousands of dollars, except per share data)	$	$	$	$	$
Sales	44,872	61,396	68,073	49,512	223,853
Operating earnings before amortization of capital assets [1]	6,915	9,824	12,203	9,224	38,166
Operating earnings [1]	6,132	9,021	11,331	8,319	34,803
Net earnings	3,518	5,415	6,789	5,124	20,846
Net earnings per common share	0.32	0.50	0.57	0.42	1.81
Diluted net earnings per common share	0.32	0.48	0.55	0.41	1.76

1 Operating earnings before amortization of capital assets and operating earnings are financial measures not prescribed by Canadian generally accepted accounting principles ("GAAP") and are not likely to be comparable to similar measures presented by other issuers. Management considers they represent useful information for comparison with other similar operations in our industry, as they present financial results related to industry practice, not affected by non-cash charges or capital structure. Operating earnings before amortization of capital assets and operating earnings are readily reconcilable to net earnings presented in our Canadian GAAP financial statements, as there are no adjustments for unusual or non-recurring items.

Fourth quarter results
Sales for the fourth quarter of 2007 reached $48.4 million, down 2.2% from $49.5 million reported for the same period in 2006. This decline is essentially owed to a $3.2 million negative impact of the strong Canadian currency on U.S. dollar denominated sales and to the last three weeks of the labour conflict in southern British Columbia.

Fourth quarter sales of utility poles reached $30.5 million, representing a 7.8% year-over-year increase in sales, as a $5.4 million contribution from the Baxter assets was offset by the impact of a strong Canadian currency and the strike in British Columbia. Railway tie sales stood at $11.3 million, 19.5% lower than a year ago owing to unfavourable currency fluctuations and a temporary shortage of railcars at year end. Industrial lumber sales declined by 9.9% to $3.7 million, while consumer lumber sales were essentially stable at $2.9 million.

Gross profit further improved in the final quarter of 2007, reaching $12.2 million, or 25.2% of sales, up from $11.4 million, or 23.0% of sales, in the corresponding period in 2006. This increase of 7.5% results primarily from overhead cost containment, plant specialization, and economies of scale from increased throughput.

Because of an $800,000 increase in selling and administrative expenses, mainly due to higher stock-based compensation and a loss on foreign exchange $500,000 above that of last year, net earnings for the period totalled $4.4 million, or $0.35 per share, fully diluted, compared with $5.1 million, or $0.41 per share, fully diluted, in the fourth quarter of 2006.

Liquidity and capital resources

The Company's working capital at December 31, 2007 was $106.5 million, an increase of $26.5 million over last year's working capital balance of $80.0 million at the same date. The $20.6 million increase in current assets is primarily related to $13.8 million in current assets acquired as part of the Baxter acquisition. The value of receivables at the end of 2007 was $5.7 million lower than a year earlier, as a result of the depreciation of the U.S. dollar on local receivables and of lower sales near the end of the year. Meanwhile, the $25.4 million increase in inventories over last year reflects the inventory acquired from Baxter, punctual purchases of raw material at favourable terms as well as projected requirements for future sales volume increases.

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. However, solid relationships and long-term contracts with certain customers enable the Company to better ascertain inventory requirements. The Company believes that its cash flow from operations and available operating lines of credit are adequate to meet its working capital requirements for the foreseeable future.

Capital assets stood at $70.3 million as at December 31, 2007, compared with $59.9 million as at December 31, 2006. This $10.3 million increase was primarily related to the Baxter acquisition in the first quarter and, to a lesser extent, to capital expenditures that were slightly in excess of amortization levels in 2007, reflecting the addition of the new treatment cylinder at the Bangor, Wisconsin facility.

Bank indebtedness at year end totalled $39.0 million, a decrease of $3.3 million over bank indebtedness of $42.3 million at the end of the previous year. This decrease essentially reflects the Company's strong cash flow generation and lower working capital requirements in the latter stages of the year. Bank indebtedness includes a $50.0 million demand operating loan with Canadian banks (unchanged from last year), as well as a US$20.0 million operating line of credit with the U.S. bankers of Stella-Jones Corporation (up from US$12.0 million last year). Total availability under the Company's Canadian and U.S. operating lines of credit was $22.7 million and US$4.4 million, respectively, as at December 31, 2007.

The Company believes that these operating lines of credit, combined with its funds from operations in the next quarters, will be adequate to meet its cash requirements for the foreseeable future. However, future corporate acquisitions may require new sources of financing.

For the year ended December 31, 2007, the Company's long-term debt amounted to $43.0 million, an increase of $14.9 million primarily related to the credit facilities arranged to finance the Baxter acquisition.

Shareholders' equity was $127.8 million as at December 31, 2007, a $21.9 million increase from December 31, 2006 levels. The Company's strong earnings generation accounted for most of this gain, offset by a greater dividend payout than last year.

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

Summary of cash flows	**Fiscal Year Ended**	
(thousands of dollars)	**December 31, 2007**	**December 31, 2006**
Operating activities	$16,979	$10,562

Financing activities	$6,020	$39,792
Investing activities	($22,999)	($50,354)

The Company's activities, acquisitions and capital expenditures are primarily financed by cash flows from operating activities, the use of cash and operating lines of credit, and the issuance of common shares.

Cash flow from operating activities before changes in non-cash working capital components was $32.9 million for the year ended December 31, 2007, compared with $26.8 million for the prior year. After taking into account the changes in non-cash working capital components, operating activities resulted in a cash generation totalling $17.0 million for the twelve months ended December 31, 2007, versus a cash generation of $10.6 million a year earlier.

The Company's net financing activities generated cash of $6.0 million for the year ended December 31, 2007. Such activities consist of increases in short and long-term bank and other borrowings as well as share issues under the employee share purchase plans, less repayments of long-term debt and the payment of annual dividends.

Investing activities that required $23.0 million in cash were primarily for the Baxter acquisition ($17.0 million – See "Business acquisition" above) and for the purchase of capital assets ($6.5 million). Capital acquisitions were mainly for the addition of a treatment cylinder at the Bangor, Wisconsin facility at a cost of $2.6 million and for various equipment upgrades and expansion.

The Company's contractual obligations for future payments are outlined in the table below:

Contractual obligations

(thousands of dollars)	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
	$	$	$	$	$
Long-term debt obligations	47,221	4,331	7,858	9,945	25,087
Capital lease obligations	223	78	145	-	-
Operating leases	18,756	2,365	3,828	1,946	10,617
Commitments for capital expenditures	-	-	-	-	-
Total contractual obligations	66,200	6,774	11,831	11,891	35,704

Share and stock option information

As at December 31, 2007, the capital stock issued and outstanding consisted of 12,341,088 common shares (12,298,015 as at December 31, 2006).

As at December 31, 2007, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 162,070 (December 31, 2006 – 183,355) of which 76,570 (December 31, 2006 – 83,355) were exercisable.

Effective May 6, 2003, the Company granted to its President and Chief Executive Officer, under a Stock Option Agreement, 300,000 options to acquire an equivalent number of common shares at an exercise price of $2.99 per share. These options become exercisable on May 6, 2008, or earlier, upon the occurrence of certain triggering events. The Stock Option Agreement also provided the President and Chief Executive Officer with the option of receiving cash in lieu of shares. In the fourth quarter of fiscal 2006, the President and Chief Executive Officer, on his own initiative, unconditionally and irrevocably waived his right to settle these options for cash.

Dividends

On March 14, 2007, the Board of Directors declared a semi-annual dividend of $0.10 per common share. On August 14, 2007, the Board of Directors declared a semi-annual dividend of $0.14 per common share.

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 earnings and financial requirements, any covenants in its loan documentation and other conditions prevailing at the time. 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 $4,588,466 (2006 – $127,396) under 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 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

Management considers that the Company may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. Nevertheless, the Company's overall competitiveness in this industry is strengthened by its access to a high quality timber supply provided by its long-term cutting licenses and its long-standing relationships with private woodland owners and other suppliers. In addition, there are a limited number of suppliers for certain of the 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. The Company is mitigating this risk by researching and identifying alternate suppliers outside of its traditional sources of supply.

The Company is subject to a variety of environmental laws and regulations, including those relating to emission to the air, discharges into water, releases of hazardous and toxic substances, and remediation of contaminated sites.

The enforcement of these laws by regulatory agencies will continue to affect the Company's operations by imposing operating and maintenance costs and capital expenditures required for compliance. Failure to comply with environmental statutes, regulations or orders could result in civil or criminal enforcement actions. The Company makes financial expenditures in order to comply with regulations governing environmental issues adopted by federal, provincial, state and local regulatory agencies.

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.

The possibility of major changes in environmental laws and regulations is another risk faced by the Company. Management believes that its commitment to the environmental integrity of the Company's plants and operations, supported by significant investments toward that end, will allow the Company to continue to meet the applicable regulatory requirements.

The Company is exposed to currency risks due to its export of goods manufactured in Canada. These risks are partially covered by purchases of goods and services denominated in U.S. dollars. The Company also uses foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars.

As at December 31, 2007, the Company had limited exposure to interest rate risk on long-term debt as only 2% (2006 – 3%) of the Company's long-term debt is at variable rates. The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. 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 hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

The geographic distribution of customers and procedures regarding commercial risk management limit the concentration of credit risks. Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. The Company reduces this risk by dealing primarily with utility and telecommunication companies and other major corporations.

Off-balance sheet arrangements and financial instruments

For details pertaining to off-balance sheet arrangements and financial instruments, refer to Note 17 to the Company's consolidated financial statements for the year ended December 31, 2007.

Critical accounting policies and estimates

The Company's significant accounting policies are described in Note 2 to the December 31, 2007 consolidated financial statements.

The Company prepares its consolidated financial statements in conformity with Canadian generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. 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 earnings in the period in which they become known.

The Company's inventory valuation involves an important degree of complexity and estimates are required with respect to the provision for slow moving stock. A change in the estimation of the adequacy of this provision, or important declines in the value of inventory, could therefore have a material impact on the financial statements.

The Company's operations are subject to federal, provincial and state environmental laws and regulations, governing among other matters, emissions, waste management and wastewater effluent discharges. The Company takes measures, and provides in its accounts, the estimated costs to comply with such laws and regulations. However, the estimated costs and measures taken are subject to the uncertainties of changing legal requirements, enforcement practices and developing technological processes.

Changes in Accounting Policies

The Canadian Institute of Chartered Accountants ("CICA") issued the following new accounting standards which were adopted by the Company effective January 1, 2007.

Handbook Section 1506, "Accounting Changes", introduced new paragraphs prescribing criterias for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. This Section is intended to enhance the relevance and reliability of an entity's financial statements and the comparability of those financial statements over time and with financial statements of other entities.

Handbook Section 3855, "Financial Instruments – Recognition and Measurement", describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives.

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent upon the classification of the financial instruments as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument or alternatively the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. The loans and receivables classificaton is applied for assets that are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. The available-for-sale classification is applied for all non-derivative financial assets that do not belong in the other categories or alternatively the standard permits that any financial assets not classified as held-for-trading may be designated as available-for-sale. Transaction costs related to financial instruments and credit facilities are expensed in the period they are incurred.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in the consolidated statement of earnings. Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are subsequently measured at amortized cost using the effective interest method of amortization.

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in the statement of Comprehensive Earnings. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair values of derivative instruments are recognized in the consolidated statement of earnings with the exception of foreign exchange risk management contracts and derivatives designated as effective cash flow hedges, as further described below.

For any guarantee issued that meets the definition of a guarantee pursuant to Accounting Guideline 14, *Disclosure of Guarantees*, the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Company's policy to not re-measure the fair value of the financial guarantee unless it qualifies as a derivative.

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 notes receivable 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 original cost, unless specified otherwise.

Bank indebtedness, accounts payable and accrued liabilities, and long-term debt 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 original cost, unless specified otherwise.

Derivative financial instruments are carried at fair value in the consolidated balance sheet.

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 adjustments relating to self-sustaining foreign operations and unrealized gains or losses on available for sale financial instruments.

Handbook 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 3861, "Financial Instruments – Disclosure and Presentation", establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

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.

When the Company uses derivative financial instruments to manage its own exposures, it determines for each derivative financial instrument whether hedge accounting is appropriate. When appropriate, the Company formally documents the hedging relationship detailing, among other things, the type of hedge (either fair value or cash flow), the item being hedged, the risk management objective, the hedging strategy and the method to be used to measure its effectiveness. The derivative financial instrument must be highly effective in accomplishing the objective of offsetting the changes in the hedged item's fair value attributable to the risk being hedged both at inception and over the life of the hedge.

The Company enters into foreign exchange forward contracts to limit its exposure under contracted cash inflows and outflows of U.S. 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. These contracts are treated as cash flow hedges for accounting purposes and are not held for trading or speculative purposes.

Effective derivative financial instruments, held for cash flow hedging purposes, are recognized at fair value and the changes in fair value related to effective portion of the hedge are recognized in other comprehensive income. The changes in fair value related to the ineffective portion of the hedge are immediately recorded in the consolidated statement of earnings. The changes in fair value of forward exchange contracts and interest rate swaps recognized in other comprehensive income are reclassified in the consolidated statement of earnings under sales and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect income.

When the derivative instrument no longer qualifies as an effective hedge, or when the hedging instrument is sold or terminated prior to maturity, if applicable, hedge accounting is discontinued prospectively. Accumulated other comprehensive income related to a forward exchange contract and interest swaps hedges that ceases to be effective are reclassified in the consolidated statement of earnings under foreign exchange gain or loss and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect income. Furthermore, if the hedged item is sold or terminated prior to maturity, hedge accounting is discontinued, and the related accumulated other comprehensive income is then immediately reclassified in the consolidated statement of earnings.

The opening balance of accumulated other comprehensive loss as at January 1, 2007 was a loss of $72,679 which relates to cumulative translation adjustments of a self-sustaining foreign operation. The adoption of these new standards translated into the following changes to the opening balance which regards to cash flow hedges: 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 twelve-month period ended December 31, 2007, the Company recorded the following transactions with regards to cash flow hedges: a net increase of $74,252 in accumulated other comprehensive income, an increase of $83,005 in short-term and long-term derivative financial instruments reported under assets and an increase of $8,753 in future income tax liabilities. During the year, a gain on foreign exchange forward contracts of $2,167,250 was reclassified from other comprehensive income to the consolidated statements of earnings.

Impact of Accounting Pronouncements not yet Implemented
The CICA issued the following new accounting standards which will be adopted by the Company effective January 1, 2008:

Handbook Section 3031, “Inventories”, will replace Section 3030 “Inventories”. The new section prescribes measurement of inventories at the lower of cost and net realized value. It provides guidance on the determination of cost, prohibits use in the future of the last-in, first-out (LIFO) method, and requires reversals of previous write-downs when there is a subsequent increase in the value of inventories. It also requires greater disclosure regarding inventories and cost of sales, including accounting policies, carrying values and the amount of any inventory write downs.

The Handbook Section 3862, “Financial Instruments – Disclosures”, describes the required disclosure for the assessment of the significance of financial instruments for the entity’s financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. This section and Section 3863, “Financial Instruments – Presentation” will replace section 3861, “Financial instruments – Disclosure and Presentation”.

Handbook Section 3863, “Financial Instruments – Presentation”, establishes standards for presentation of the financial instruments and non-financial derivatives. It carries forward the presentation related requirements of Section 3861, “Financial Instruments – Disclosure and

Presentation".

Handbook Section 1535, "Capital Disclosures", establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure requirements of the entity's objectives, policies and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and, if it has not complied, the consequences of such non-compliance.

The Company is presently assessing the impact of these new accounting standards on its consolidated financial statements.

The CICA issued the following accounting standards which will be adopted by the Company effective January 1, 2009:

Handbook Section 3064 "Goodwill and Intangible Assets", which will replace Section 3062 "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Section 1000, "Financial Statements Concepts" was amended accordingly to Section 3064. This new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented companies. The Company is presently assessing the impact of these new accounting standards on its consolidated financial statements.

In January 2006, the CICA adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada are to converge with the International Financial Reporting Standards by 2011. The Company continues to monitor and assess the impact of these convergence efforts.

Disclosure Controls

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 are designed to provide reasonable assurance that information required to be disclosed in its various reports are recorded, processed, summarized and reported accurately.

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 effectiveness of the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109-Certification of Disclosure in Issuer's Annual and Interim Filings) as at December 31, 2007, and have concluded that such disclosure controls and procedures were designed and operating effectively.

Internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles.

Management evaluated the design of its internal controls and procedures over financial reporting as defined under Multilateral Instrument 52-109 for the year ended December 31, 2007. 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 internal controls and procedures over financial reporting were appropriately designed.

The Company did not make any material changes to the design of internal controls over financial reporting during the twelve months ended December 31, 2007 that have had a material effect on the Company's internal controls over financial reporting. The Company has experienced rapid expansion through many acquisitions in recent years and has recently added resources to its accounting and administrative departments to support the growth and strengthen proper control and procedures over financial reporting. On an ongoing basis, the Company will continue to analyze its controls and procedures for potential areas of improvement.

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. In the unforeseen event that lapses in the disclosure or internal controls and procedures occur and/or mistakes happen, the Company intends to take the steps necessary to minimize the consequences thereof.

Related party transactions

In 2007, the Company paid a total of $300,000 (2006 - $300,000) to its parent company and ultimate shareholders with respect to marketing and technical services fees and incurred interest expense of $75,714 (2006 - $86,774) with respect to loans to the same parties, as detailed in Note 18 to the December 31, 2007 audited consolidated financial statements.

These transactions were with the majority shareholder, Stella Jones International S.A. (marketing services and interest on promissory note) and the ultimate shareholders, Stella S.p.A. and James Jones & Sons Ltd. (technical services and interest on loans). The majority shareholder and ultimate shareholders have extensive international experience in the forest products and wood treating industries and Management considers the amounts paid with respect to the various transactions to be reasonable and competitive.

Outlook

Stella-Jones' core markets are still experiencing strong fundamentals and Management remains optimistic about future organic and external growth. Integration of the potential BPB acquisition will be a key success factor in upcoming periods. The Company will continue to seek organic growth by focusing on its key markets and by capturing more of its existing clients' business by leveraging the opportunities offered through economies of scale. Management also remains committed to expanding its customer base in Canada and the U.S., as it realizes the full potential of recent acquisitions.

The market for utility poles in the United States has slightly softened, which is causing competitive pressures. Nevertheless, fundamental factors remain strong with solid demand from emerging energy sources, such as wind farms, and an aging infrastructure creating pent-up demand for pole replacement. A full-year contribution and further operational efficiencies stemming from the integration of the Baxter acquisition should nevertheless favour upward momentum. Geographical diversification and a complete product offering are key attributes that give Stella-Jones the ability to promptly respond to market opportunities.

The railway tie market, in which Stella-Jones would become the second largest player should the BPB proposed acquisition be finalized as intended, is expected to stay strong driven by Class-1 railroad capital expenditures and short-line railroad expansion projects. The optimization of the BPB assets to be acquired, along with expanded capacity at the Bangor, Wisconsin facility with the addition of a new treating cylinder should enable the Company to better service its growing customer base in the United States.

Finally, Management also believes that room for growth exists in industrial and consumer lumber, as the Company increasingly establishes itself as a preferred supplier by means of its ability to service most requirements through extensive product ranges.

Given the fragmented state of the wood treatment industry, strategic acquisitions will remain an integral part of the Company's growth plan. Management will continue to seek targets in its core railway tie and utility pole markets that meet its stringent investment requirements, provide synergistic opportunities, and, most of all, add value to Stella-Jones' shareholders.

March 12, 2008