The following Management's Discussion and Analysis ("MD&A") dated March 12, 2009 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2008 compared with the fiscal year ended December 31, 2007. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2008 and 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 Investor/Media Centre 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: railway ties for rail transportation companies; treated wood utility poles for utility and telecommunication companies; industrial lumber products for construction and maritime applications, and treated consumer lumber products for the residential market.

As of March 12, 2009, the Company owns and operates fifteen wood treating plants, two distribution centres, two pole peeling facilities and has a 50% interest in a third pole peeling operation. These twenty facilities are located in six Canadian provinces and seven American states. The Company's workforce currently numbers approximately 725 employees.

Stella-Jones enjoys a number of key attributes which should further enhance the Company's strategic positioning and competitive advantage in the wood treatment 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, 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.

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 2008

Stella-Jones' operational highlight of 2008 was the acquisition, on April 1, of The Burke-Parsons-Bowlby Corporation ("BPB") through a merger between BPB and a wholly-owned U.S. subsidiary of the Company. BPB produces pressure treated wood products, primarily for the railway industry. This acquisition included five treating plants located in DuBois, Pennsylvania; Goshen, Virginia; Spencer, West Virginia; and Stanton and Fulton, Kentucky. 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.

Financial results for the year ended December 31, 2008, marked the eighth consecutive year of uninterrupted growth. Revenues grew by 42.7%, primarily as a result of acquisitions completed in 2008 and 2007. Gross profit further increased on an absolute dollar basis, while it decreased as a percentage of sales, reflecting the higher proportion of railway tie sales in the Company's product mix and the lower margins generated in the integration and transition phase of BPB's operations. As a result, net earnings grew 11.1% to reach $28.5 million. Despite mounting economic uncertainty in North America, demand held firm for the Company's two main product categories, railway ties and utility poles.

Stella-Jones' solid performance once again produced strong cash flow generation in 2008, with cash flow from operations (before changes in non-cash working capital components) reaching $41.1 million compared with $33.4 million in 2007. This growth was achieved while maintaining a sound balance sheet, with a total long-term debt to equity ratio of 0.66:1 and a ratio of average total debt to operating earnings before amortization of capital and intangible assets of 2.35:1.

Key performance indicators

For the years ended December 31	**2008**	2007	2006
(thousands of dollars, except per share data and ratios)	**$**	$	$
Sales	**384,822**	269,714	223,853
Gross profit	**78,398**	66,788	50,363
Net earnings	**28,547**	25,700	20,846
Net earnings per common share	**2.29**	2.09	1.81
Diluted net earnings per common share	**2.25**	2.03	1.76
Total assets	**407,546**	244,856	213,675
Total long-term debt*	**105,759**	47,444	31,893
Total long-term debt* to equity ratio	**0.66:1**	0.37:1	0.30:1
Dividend per share	**0.34**	0.24	0.14

*Including current portion

Foreign exchange

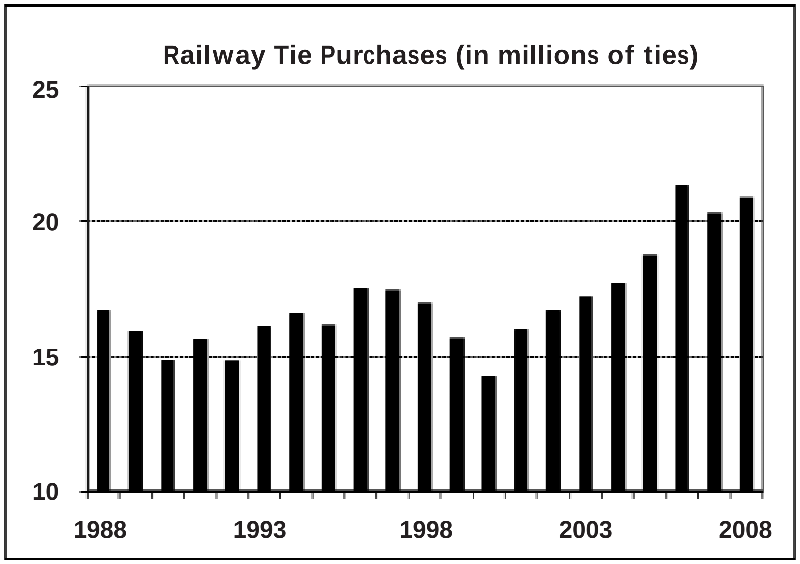
The table below shows exchange rates applicable to the periods ended December 31, 2008 and 2007. Average rates are used to translate sales and expenses for the periods mentioned, while closing rates translate assets and liabilities of self-sustaining foreign operations and monetary assets and liabilities of the Canadian operations.

Cdn$/US$	**2008**		2007	
	Average	**Closing**	Average	Closing
First Quarter	**0.9909**	**1.0265**	1.1697	1.1546
Second Quarter	**1.0110**	**1.0197**	1.0958	1.0654
Third Quarter	**1.0425**	**1.0642**	1.0631	0.9948
Fourth Quarter	**1.1686**	**1.2180**	0.9798	0.9913
Fiscal Year	**1.0515**	**1.2180**	1.0812	0.9913

Industry overview

Railway ties

As reported by the Railway Tie Association, railway tie purchases grew nearly 3.0% to 20.9 million ties in 2008, surpassing the 20 million mark for the third consecutive year, and further extending a growth trend that emerged at the beginning of the decade.



Volatile fuel prices and persistent highway congestion have increasingly caused shippers to favour rail, a more fuel efficient transportation mode, over trucks. As a result, freight tends to shift from road to rail in periods of soaring fuel costs. The resulting surge in rail transportation volume, combined with an aging infrastructure, yielded increased demand for products and services related to the modernization and extension of the North American rail network, including railway ties.

Source: Railway Tie Association

According to the Association of American Railroads, combined 2008 volume for 12 reporting U.S. and Canadian railroads declined only marginally, namely 3.0% for carloads and 3.3% for intermodal trailers and containers, a situation attributable to a weaker economy.

Operating results

Sales

Sales for the year ended December 31, 2008 reached $384.8 million, an increase of $115.1 million, or 42.7%, over last year's sales of $269.7 million. All of the Company's product categories posted gains and its two largest categories – railway ties and utility poles - accounted for the majority of the increase. The BPB operations contributed sales of approximately $91.0 million over a nine-month period. A full-year contribution, in 2008, from the Arlington, Washington facility, compared with ten months in the preceding year, also favourably impacted sales growth. Organically, sales grew approximately 8.0%, reflecting demand that held firm for the Company's core products throughout most of 2008. To a lesser degree, organic growth was supplemented by the negative effect on 2007 results 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. When compared with the previous year, fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, reduced the value of U.S. dollar denominated sales by about $6.0 million.

Sales by product group

Railway ties

Railway tie sales for the year amounted to $181.1 million, a 92.3% increase over sales of $94.2 million achieved in 2007. These results reflect the contribution from the BPB operations as well as solid industry demand in North America. Although a slowing economy has reduced volume in the rail transport sector, railway operators have maintained their investments in the modernization of existing infrastructure and network extension through installation of double-tracking and new siding construction. Railway tie sales accounted for 47.0% of the Company's total sales in fiscal 2008.

Utility poles

Utility pole sales amounted to $137.8 million in 2008, an increase of $8.2 million or 6.4% over sales of $129.6 million in 2007. The increase is due to improved sales of distribution poles, stable demand for transmission poles and a full-year contribution from the Arlington, Washington facility, compared with only 10 months in 2007. Year-over-year revenue growth in 2008 also reflects the three-month labour conflict in British Columbia in 2007. Utility pole sales accounted for 35.9% of the Company's total sales in 2008.

Industrial lumber

Industrial lumber sales more than doubled in 2008, reaching $33.2 million, compared with $16.4 million in 2007. This increase is related to the BPB acquisition, which added both new products aimed at the rail transportation industry, such as panelized railway crossings, as well as additional bridge timber sales. This product category also includes BPB's custom log home construction business. The category represented 8.6% of overall sales in 2008.

Consumer lumber

Sales in the consumer lumber category totalled $32.8 million in 2008, up 10.7% from $29.6 million in 2007. The increase is attributable to a steady renovation market in Canada which remained, for most of 2008, relatively unaffected by the U.S. mortgage credit crisis, and to the opening of several new locations by the Company's main customer in this category. Consumer lumber accounted for 8.5% of Stella-Jones' total sales in 2008.

Sales by destination

In 2008, sales in Canada grew 10.4% over 2007 levels, reaching $180.1 million, or 46.8% of the Company's total sales, whereas sales in the United States amounted to $204.8 million, or 53.2% of sales, a 92.1% increase over 2007. Sales of products exported to the United States from the Canadian-based facilities totalled $25.5 million in 2008, compared with $32.7 million in 2007.

The strong increase in sales in the U.S. market came mainly as a result of the contribution of the BPB operations, acquired in April 2008, the full-year contribution from the Arlington, Washington facility, acquired in February 2007, and increased sales from the Bangor, Wisconsin facility following its capacity expansion in May 2007.

Management believes that the U.S. market presents additional growth opportunities, as the wood treatment industry remains highly fragmented. The acquisition of BPB further strengthened the Company's position in the North American railway tie market, making it the second largest player, with an estimated market share of 25.0%.

Gross profit

Gross profit reached $78.4 million or 20.4% of sales in 2008, up from $66.8 million or 24.8% of sales in 2007. The improvement in gross profit dollars essentially stems from the contribution of the BPB operations. However, gross profit as a percentage of sales declined mainly because of lower margins generated by the BPB operations. A different product mix and higher wood, energy and transportation costs also negatively affected gross profit as a percentage of sales, partially offset by plant specialization and economies of scale from increased overall volume in the Company's core markets.

Expenses

Selling and administrative expenses for 2008 were $20.4 million, an increase of $4.5 million, or 28.4%, over 2007's selling and administrative expenses of $15.9 million, mainly attributable to the BPB acquisition. As a percentage of sales, selling and administrative expenses represented 5.3% of sales in 2008, compared with 5.9% in the prior year. This reduction as a percentage of sales reflects overhead cost containment, synergies from increased volumes for the year and reduced compensation expenses.

The Company realized a foreign exchange gain of $0.3 million for the year ended December 31, 2008, versus a foreign exchange loss of $1.5 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 U.S. Holding Corporation, the Company's wholly-owned U.S. subsidiary, is a self-sustaining foreign operation and unrealized 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 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, 2008, the Company had on hand foreign exchange contracts for the future sale of US$27.4 million at an average exchange rate of Cdn$1.2235/US$1.00. The unrealized net foreign exchange gain on these contracts totalled $318,000 as at December 31, 2008.

Amortization of capital and intangible assets totalled $8.4 million in 2008, an increase of nearly $3.0 million over 2007. This increase is mainly attributable to the BPB acquisition.

Financial expenses for 2008 amounted to $8.7 million, an increase of $3.2 million over financial expenses of $5.5 million incurred in 2007. The rise in financial expenses is due to increases in long- and short-term borrowings resulting from the BPB acquisition and working capital requirements, respectively, somewhat offset by lower interest rates, on average, in 2008.

Earnings before income taxes and income tax expense

Stella-Jones generated earnings before income taxes of $41.2 million, or 10.7% of sales, in 2008. This represents an increase of $2.6 million over earnings before income taxes of $38.6 million, or 14.3% of sales, in the prior year.

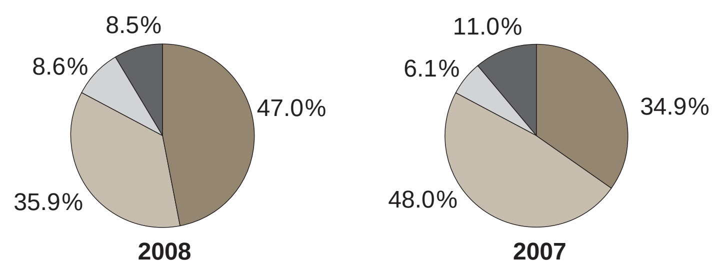
Stella-Jones' income tax expense totalled $12.7 million in 2008, representing an effective tax rate of 30.8%. In 2007, the income tax expense stood at $12.9 million, equivalent to an effective tax rate of 33.3%. The lower effective tax rate is a consequence of the higher proportion of revenue generated in the United States that is subject to the domestic manufacturing tax deduction for qualifying manufacturing income and deductions for Canadian income tax related to dividends received from a related party. 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 $28.5 million, or $2.25 per share, fully diluted, compared with $25.7 million, or $2.03 per share, fully diluted, in 2007. This represents a year-over-year increase in net earnings of $2.8 million, or 11.1%.

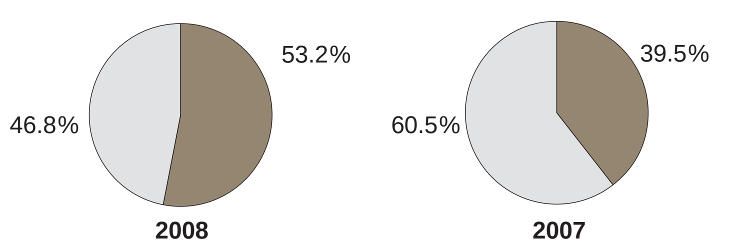
Sales by product
(% of revenues)

- Railway Ties 47.0% (2007 – 34.9%)
- Utility Poles 35.9% (2007 – 48.0%)
- Industrial Lumber 8.6% (2007 – 6.1%)
- Consumer Lumber 8.5% (2007 – 11.0%)



Sales by geographic region
(% of revenues)

- United States 53.2% (2007 – 39.5%)
- Canada 46.8% (2007 – 60.5%)



Business acquisition

On April 1, 2008, the Company completed the acquisition of The Burke-Parsons-Bowlby Corporation ("BPB") through a merger between BPB and a wholly-owned U.S. subsidiary of the Company. BPB produces pressure treated wood products, primarily for the railway industry. This acquisition included five treating plants located in DuBois, Pennsylvania; Goshen, Virginia; Spencer, West Virginia; and Stanton and Fulton, Kentucky. BPB had sales of approximately US$107.0 million for the twelve-month period ended March 31, 2008.

Total consideration for this acquisition was approximately $44.0 million (US$43.0 million), including estimated acquisition costs of approximately $1.1 million (US$1.1 million), and cash on hand of $0.1 million (US$0.1 million). This amount includes $33.7 million (US$33.0 million) paid to BPB stockholders through the conversion of each outstanding share of common stock of BPB into the right to receive US$47.78 per share in cash, $3.5 million (US$3.4 million) representing an additional payment equal to BPB's audited net income for its fiscal year ending March 31, 2008, less any distributions to shareholders during that period and other post-closing adjustments, as well as an additional discounted amount of $5.8 million (US$5.7 million) payable in equal quarterly installments over a six-year period with respect to non-compete agreements entered into with certain former BPB executives.

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, 2008. The results of operations of BPB have been included in the consolidated financial statements from the acquisition date.

The transaction was financed through additional borrowings of approximately $40.9 million (US$40.0 million), including the issuance of a $25.5 million (US$25.0 million) unsecured and non-convertible debenture to the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)*, a $10.2 million (US$10.0 million) revolving term loan from a Canadian bank and a draw-down on an existing operating margin of $5.1 million (US$5.0 million).

Quarterly results

In keeping with the Company's history, sales followed a seasonal pattern, with railway tie, utility pole 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 increases in each quarter of 2008, compared with the corresponding periods in 2007, with BPB contributing in the last three quarters. Operating earnings also increased in all periods with the exception of the first quarter, where an unfavourable product mix reduced operating margins. Although the 2008 average annual exchange rate between the Canadian dollar, Stella-Jones' reporting currency, and the U.S. dollar was relatively similar to that of 2007, the first three quarters of 2008 were marked by a year-over-year reduction in the conversion rate applicable to the Company's revenue stream generated in U.S. dollars. Conversely, the fourth quarter witnessed a rapid decline in the value of the Canadian currency, which positively affected the value of U.S. dollar denominated sales on conversion.

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

2008					
For the quarters ended	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
(thousands of dollars, except per share data)	**$**	**$**	**$**	**$**	**$**
Sales	**66,182**	**123,081**	**111,828**	**83,731**	**384,822**
Operating earnings before amortization of capital and intangible assets [1]	**10,997**	**19,394**	**14,148**	**13,790**	**58,329**
Operating earnings [1]	**9,616**	**17,599**	**12,127**	**10,622**	**49,964**
Net earnings	**5,323**	**10,047**	**6,850**	**6,327**	**28,547**
Net earnings per common share	**0.43**	**0.81**	**0.55**	**0.50**	**2.29**
Diluted net earnings per common share	**0.42**	**0.80**	**0.54**	**0.50**	**2.25**

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	48,439	269,714
Operating earnings before amortization of capital and intangible assets [1]	12,301	14,725	13,254	9,219	49,500
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

1 Operating earnings before amortization of capital and intangible 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 and intangible 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.

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

Sales for the fourth quarter of 2008 reached $83.7 million, up 72.9% from $48.4 million reported for the same period in 2007. This increase is mainly attributable to the BPB operations, which generated revenues of approximately $28.0 million, demand that held firm in the Company's core markets and a weaker Canadian currency, Stella-Jones' reporting currency, that increased the value of U.S. dollar denominated sales by approximately $2.4 million. Last year's fourth quarter results were lowered due to the continuation of the labour conflict in southern British Columbia, which only ended in late October, 2007.

Fourth quarter sales of railway ties amounted to $34.6 million, up from $11.5 million a year earlier. This increase reflects the BPB acquisition, favourable currency translation on U.S. dollar denominated sales as well as last year's temporary shortage of railcars at year end. Utility pole sales reached $35.5 million, representing an increase of 18.1% over sales of $30.0 million in the fourth quarter of 2007, a period affected by the final three weeks of the strike in British Columbia. Industrial lumber sales amounted to $10.4 million, compared with $4.0 million a year earlier, essentially reflecting the BPB acquisition, while consumer lumber sales grew 11.2% to $3.3 million.

Gross profit in the fourth quarter of 2008 totalled $18.7 million, or 22.3% of sales, compared with $12.7 million, or 26.3% of sales, in the corresponding period in 2007. The increase in gross profit dollars principally reflects the contribution of the BPB operations, whose lower margins have caused the reduction in gross profit as a percentage of sales. The Company has begun the process with its customers of requesting annual selling price adjustments, as permitted by the terms and conditions in many of its fixed price multi-year railway tie contracts, to reflect wood cost increases incurred during the year.

Net earnings for the period totalled $6.3 million, or $0.50 per share, fully diluted, compared with $4.4 million, or $0.35 per share, fully diluted, in the fourth quarter of 2007.

Balance sheet

The Company's working capital at December 31, 2008 was $156.9 million, an increase of $53.7 million over last year's working capital balance of $103.2 million at the same date. Reflecting the BPB acquisition and greater overall business activity, the value of current assets was $107.5 million higher than a year ago. Receivables increased $15.1 million, to $41.5 million, reflecting the effect of local currency appreciation on U.S. dollar denominated receivables and higher sales near the end of the year. Inventories stood at $223.2 million, a value $84.4 million higher than a year earlier, as a result of inventory acquired in the BPB acquisition, the impact of local currency appreciation on U.S. based inventory, wood cost increases in the latter half of the year, and projected requirements for future sales volume increases.

Excluding BPB, the value of accounts receivable amounted to $29.6 million, while inventories totalled $171.5 million.

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 $108.8 million as at December 31, 2008, compared with $73.3 million as at December 31, 2007. This $35.5 million increase was primarily related to the BPB acquisition and, to a lesser extent, to capital expenditures in excess of amortization levels in 2008.

Following the BPB acquisition, intangible assets totalling $10.8 million, comprised of customer relationships and the discounted value of the non-compete agreements, and goodwill of $6.4 million, were included in the Company's balance sheet as at December 31, 2008.

Bank indebtedness at the end of 2008 totalled $81.6 million, an increase of $42.6 million over bank indebtedness of $39.0 million at the end of 2007. This increase mirrors higher working capital requirements. Bank indebtedness represents the amounts borrowed under the Company's Canadian and U.S. operating lines. These consist of a $50.0 million demand operating loan with a Canadian bank (unchanged from last year), as well as a US$45.0 million operating line of credit with the U.S. bankers of Stella-Jones' U.S. subsidiaries (up from US$20.0 million last year). Total availability under the Company's Canadian and U.S. operating lines of credit was $10.9 million and US$7.1 million, respectively, as at December 31, 2008.

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 acquisitions may require new sources of financing.

As at December 31, 2008, the Company's long-term debt, including the current portion, amounted to $105.8 million, up from $47.4 million as at December 31, 2007. This increase is due to the credit facilities arranged to finance the BPB acquisition and unfavourable currency movements near the end of 2008 that increased the Canadian dollar equivalent of U.S. dollar denominated long-term debt.

Shareholders' equity was $161.1 million as at December 31, 2008, a $33.3 million increase from December 31, 2007 levels. The Company's strong earnings generation accounted for most of this gain, offset by a greater dividend payout than the previous year. Book value stood at $12.82 per common share as at December 31, 2008, up from $10.35 per share twelve months earlier.

Liquidity and capital resources

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, 2008**	December 31, 2007
	$	$
Operating activities	**(3,296)**	17,394
Financing activities	**52,335**	6,139
Investing activities	**(49,039)**	(23,533)
Cash and cash equivalents	**—**	—

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. The Company's operating lines of credit are demand operational facilities that are renewable annually and are subject to review by the Company's bankers at intervals no greater than one year. In December 2008, the banker for the U.S. operating line amended its credit facilities and approved an increase to the Company's demand operating line to US$45.0 million from US$40.0 million. Subsequent to year-end, the Company's Canadian bankers amended the interest rate structure with no change to the available amount of the operating facility and approved an increase to the credit availability for the purchase of foreign exchange contracts. The Company anticipates no difficulties in its ability to renew these demand operating facilities.

Cash flow from operating activities before changes in non-cash working capital components was $41.1 million for the year ended December 31, 2008, compared with $33.4 million for the prior year. This 22.8% increase reflects net earnings growth and adjustments for higher non-cash expenses such as amortization of capital and intangible assets and future income taxes.

Changes in non-cash working capital components required liquidity of $44.4 million versus $16.0 million a year ago. This increase essentially mirrors required increases in inventory levels and a decrease in accounts payable. As a result, operating activities reduced liquidity by $3.3 million for the twelve months ended December 31, 2008, as opposed to providing liquidity of $17.4 million a year earlier.

The Company's net financing activities generated a cash flow of $52.3 million for the year ended December 31, 2008. This amount mainly consists of net increases in long-term debt ($35.9 million), essentially associated with the BPB acquisition, short-term bank indebtedness ($20.6 million) and proceeds from issuance of common shares under the stock option and employee share purchase plans ($1.0 million), less the payment of annual dividends ($4.2 million). For the year ended December 31, 2007, cash flows from financing activities generated liquidity of $6.1 million.

Investing activities required $49.0 million in cash during 2008, primarily for the BPB acquisition ($38.2 million – See "Business acquisition" above) and for the purchase of capital assets ($10.4 million). Purchases of capital assets were mainly for the addition of various equipment upgrades and expansion. For the year ended December 31, 2007, cash flows from investing activities reduced liquidity by $23.5 million.

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

Payments due by period

(thousands of dollars)

	Less than 1 year	1-3 years	4-5 years	After 5 years	Total
	$	$	$	$	$
Bank indebtedness	81,560	—	—	—	81,560
Accounts payable and accrued liabilities	28,694	—	—	—	28,694
Long-term debt obligations	5,199	12,822	21,156	67,826	107,003
Interest on long-term debt obligations	6,150	11,534	9,721	9,937	37,342
Capital lease obligations	189	344	383	1,105	2,201
Interest on capital lease obligations	78	133	110	91	412
Forward foreign exchange contracts					
Outflow	5,319	3,234	—	—	8,553
Inflow	(5,603)	(3,410)	—	—	(9,013)
Non-compete agreements	1,523	3,046	3,046	381	7,996
Total	123,109	27,703	34,416	79,340	264,568

Share and stock option information

As at December 31, 2008, the capital stock issued and outstanding consisted of 12,564,925 common shares (12,341,088 as at December 31, 2007). As at March 12, 2009, the capital stock issued and outstanding consisted of 12,564,925 common shares.

As at December 31, 2008, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 147,785 (December 31, 2007 – 162,070) of which 93,285 (December 31, 2007 – 76,570) were exercisable. As at March 12, 2009, the number of outstanding options was 147,785 of which 93,285 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 became exercisable on May 6, 2008 and 100,000 remained outstanding as at March 12, 2009.

Dividends

On March 11, 2009, the Board of Directors declared a semi-annual dividend of $0.18 per common share. On August 13, 2008, the Board of Directors declared a semi-annual dividend of $0.18 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, 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 $14,788,448 (2007 – $4,588,466) 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 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.

Current economic conditions

In light of the rapid deterioration in the economy and financial markets, the Company is carefully monitoring its strategy and risk management. Although financial results remain positive, the economic climate is prompting Management to take a more cautious approach in executing its business strategy.

Operations

Tighter credit market conditions have resulted in the deferral or cancellation of certain projects, especially in alternative energy, for which some of the Company's products could be required. Such projects include ethanol plants and wind farms, both of which have significant capital requirements. In recent years, the Company has supplied railway ties to link up ethanol plants with the continental rail network and utility poles to connect wind farms with the electricity transmission grid. As at March 12, 2009, Stella-Jones has not been materially affected by such deferrals or cancellations.

Though not recession proof, the Company's core utility pole and railway tie product categories are integral to capital infrastructure projects that governments often initiate during times of economic slowdown. Therefore, the Company's position as a supplier of utility poles and railway ties could prove particularly advantageous given the American and Canadian governments' stated intention to invest heavily in infrastructure projects. Moreover, various U.S. tax credit initiatives, whether enacted into law or proposed, could prove a significant stimulus for infrastructure projects.

Liquidity

As at December 31, 2008, the Company is in full compliance with its debt covenants and contractual obligations. In addition, it has total availability under its Canadian and U.S. operating lines of credit of $10.9 million and US$7.1 million, respectively, as at December 31, 2008.

Management considers that substantially all receivables are fully collectible as major customers, mainly Class 1 railroad operators and large-scale utility service providers, have good credit standing and limited history of default. Nevertheless, Management is providing additional focus on accounts receivable collection and credit extensions.

Inventories increased during 2008 as a result of higher wood costs and projected requirements for future sales volume increases, as well as to ensure efficient treatment operations given that air-dried wood reduces treatment cycles. Management will continue to monitor the levels of inventory with the demand for its products.

Risks and uncertainties

Environmental laws and regulations

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.

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. Contamination on and from the Company's sites could 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. 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.

Availability and cost of raw materials

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.

Currency risk

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.

Interest rate fluctuations

As at December 31, 2008, the Company had limited exposure to interest rate risk on long-term debt as only 7.3% (2007 – 2.0%) 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.

Credit risk

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 19 to the Company's audited consolidated financial statements for the year ended December 31, 2008.

Critical accounting policies and estimates

The Company's significant accounting policies are described in Note 2 to the December 31, 2008 audited 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.

Significant items subject to estimates and assumptions include the estimated useful life of assets, impairment of long-lived assets, future income taxes, stock-based compensation, pension and post retirement benefits, legal liabilities, bad debts, allowance for doubtful accounts and environmental provisions.

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, 2008:

Handbook Section 3031, "Inventories", replaces Section 3030, "Inventories". The new section prescribes measurement of inventories at the lower of cost and net realizable value. It provides guidance on the determination of cost, prohibits use in the future of the last-in, first-out (LIFO) method, and requires reversal 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.

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, below, 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.

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.

Handbook Section 1400, "General Standards of Financial Statement Presentation", establishes requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of this Section did not have an impact on the Company's consolidated financial statements.

Additional disclosures required as a result of the adoption of these standards are included in Notes 7, 19 and 20 to the Company's audited consolidated financial statements for the year ended December 31, 2008.

Impact of accounting pronouncements not yet implemented

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", 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.

The CICA issued the following accounting standards which will be adopted by the Company effective January 1, 2011:

Handbook Section 1582, "Business Combinations", which replaces Section 1581, "Business Combinations". The Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to the IFRS standard, IFRS 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is currently evaluating the impact of the adoption of this new accounting standard on the consolidated financial statements.

Handbook Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", which together replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS standard, IAS 27 (Revised), "Consolidated and Separate Financial Statements". Earlier adoption is permitted as of the beginning of a fiscal year. The Company is currently evaluating the impact of the adoption of these new accounting standards on the consolidated financial statements.

International financial reporting standards

In February 2008, the Canadian Accounting Standards Board (CASB) confirmed that Canadian publicly listed companies will be required to use International Financial Reporting Standards (IFRS) in the preparation of financial statements for fiscal years beginning on or after January 1, 2011.

In the Company's case, the use of IFRS will be required for the interim and annual financial statements dated after January 1, 2011, although this transition date will require the restatement of comparative figures reported for the year ended December 31, 2010.

Management has established an IFRS implementation team to develop an IFRS changeover plan. This process is presently in the diagnostic stage, which includes a review of the differences between current Canadian GAAP (as applied by the Company) and IFRS, and the analysis of possible options regarding adoption. In 2008, a preliminary diagnostic analysis was prepared by external consultants. Once this stage is complete, Management will be able to determine the exact consequences of the change. A comprehensive assessment will then be done to precisely establish the changes to be made to accounting principles and computer systems, training requirements, internal control mechanisms for financial reporting and the repercussions on the Company's business activities. The financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

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 National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) as at December 31, 2008, 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 has evaluated the design and effectiveness of its internal controls and procedures over financial reporting (as defined in National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) for the year ended December 31, 2008. The evaluation was based on 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 internal controls and procedures over financial reporting were appropriately designed and operating effectively.

The Company did not make any material changes to the design of internal controls over financial reporting during the twelve months ended December 31, 2008 that have had a material effect on the Company's internal controls over financial reporting.

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 of internal controls and procedures occur and/or mistakes happen of a material nature, the Company intends to take the steps necessary to minimize the consequences thereof.

Related party transactions

In 2008, the Company paid a total of $300,000 (2007 - $300,000) to its parent company and ultimate shareholders with respect to marketing and technical services fees and incurred interest expense of $64,000 (2007 - $76,000) with respect to loans to the same parties, as detailed in Note 21 to the December 31, 2008 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

While the global economic situation calls for a more cautious outlook, the key role played by Stella-Jones' products in basic transportation and utility infrastructure should enable the Company to maintain market share and grow its business. The full-year contribution and the successful integration of the BPB operations will also be major performance drivers in 2009. Organically, Stella-Jones will strive to capture more of its existing clients' business in the railway tie and utility pole markets across North America, while also diligently seeking new market opportunities, as it realizes the full potential of recent acquisitions.

The Company's products are integral to capital infrastructure projects that governments often initiate during times of economic slowdown. Such actions would drive demand, as they would potentially involve, in both maintenance and new installation endeavours, many of the Company's clients in the railway and electrical transmission and distribution industries.

Although the year ahead will be focused on cash generation and debt reduction, strategic acquisitions will remain an integral part of the Company's growth plan given the fragmented state of the wood treatment industry. 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 for Stella-Jones' shareholders.

As we go forward in challenging economic times, the strength of Stella-Jones remains its ability to adapt swiftly to changing situations. That strength derives from a constant drive to pursue efficiencies throughout the organization. More importantly, the Company's long-term strategic vision, focused on continental expansion and consolidation, remains intact.

March 12, 2009