CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Management's Statement of Responsibility for Financial Information

The consolidated financial statements contained in this Annual Report are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles. Where necessary, management has made judgements and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in the Annual Report and for ensuring that this information is consistent, where appropriate, with the information and data included in the consolidated financial statements.

The Company maintains a system of internal controls to provide reasonable assurance as to the reliability of the financial records and safeguarding of its assets. The consolidated financial statements have been examined by the Company's independent auditors, PricewaterhouseCoopers LLP, and they have issued their report thereon.

The Board of Directors is responsible for overseeing management in the performance of its responsibilities for financial reporting. The Board exercises its responsibilities through the Audit Committee which is comprised of four independent directors. The Audit Committee meets from time to time with management and the Company's independent auditors to review the financial statements and matters relating to the audit. The Company's independent auditors have full and free access to the Audit Committee. The consolidated financial statements have been reviewed by the Audit Committee, who recommended their approval by the Board of Directors.

Brian McManus
President and Chief Executive Officer

George T. Labelle, CA
Senior Vice-President and Chief Financial Officer

Saint-Laurent, Quebec
March 12, 2010

AUDITORS' REPORT

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheets of Stella-Jones Inc. as at December 31, 2009 and 2008 and the consolidated statements of shareholders' equity, earnings, comprehensive income and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP[1]

Montréal, Quebec
March 12, 2010

[1] Chartered accountant auditor permit No. 9986

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

CONSOLIDATED BALANCE SHEETS

As at December 31, 2009 and 2008 (expressed in thousands of dollars)	2009 $	2008 $
Assets		
Current assets		
Accounts receivable (notes 6, 11 and 12)	30,160	41,501
Derivative financial instruments (note 19)	2,196	381
Inventories (notes 7, 11 and 12)	212,590	223,199
Prepaid expenses	3,223	5,910
Income taxes receivable	4,726	3,778
Future income taxes (note 15)	1,683	2,338
	254,578	277,107
Capital assets (notes 8, 11, 12)	96,885	108,763
Derivative financial instruments (note 19)	—	347
Intangible assets (note 9)	7,580	10,773
Goodwill (note 5)	5,494	6,367
Other assets (note 10)	4,878	3,343
Future income taxes (note 15)	1,380	846
	370,795	407,546
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 11)	56,119	81,560
Accounts payable and accrued liabilities	19,152	28,694
Customer deposits	2,344	2,971
Derivative financial instruments (note 19)	31	266
Future income taxes (note 15)	869	118
Current portion of long-term debt (note 12)	4,746	4,914
Current portion of asset retirement obligations (note 13)	315	717
Current portion of non-competes payable (note 5)	920	969
	84,496	120,209
Long-term debt (note 12)	82,334	100,845
Future income taxes (note 15)	16,257	16,625
Asset retirement obligations (note 13)	932	577
Employee future benefits (note 16)	1,716	1,541
Derivative financial instruments (note 19)	1,400	1,303
Non-competes payable (note 5)	3,682	5,334
	190,817	246,434
Shareholders' equity		
Capital stock (note 14)	52,019	49,910
Contributed surplus	777	1,905
Retained earnings	130,580	105,055
Accumulated other comprehensive income (loss)	(3,398)	4,242
	179,978	161,112
	370,795	407,546

Commitments and contingencies (note 18).

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors

Tom A. Bruce Jones, CBE
Director

Richard Bélanger, FCA
Director

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended December 31, 2009 and 2008 (expressed in thousands of dollars, except number of shares in thousands)	2009 #	2008 #
Capital stock		
Number of shares outstanding – Beginning of year	12,565	12,341
Stock option plan	4	14
Stock option agreement	100	200
Share purchase plan	15	10
Number of shares outstanding – End of year	12,684	12,565
	$	$
Shares outstanding – Beginning of year	49,910	46,023
Stock option plan	80	286
Stock option agreement	1,692	3,384
Share purchase plan	337	217
Shares outstanding – End of year	52,019	49,910
Contributed surplus		
Balance – Beginning of year	1,905	4,045
Stock-based compensation	292	741
Exercise of stock options	(1,420)	(2,881)
Balance – End of year	777	1,905
Retained earnings		
Balance – Beginning of year	105,055	80,745
Net earnings for the year	30,069	28,547
Dividends on common shares	(4,544)	(4,237)
Balance – End of year	130,580	105,055
Accumulated other comprehensive income (loss)		
Balance – Beginning of year	4,242	(3,056)
Other comprehensive income (loss)	(7,640)	7,298
Balance – End of year	(3,398)	4,242
Shareholders' equity	179,978	161,112

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS

For the years ended December 31, 2009 and 2008 (expressed in thousands of dollars, except earnings per common share)	2009 $	2008 $
Sales	411,119	384,822
Expenses (income)		
Cost of sales (note 7)	334,450	306,424
Selling and administrative	20,444	20,346
Foreign exchange gain	(1,435)	(277)
Gain on derivative financial instrument (note 19)	(2,196)	—
Amortization of capital assets and intangible assets	8,755	8,365
Asset impairment	833	—
	360,851	334,858
Operating earnings	50,268	49,964
Financial expenses		
Interest on long-term debt	6,451	6,262
Other interest	2,025	2,472
	8,476	8,734
Earnings before income taxes	41,792	41,230
Provision for income taxes (note 15)		
Current	9,843	10,971
Future	1,880	1,712
	11,723	12,683
Net earnings for the year	30,069	28,547
Net earnings per common share (note 14(b))	2.38	2.29
Diluted net earnings per common share (note 14(b))	2.37	2.25

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the years ended December 31, 2009 and 2008 (expressed in thousands of dollars)	2009 $	2008 $
Net earnings for the year	30,069	28,547
Other comprehensive income (loss)		
Net change in unrealized gains (losses) on translation of financial statements of self-sustaining foreign operation	(13,078)	15,003
Net change in unrealized gains (losses) on translation of long-term debt designated as a hedge of net investment in self-sustaining foreign operation	5,845	(6,482)
Change in gains (losses) on fair value of derivatives designated as cash flow hedges	(272)	(1,142)
Reclassification to net earnings of gains on cash flow hedges	(319)	(630)
Income tax recovery on change in fair value of cash flow hedges and cash flow hedges reclassified to net earnings	184	549
	(7,640)	7,298
Comprehensive income	22,429	35,845

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31, 2009 and 2008 (expressed in thousands of dollars)	2009 $	2008 $
Cash flows from		
Operating activities		
Net earnings for the year	30,069	28,547
Adjustments for		
Amortization of capital assets	6,872	7,052
Amortization of intangible assets	1,883	1,313
Amortization of deferred financing costs	68	57
Change in fair value of debt	850	773
Loss (gain) on disposal of capital assets	151	(19)
Employee future benefits	(156)	243
Stock-based compensation	292	741
Loss (gain) on derivative financial instruments	(2,196)	388
Asset impairment	833	—
Future income taxes	1,880	1,712
Other	390	248
	40,936	41,055
Changes in non-cash working capital components		
Accounts receivable	9,652	4,135
Inventories	(1,819)	(36,996)
Prepaid expenses	2,335	(3,809)
Income taxes receivable	(1,558)	(2,473)
Accounts payable and accrued liabilities	(8,777)	(7,757)
Customer deposits	(241)	2,473
Asset retirement obligations	(47)	76
	(455)	(44,351)
	40,481	(3,296)
Financing activities		
Increase (decrease) in bank indebtedness	(21,775)	20,560
Increase in long-term debt	—	46,794
Repayment of long-term debt	(9,041)	(10,838)
Non-competes payable	(1,549)	(950)
Proceeds from issuance of common shares	689	1,006
Dividends on common shares	(4,544)	(4,237)
	(36,220)	52,335
Investing activities		
Decrease (increase) in other assets	57	(337)
Business acquisitions, net of cash	—	(38,220)
Purchase of capital assets	(4,811)	(10,392)
Assets held for sale	360	(272)
Proceeds from disposal of capital assets	133	182
	(4,261)	(49,039)
Net change in cash and cash equivalents during the year	—	—
Cash and cash equivalents – Beginning and end of year	—	—
Supplemental disclosures		
Interest paid	9,244	6,998
Income taxes paid	9,977	13,759

The accompanying notes are an integral part of these consolidated financial statements.

1 DESCRIPTION OF THE BUSINESS

Stella-Jones Inc. (the "Company") is a North American producer and marketer of industrial treated wood products, specializing in the production of railway ties and timbers as well as wood poles supplied to electrical utilities and telecommunication companies. The Company also provides treated consumer lumber products and customized services to lumber retailers and wholesalers for outdoor applications. Other products include marine and foundation pilings, construction timbers, highway guardrail posts and treated wood for bridges. The Company is incorporated under the *Canada Business Corporations Act*; its common shares are listed on the Toronto Stock Exchange.

2 SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Company, its wholly owned Canadian subsidiaries, Guelph Utility Pole Company Limited, I.P.B.-W.P.I. International Inc., Stella-Jones Canada Inc., and its wholly owned US subsidiaries, Stella-Jones U.S. Holding Corporation, Stella-Jones Corporation ("SJ Corp") and Stella-Jones U.S. Finance Corporation. On December 16, 2009, The Burke-Parsons-Bowlby Corporation ("BPB") (see note 5) was merged with SJ Corp and SJ Corp remained as the surviving corporation. The consolidated accounts of Stella-Jones Canada Inc. include a 50% interest in the accounts of Kanaka Creek Pole Company Limited ("Kanaka"), a joint venture which is accounted for under the proportionate consolidation method.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. 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, inventory valuations, reforestation and environmental provisions. It is possible that actual results could differ from those estimates and such differences could be material. Estimates are reviewed periodically, and as adjustments become necessary, they are reported in earnings in the period in which they become known.

Revenue recognition

Revenue from the sale of products and services is recognized when persuasive evidence of an arrangement exists, when products are shipped to customers or the services are rendered, when the risks and rewards related to the ownership of the product are assumed by the customer, when collection is considered reasonably assured and when the sales price is fixed or determinable.

Revenue is net of trade or volume discounts, returns and allowances and claims for damaged goods.

Logs are harvested from timber licences operated by the Company as part of a process to procure raw material for processing and treatment of utility poles. Logs not meeting pole-quality standards are regularly harvested and sold to third parties. Proceeds from the sale of non-pole-quality logs are included in the cost of poles sold since the production of non-pole-quality logs are a by-product of the Company's pole raw material procurement operations. Sales of non-pole-quality logs totalled $7,784,512 for the year ended December 31, 2009 (2008 – $13,023,124).

Cash and cash equivalents

Cash and cash equivalents include cash on hand, bank balances and short-term liquid investments with maturities of three months or less. As at December 31, 2009 and 2008, the Company had no cash and cash equivalents.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories of raw materials are valued at the lower of average cost and net realizable value. Finished goods are valued at the lower of average cost and net realizable value and include the cost of raw materials, direct labour and manufacturing overhead expenses. Net realizable value is the estimated selling price less cost necessary to make the sales.

Capital assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis using rates based on the estimated useful lives of the assets. In 2009, management reviewed and increased the useful life of certain capital assets in order to better reflect their use in time. These changes were applied prospectively from October 1, 2009. The impact on amortization expense for the year ended December 31, 2009 was as follows:

	Previous useful lives	Revised useful lives	Reduction in amortization expense $
Buildings	20 to 40 years	20 to 60 years	81,725
Production equipment	5 to 40 years	5 to 60 years	405,175
Rolling stock	3 to 10 years	3 to 15 years	5,100
Anti-pollution equipment	10 to 20 years	10 to 60 years	81,675
Office equipment	2 to 10 years	2 to 10 years	5,950
			579,625

Roads are recorded at cost less accumulated amortization, which is provided on the basis of timber volumes harvested. Amortization amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested in the licensed area served by the road, and are applied against the historical cost.

Cutting rights are recorded at cost less accumulated amortization, which is provided on the basis of timber volumes harvested. Amortization amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested during a 40-year period, and are applied against the historical cost.

Standing timber costs are recorded at cost less accumulated amortization, which is provided on the basis of timber volumes harvested. In Canada, the Company has perpetual cutting rights where planning and site preparation costs for specific geographical areas are capitalized until the harvest process can begin. Amortization amounts are charged to operations based on a pro rata calculation of timber volumes harvested over the estimated volumes to be harvested in the specific area.

Intangible assets

Intangible assets with finite useful lives are recorded at cost and are amortized on a straight-line basis over their useful lives. The amortization method and estimate of the useful life of an intangible asset are reviewed on an annual basis:

Customer relationships	3 to 10 years
Non-compete agreements	6 years

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Business combinations and goodwill

The Company accounts for its business combinations using the purchase method of accounting. Under this method, the Company allocates the purchase price to tangible and intangible assets acquired and liabilities assumed based on estimated fair values at the date of acquisition, with the excess of the purchase price amount being allocated to goodwill. Goodwill is not amortized; it is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it might be impaired. Testing for impairment is accomplished mainly by determining whether the fair value of a reporting unit, based on discounted estimated cash flows, exceeds the net carrying amount of that reporting unit as at the assessment date. If the fair value is greater than the net carrying amount, no impairment is necessary. In the event that the net carrying amount exceeds the sum of the discounted estimated cash flows, a second test must be performed whereby the fair value of the reporting unit's goodwill must be estimated to determine if it is less than its net carrying amount. Fair value of goodwill is estimated in the same way as goodwill was determined at the date of the acquisition, that is, the excess of the fair value of the reporting unit over the fair value of the identifiable net assets of the reporting unit. The Company conducted its annual goodwill impairment test for 2009 and 2008 and concluded that no adjustments were required.

Impairment of long-lived assets

Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. Any impairment loss would be determined as the excess of the carrying value of the assets over their fair value.

Asset retirement obligations

Reforestation obligations

The *Forest Act* (British Columbia) and the *Forests Act (*Alberta) require the industry to assume the costs of reforestation on certain harvest licences. Accordingly, the Company records the fair value of the cost of reforestation in the period in which the timber is harvested, with the fair value of the liability determined with reference to the present value of the estimated future cash flows. Reforestation costs are included in the costs of current production.

Site remediation obligations

Site remediation obligations relate to the discounted present value of estimated future expenditures associated with the obligations of restoring the environmental integrity of certain properties. The Company reviews estimates of future site remediation expenditures on an ongoing basis and records any revisions, along with the accretion expense on existing obligations, in other expenses.

Income taxes

The Company applies the liability method to account for income taxes. Under this method, future income taxes at the balance sheet date are determined using the differences between the accounting and tax bases of assets and liabilities and the substantively enacted income tax rates to be in effect when these differences are expected to reverse. Future tax assets are recognized when it is more likely than not that the assets will be realized.

Employee future benefits

Post-retirement benefit programs

The cost of future benefits earned by employees is established by actuarial calculations using the projected benefit method pro-rated on years of service based on management's best estimate of economic and demographic assumptions.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Defined benefit pension plan

The Company accrues obligations and related costs under defined benefit pension plans, net of plan assets. The cost of pensions earned by employees is actuarially determined using the projected benefits method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and discount rates on obligations. For the purpose of calculating the expected return on plan assets, those assets are valued at fair market value. Past service costs from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment. The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligations and the fair value of plan assets is amortized over the average remaining service life of the active employees, which ranges from 9 to 19 years.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

Stock-based compensation and other stock-based payments

The Company accounts for stock options granted to employees using the fair value method. Under this method, compensation expense for stock options granted is measured at the fair value at the grant date using the Black-Scholes valuation model and is charged to operations over the vesting period of the options granted, with a corresponding credit to contributed surplus. Any consideration paid on the exercise of stock options is credited to capital stock together with any related stock-based compensation expense included in contributed surplus.

The obligation related to stock appreciation rights and restricted stock units is accounted for as a liability over the period that the right is acquired, is revalued at each balance sheet date and is included in accounts payable and accrued liabilities.

Foreign currency transactions

Except for self-sustaining foreign operations, revenues and expenses denominated in a foreign currency are translated by applying the monthly average exchange rates in effect at the transaction date. At year-end, monetary assets and liabilities denominated in a foreign currency are translated at the rate in effect at the balance sheet date. Any resulting foreign currency translation gains or losses are included in the consolidated statement of earnings.

The financial statements of Stella-Jones U.S. Holding Corporation, a self-sustaining foreign operation, are translated using the rate in effect at the balance sheet date for assets and liabilities, and the average exchange rates during the year for revenues and expenses. Adjustments arising from this translation are recorded in accumulated other comprehensive income (loss) in shareholders' equity.

Financial instruments

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 on 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. 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 classification 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. Alternatively, the standard permits that any financial asset not classified as held-for-trading may be designated as available-for-sale. Significant transaction costs related to long-term credit facilities are capitalized and amortized over the life of the instrument. Other transaction costs related to short-term credit facilities are expensed in the period they are incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

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 rate 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 consolidated statement of comprehensive income. 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 financial 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 financial 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 Canadian Institute of Chartered Accountants ("CICA") 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 remeasure the fair value of the financial guarantee unless it qualifies as a derivative.

The Company has implemented the following classifications:

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 the original cost unless otherwise specified.

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 the original cost unless otherwise specified.

Hedging transactions

The Company enters into foreign exchange forward contracts to limit its exposure under contracted cash inflows and outflows of US dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. 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 the effective portion of the hedge are recognized in other comprehensive income (loss). 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 foreign exchange forward contracts and interest rate swaps recognized in other comprehensive income (loss) 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 earnings.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Hedging transactions (continued)

When the derivative financial instrument no longer qualifies as an effective hedge, or when the hedging instrument is sold or terminated prior to maturity, hedge accounting, if applicable, is discontinued prospectively. Accumulated other comprehensive income (loss) related to a foreign exchange forward contract and interest swap hedges that cease 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 earnings. Furthermore, if the hedged item is sold or terminated prior to maturity, hedge accounting is discontinued, and the related accumulated other comprehensive income (loss) is then reclassified in the consolidated statement of earnings at the original maturity date of the hedged item.

Effective September 26, 2008, the Company designated a portion of its US dollar-denominated long-term debt as a hedge of its net investment in a self-sustaining foreign operation. For such debt designated as a hedge of the net investment in a self-sustaining foreign operation, exchange gains and losses are recognized in accumulated other comprehensive income (loss).

Earnings per share

Diluted earnings per share are calculated using the treasury stock method. Under the treasury stock method, earnings per share data are computed as if the options were exercised at the beginning of the year (or at the time of issuance, if later) and as if the funds obtained from exercise were used to purchase common shares of the Company at the average market price during the year.

3 CHANGES IN ACCOUNTING POLICIES

The CICA issued the following new accounting standards which were adopted by the Company effective January 1, 2009.

Handbook Section 3064, “Goodwill and Intangible Assets”, replaces Section 3062, “Goodwill and Other Intangible Assets”, and Section 3450, “Research and Development Costs”. Section 1000, “Financial Statement Concepts”, was amended according 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 has assessed that the impact of this new accounting standard is not significant. Additionally, the required disclosures have been included in note 9.

Handbook Section 3862, “Financial Instruments – Disclosures”, was amended to include additional disclosure and presentation requirements about fair value measurements of financial instruments and to enhance liquidity risk disclosure and presentation requirements for publicly accountable enterprises and other entities after September 30, 2009. The adoption of this amended Section has had no material impact on the Company’s consolidated financial statements other than to provide enhanced disclosures in note 19.

On January 20, 2009, the Emerging Issues Committee (“EIC”) of the Canadian Accounting Standards Board (“AcSB”) issued EIC Abstract 173, “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”, which establishes that an entity’s own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. EIC Abstract 173 should be applied retrospectively without restatement of prior years to all financial assets and financial liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The Company has assessed that the impact of EIC Abstract 173 is not significant.

4 IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

The CICA issued the following accounting standards which will be adopted by the Company effective January 1, 2010.

Handbook Section 1582, "Business Combinations", replaces Section 1581 of the same title. The new Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting 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. The Company will apply this new standard effective January 1, 2010 as early adoption is permitted.

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 International Accounting Standard 27 (Revised), "Consolidated and Separate Financial Statements". The Company will apply these new standards effective January 1, 2010 as early adoption is permitted. Their adoption will not have a significant impact on the Company's consolidated financial statements.

5 BUSINESS ACQUISITIONS

On April 1, 2008, the Company completed the acquisition of BPB through a merger of BPB with a wholly owned US subsidiary of the Company. BPB produces pressure treated wood products primarily for the railroad industry. This acquisition included five treating plants located in DuBois, Pennsylvania; Goshen, Virginia; Spencer, West Virginia; and Stanton and Fulton, Kentucky.

Total consideration for the 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 shareholders 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 ended 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) guaranteed by a letter of credit to be paid in equal quarterly instalments 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 at the acquisition date. The results of operations of BPB have been included in the Company's consolidated financial statements from the acquisition date.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

5 BUSINESS ACQUISITIONS (continued)

The following is a final summary of the net assets acquired at fair value as at the acquisition date. The original transaction was made in US dollars and converted into Canadian dollars as at the acquisition date.

	$
Assets acquired	
Non-cash working capital	41,600
Capital assets	24,432
Cash surrender value of life insurance	325
Customer relationships	4,475
Non-compete agreements	5,814
Non-deductible goodwill	5,340
Future income tax assets	1,283
	83,269
Liabilities assumed	
Notes payable to banks	14,007
Accounts payable and accrued liabilities	6,858
Long-term debt	9,206
Interest-bearing employee deposits	2,134
Future income tax liabilities	7,030
	39,235
Total consideration	44,034
Consideration	
Cash, financed by debt	33,716
Purchase price adjustment paid in cash	3,478
Non-compete agreements payable	5,814
Cash on hand	(97)
Acquisition costs	1,123
Total consideration	44,034

The BPB acquisition 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 drawdown on an existing operating margin of $5.1 million (US$5.0 million). Details of the financing are available in notes 11 and 12.

6 ACCOUNTS RECEIVABLE

	2009 $	2008 $
Trade	28,530	40,069
Other	1,630	1,432
	30,160	41,501

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

7 INVENTORIES

	2009 $	2008 $
Raw materials	160,351	177,440
Finished goods	52,239	45,759
	212,590	223,199

The inventory cost included in cost of sales as at December 31, 2009 is $295,907,000 (2008 – $268,997,581).

8 CAPITAL ASSETS

			2009
	Cost $	Accumulated Amortization $	Net $
Land	6,498	—	6,498
Roads	2,617	853	1,764
Cutting rights	6,505	355	6,150
Standing timber	4,717	1,666	3,051
Buildings	22,497	4,712	17,785
Production equipment	68,425	21,304	47,121
Rolling stock	6,467	2,178	4,289
Anti-pollution equipment	14,742	5,559	9,183
Office equipment	1,984	940	1,044
	134,452	37,567	96,885

During the year, the Company decided to close and sell its Stanton (Kentucky) plant. As a result $2,401,782 in capital assets were reclassified to assets held for sale (see note 10).

			2008
	Cost $	Accumulated Amortization $	Net $
Land	8,648	—	8,648
Roads	2,188	760	1,428
Cutting rights	6,505	271	6,234
Standing timber	4,140	1,198	2,942
Buildings	24,645	4,281	20,364
Production equipment	74,653	22,376	52,277
Rolling stock	8,569	2,693	5,876
Anti-pollution equipment	15,817	5,941	9,876
Office equipment	2,357	1,239	1,118
	147,522	38,759	108,763

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

8 CAPITAL ASSETS (continued)

The net book value of assets held under capital leases as at December 31 is as follows:

	2009 $	2008 $
Cost	1,986	1,551
Accumulated amortization	143	55
Net book value	1,843	1,496

9 INTANGIBLE ASSETS

The Company has recognized intangible assets as part of a previous acquisition. The acquisition cost of intangible assets, which consist of customer relationships and non-compete agreements, was initially evaluated at fair value, which subsequently became the cost. The presentation in the consolidated balance sheet is at cost less accumulated amortization and the related amortization expense is included in amortization in the consolidated statement of earnings.

Customer relationships comprise long-term agreements with certain customers and ongoing business relationships. The acquisition cost was established based on future benefits associated with these relationships. Intangible assets associated with long-term customer agreements are amortized over the terms of the agreements, which are between three and five years. Intangible assets associated with ongoing business relationships are amortized over ten years.

The acquisition cost of the non-compete agreements was established based on the discounted value of future payments using a discount rate of 10.2%, for the acquisition note (note 5). For cash flow purposes, this has been treated as a non-cash transaction. The intangible asset associated with the non-compete agreements is amortized on a straight-line basis over the terms of the agreements, which are six years.

As at December 31, 2009, the amortization expenses for customer relationships and the non-compete agreements were $789,466 and $1,093,490 (2008 – $550,668 and $762,732) respectively. The net book value of these assets was as follows:

			2009
	Cost $	Accumulated Amortization $	Net $
Customer relationships	4,603	1,259	3,344
Non-compete agreements	5,980	1,744	4,236
	10,583	3,003	7,580

			2008
	Cost $	Accumulated Amortization $	Net $
Customer relationships	5,335	626	4,709
Non-compete agreements	6,930	866	6,064
	12,265	1,492	10,773

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

10 OTHER ASSETS

	2009 $	2008 $
Advances against third party cutting rights	300	322
Notes receivable	267	277
Accrued benefit asset (note 16(b))	1,416	1,086
Assets held for sale*	2,895	1,633
Other	—	25
	4,878	3,343

* In 2009, the Company decided to close and sell its Stanton (Kentucky) plant. Included in assets held for sale are an office building with its underlying land and the Stanton plant. These assets are considered redundant. Assets held for sale were written down by $833,000 (2008 – nil).

11 BANK INDEBTEDNESS

	2009 $	2008 $
Demand operating loan with a Canadian bank (notes 11(a) and 20)	28,786	32,302
Demand operating loan with a US bank (notes 11(b) and 20)	24,969	46,166
Proportionate share of Kanaka demand operating loan (note 11(c))	2,364	3,092
	56,119	81,560

a) The Company has available a credit facility with a Canadian bank, renewable annually, comprising a maximum demand operating loan of $50,000,000 (2008 – $50,000,000), of which $13,242,974 was available as at December 31, 2009. The credit facility also includes a term loan facility of $6,900,000, a bid and performance bond guarantee facility of up to a maximum of $5,000,000, a $4,759,772 capital lease facility, a demand revolving line of credit in the amount of $12,024,000 for the purchase of foreign exchange forward contracts with an aggregate nominal value of $34,000,000 and an interest rate swap facility for up to the full amount outstanding under the term loans (note 12(a)).

The credit facility is subject to covenants which the Company was in compliance with at December 31, 2009.

The interest rate on the operating loan was the bank's prime rate plus 0.25% or bankers' acceptance ("BA") rate plus a stamping fee of 1.50% per annum for Canadian BA advances. For US dollar advances, the interest rate was the bank's US base rate plus 0.25% or LIBOR plus 1.50%. Effective June 8, 2009, the Company entered into a BA interest rate swap fixing the interest rate at 2.19% with a termination date of June 8, 2012. This interest rate swap applies on the first $15,000,000 of bank indebtedness under this credit facility and renews every 30 days. As collateral, the bank holds moveable hypothecs and general security agreements over the universality of the Company's Canadian assets, creating a first charge over all of its Canadian current assets of $151,786,982 as at December 31, 2009 and a second ranking charge over all of the Canadian capital assets of $54,264,077 as at December 31, 2009, subject to prior loans approved by the Canadian bankers. The bank also holds a first ranking security under Section 427 of the Bank Act over the Company's Canadian inventories.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

11 BANK INDEBTEDNESS (continued)

b) Stella-Jones US Holding Corporation and SJ Corp (collectively, "the US subsidiaries") have available a credit facility arranged with a US bank, renewable annually, comprising a maximum demand operating loan of US$45,000,000 (2008 – US$45,000,000), of which US$14,064,514 was available as at December 31, 2009. The credit facility is subject to covenants which the Company was in compliance with at December 31, 2009. The operating line of credit bears interest at the bank's prime rate minus 0.50% or LIBOR plus 1.50%. Effective June 10, 2009, the Company entered into a LIBOR interest rate swap fixing the interest rate at 2.57% with a termination date of June 10, 2012. This interest rate swap applies on the first US$15,000,000 of bank indebtedness under this credit facility and renews every 30 days.

As collateral for the US demand operating loan, the US bank holds a first security interest on all non-real estate assets of the US subsidiaries (except for certain equipment) having a net book value of US$101,566,554 as at December 31, 2009. The bank also has a second security interest on certain equipment of the US subsidiaries having a net book value of US$35,336,737 as at December 31, 2009. There is no recourse to the Canadian parent company, i.e. the Company, in the event of default by the US subsidiaries. The Company has signed an inventory repurchase agreement with the US bank whereby it has agreed to purchase any or all inventory of the US subsidiaries at book value upon an event of default by the US subsidiaries, if requested by the US bank.

c) The Company includes in its consolidated financial statements its 50% proportionate share of Kanaka, which has a credit facility with a Canadian bank comprising a $7,000,000 demand operating loan. The demand operating loan bears interest at the bank's prime rate plus 0.25%, the bank's US base rate plus 0.25%, LIBOR plus 1.1375% or BA rate plus 1.1375%. One half of the indebtedness, up to a maximum of $5,000,000, has been guaranteed by Stella-Jones Canada Inc. and the Company. The Company has also provided an Environmental Indemnity Agreement to the bank with respect to the Maple Ridge property, the site of Kanaka's operations, with liability limited to one half of the monies which become due and owing to the bank under such indemnity.

12 LONG-TERM DEBT (note 20)

	2009 $	2008 $
Term loans with a Canadian bank (note 12(a))	2,539	3,654
Revolving term loan with a Canadian bank (note 12(b))	22,098	23,768
Term loan with a US bank (note 12(c))	8,693	11,572
Unsecured and non-convertible debenture (note 12(d))	10,000	10,000
Unsecured and non-convertible debenture (note 12(e))	—	4,000
Unsecured and non-convertible debenture (note 12(f))	26,275	30,450
Promissory note (note 12(g))	788	913
Promissory note (note 12(h))	755	1,053
Subordinated note (note 12(i))	6,822	8,323
Bond (note 12(j))	4,788	5,728
Promissory note (note 12(k))	373	508
Promissory note (note 12(l))	356	447
Mortgage loans (note 12(m))	2,786	4,317
Obligations under capital leases (note 12(n))	1,294	1,609
	87,567	106,342
Deferred financing costs	(487)	(583)
	87,080	105,759
Less: Current portion of long-term debt	4,811	4,982
Less: Current portion of deferred financing costs	(65)	(68)
	82,334	100,845

12 LONG-TERM DEBT (note 20) (continued)

a) The Company has available three term loans of $2,300,000, $2,700,000 and $1,900,000 with a Canadian bank.

Amounts owing under the $2,300,000 term loan are repayable in 19 equal consecutive principal repayments of $82,143 on each three-month anniversary of the date on which the initial advance was made (December 28, 2005), and a balloon repayment of $739,283 constituting the twentieth and final payment of the residual capital balance on December 28, 2010. Subsequently, as a result of an interest rate swap agreement, the loan bears interest at a fixed rate of 5.81% over its term.

Amounts owing under the $2,700,000 term loan are repayable in 19 equal consecutive principal repayments of $96,429 on each three-month anniversary of the date on which the initial advance was made (February 1, 2006), and a balloon repayment of $867,849 constituting the twentieth and final payment of the residual capital balance on February 1, 2011. Subsequently, as a result of an interest rate swap agreement, the loan bears interest at a fixed rate of 5.85% over its term.

Amounts owing under the $1,900,000 term loan are repayable in 19 equal consecutive principal repayments of $100,000 on each three-month anniversary of the date on which the initial advance was made (December 19, 2005) and shall be repaid in full by September 30, 2010. The loan bears interest at a fixed rate of 5.93% over its term.

b) The Company has a two-year revolving term loan, which matures February 16, 2011, with a Canadian bank comprising a Canadian dollar loan of $11,587,500 and a US dollar loan of US$10,000,000 as well as an amount not exceeding US$5,000,000 to purchase foreign exchange forward contracts. The US$10,000,000 term loan was designated as a hedge of net investment in a self-sustaining foreign operation. The revolving term loan is subject to covenants of which the Company was in compliance with at December 31, 2009.

For loans in Canadian dollars, the credit facility bears interest at the bank's prime rate plus 0.95% or bankers' acceptance rate plus 2.10%, and for loans in US dollars, the credit facility bears interest at the bank's US base rate plus 0.95% or LIBOR plus 2.10%. Effective April 3, 2009, the Company entered into a 30 day LIBOR interest rate swap fixing the interest rate on the US$10,000,000 term loan at 1.53%. As collateral, the bank holds moveable hypothecs and general security agreements creating a first charge over all of the Company's Canadian capital assets of $54,264,077 as at December 31, 2009 and a second ranking charge over all of the Canadian current assets of $151,786,982 as at December 31, 2009. Amounts owing under the revolving term loan are payable at maturity which can be extended each year for one additional year upon the Company's request and subject to the bank's approval. Starting January 2008, the credit facility was increased by the equivalent amount of the capital payments of the term facilities provided by the credit facility in note 12(a) to a maximum of $27,500,000 as at January 2011.

c) The Company's US subsidiaries entered into a US$10,000,000 term loan agreement with a US bank. The term loan is repayable in 84 consecutive monthly instalments of US$119,048 and matures July 1, 2015. The loan is subject to two interest rate swaps of US$5,000,000 each, fixing the rates at 5.80% and 5.54% over the term of the loan. The revolving term loan is subject to covenants which the Company was in compliance with at December 31, 2009.

As collateral, the bank has a first priority security interest on certain real property and improvements thereon as well as equipment of the US subsidiaries, bearing an aggregate net book value of US$39,146,790 as at December 31, 2009. The bank also has a second priority security interest on the accounts receivable and inventories of the US subsidiaries having a book value of US$85,431,636 as at December 31, 2009.

d) Unsecured and non-convertible debenture bearing interest at 7.72%, repayable in five consecutive annual principal repayments of $1,000,000 beginning July 1, 2011 and a final payment of $5,000,000 on July 1, 2016.

e) Unsecured and non-convertible debenture bearing interest at 7.0%, repayable after December 31, 2006 in five consecutive annual principal repayments of $333,333 and a final payment of $3,000,000 on December 21, 2012. This debt was repaid in two payments of $2,000,000 in November and December 2009.

12 LONG-TERM DEBT (note 20) (continued)

f) Unsecured and non-convertible debenture bearing interest at 7.89%, repayable in five consecutive annual principal repayments of US$2,500,000 starting on April 1, 2013 and a final payment of US$12,500,000 on April 1, 2018. This debenture was designated as a hedge of net investment in a self-sustaining foreign operation.

g) SJ Corp borrowed US$750,000 from the Company's majority shareholder, Stella Jones International S.A., by way of a subordinated promissory note. The note is for a term of six years, bears interest at LIBOR plus 4.5% and is repayable in full on the sixth annual anniversary of the date of disbursement or August 3, 2011. The note is unsecured and subordinated in right of payment to the prior payment in full of the US subsidiaries' loans to all of its secured lenders.

h) As part of a previous acquisition, SJ Corp assumed an unsecured promissory note payable. The imputed interest rate of the note is 8.0%. The note is payable in quarterly instalments of US$52,891 including interest and matures on October 1, 2013.

i) Pursuant to a business acquisition of February 28, 2007, SJ Corp issued a note payable to J.H. Baxter and Co. The note is subordinated to existing lenders and bears interest at 5.0%. The note is repayable in five annual principal repayments of US$500,000 with a final payment of US$5,500,000 on the sixth anniversary date. The note was initially recorded at a fair value of $6,981,288 using an interest rate of 8.0%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.

j) Pursuant to the BPB acquisition, the US subsidiaries assumed a bond issued in favour of the County of Fulton, Kentucky (the Burke-Parsons-Bowlby Project), Series 2006, repayable in annual principal repayments of US$200,000 starting July 2008 through July 2011, US$300,000 starting July 2012 through July 2019 and US$400,000 starting July 2020 through July 2026. The bond bears interest at a variable rate based on the SIFMA Municipal Swap Index. On June 15, 2009, the Company entered into an interest rate swap agreement fixing the rate at 2.99% up to December 1, 2015. The bond is secured by substantially all assets of BPB's Fulton facility, which have a net book value of US$7,840,115 as at December 31, 2009. The bond was initially recorded in the consolidated financial statements at a fair value of US$4,835,379 using an interest rate of 6.50%. The difference between the face value and the fair value of the bond is being accreted on an effective yield basis over its term.

In order to provide security for the timely payment of the principal and interest due on the bond, the US subsidiaries entered into a US$5,600,000 irrevocable letter of credit with the bank that is also the trustee for the Series 2006 Bond Indenture, at an annual fee of 1.0% of the outstanding loan balance. The letter of credit expires on January 17, 2026.

k) Pursuant to the BPB acquisition, the US subsidiaries assumed a promissory note payable to Hickman-Fulton Rural Electric Cooperative Corporation, bearing interest at a fixed rate of 3.0% and repayable in 84 equal monthly instalments of principal and interest of approximately US$6,604 starting January 15, 2008. The note is secured by a US$500,000 irrevocable letter of credit issued by a regional financial institution and expires December 17, 2017. The note was initially recorded in the consolidated financial statements at a fair value of US$462,344 using an interest rate of 5.55%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.

l) Pursuant to the BPB acquisition, the US subsidiaries assumed a promissory note payable to Hickman-Fulton Rural Electric Cooperative Corporation, bearing no interest and repayable in 108 equal monthly instalments of US$4,167 starting January 1, 2009. The note is secured by a US$450,000 irrevocable letter of credit issued by a regional financial institution and expires December 17, 2017. The note was initially recorded in the consolidated financial statements at a fair value of US$354,217 using an interest rate of 6.0%. The difference between the face value and the fair value of the note is being accreted on an effective yield basis over its term.

m) The mortgage loans bear interest at a weighted average rate of 6.2% as at December 31, 2009 (2008 – 6.3%) and certain specific capital assets with a net book value of $4,128,705 (2008 – $5,638,867) have been pledged as collateral. The mortgage loans include loans denominated in US dollars amounting to US$2,650,669 (2008 – US$3,407,858). The loans are repayable in monthly instalments of $82,583 (2008 – $95,705) including interest and mature at various dates to January 2018.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

12 LONG-TERM DEBT (note 20) (continued)

n) The repayment requirements on the long-term debt during the next five years and thereafter are as follows:

	Capital leases				
Years	Minimum payments $	Interest $	Principal $	Principal $	Principal repayments $
2010	203	60	143	4,923	5,066
2011	96	55	41	6,060	6,101
2012	96	53	43	4,148	4,191
2013	236	44	192	11,789	11,981
2014	81	40	41	5,888	5,929
Thereafter	872	38	834	55,181	56,015
	1,584	290	1,294	87,989	89,283
Fair value adjustment	—	—	—	(1,716)	(1,716)
	1,584	290	1,294	86,273	87,567

o) The aggregate fair value of the Company's long-term debt was estimated at $85,715,000 as at December 31, 2009 (2008 – $109,660,000) based on discounted future cash flows, using interest rates available to the Company for issues with similar terms and average maturities.

13 ASSET RETIREMENT OBLIGATIONS

Stella-Jones Canada Inc. has asset retirement obligations relating to reforestation and site remediation that have been estimated using a credit-adjusted risk-free rate of 6.6% (2008 – 4.5%) to approximate the present value of future expenditures.

Reforestation

Reforestation obligations represent discounted cash flow estimates of future silviculture costs relating to areas logged that are the Company's responsibility to reforest.

	2009 $	2008 $
Reforestation obligations – Beginning of year	1,246	1,160
Changes to reforestation estimates and accretion expense	394	708
Expenditures	(481)	(622)
Reforestation obligations – End of year	1,159	1,246
Less: Current portion	315	669
	844	577

Future non-discounted reforestation expenditures are estimated at between $335,000 and $495,000 in each of the next three years. There are uncertainties in estimating future reforestation costs due to potential regulatory changes as well as the impact of weather-related changes on reforested areas. Accordingly, the actual cost of reforestation may differ from current estimates.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

13 ASSET RETIREMENT OBLIGATIONS (continued)

Reforestation (continued)

The Company has contracts whereby third party licensees that harvest certain areas assume the responsibility for reforestation. Should the third party licensees fail to perform, the Company is responsible for these additional future reforestation costs, which are currently estimated to be $692,430 (2008 – $507,082). Payments, if any, required as a result of this contingency will be expensed in the period in which they are determined and are not included in the provision for reforestation noted above.

Site remediation

Site remediation obligations represent discounted cash flow estimates relating to future environmental remediation costs of former treating sites.

	2009 $	2008 $
Site remediation obligations – Beginning of year	48	58
Changes to site remediation estimates	52	—
Expenditures	(12)	(10)
Site remediation obligations – End of year	88	48
Less: Current portion	—	48
	88	—

Total asset retirement obligations

	2009 $	2008 $
Reforestation obligations	1,159	1,246
Site remediation obligations	88	48
	1,247	1,294
Less: Current portion	315	717
	932	577

14 CAPITAL STOCK

a) Capital stock consists of the following:

Authorized
An unlimited number of preferred shares issuable in series
An unlimited number of common shares

14 CAPITAL STOCK (continued)

b) Earnings per share

The following table provides the reconciliation between net earnings per common share and diluted net earnings per common share:

	2009	2008
Net earnings applicable to common shares	$30,069	$28,547
Weighted average number of common shares outstanding*	12,638	12,483
Effect of dilutive stock options	66	212
Weighted average number of diluted common shares outstanding*	12,704	12,695
Net earnings per common share	$2.38	$2.29
Diluted net earnings per common share	$2.37	$2.25

* Number of shares is presented in thousands.

c) Stock option plan

The Company has a stock option plan (the "Plan") for directors, officers and employees whereby the Board of Directors or a committee appointed for such purpose ("Committee") may, from time to time, grant to directors, officers or employees of the Company options to acquire common shares in such numbers, for such terms and at such exercise prices as are determined by the Board of Directors or such Committee. The stated purpose of the Plan is to secure for the Company and its shareholders the benefits of incentives inherent in share ownership by directors, officers and employees of the Company.

Under the Plan adopted on June 13, 1994 and amended on May 3, 1995, March 15, 2001 and May 3, 2007, the aggregate number of common shares in respect of which options may be granted is 1,200,000 and no optionee may hold options to purchase common shares exceeding 5% of the number of common shares issued and outstanding from time to time. The exercise price of an option shall not be lower than the closing price of the common shares on the Toronto Stock Exchange ("TSX") on the last trading day immediately preceding the date of the granting of the option. Each option shall be exercisable during a period established by the Board of Directors or Committee, and the term of the option may not exceed 10 years. Options will not be assignable and will terminate, in the case of an employee, either 30 or 180 days following cessation of service with the Company depending on the circumstances of such cessation, and in the case of a director who is not an employee of the Company, either 30 or 180 days following the date on which such optionee ceases to be a director of the Company, depending on the circumstances.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

14 CAPITAL STOCK (continued)

c) Stock option plan (continued)

Changes in the number of options outstanding under the Plan were as follows:

	2009		2008	
	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $
Outstanding				
Beginning of year	147,785	18.63	162,070	18.17
Exercised	(4,000)	13.00	(14,285)	13.38
Granted	57,000	24.05	—	—
Forfeited	(3,000)	19.50	—	—
Outstanding – End of year	197,785	20.29	147,785	18.63
Options exercisable-				
End of year	126,185	17.49	93,285	15.97

The following options were outstanding under the Plan as at December 31, 2009:

	Options outstanding		Options exercisable		
Year granted	Number of options	Weighted average exercise price $	Number of options	Weighted average exercise price $	Expiration date
2001	18,285	2.15	18,285	2.15	2011
2005	39,000	13.00	39,000	13.00	2015
2006	61,000	19.78	48,000	19.76	2016
2007	22,500	39.58	13,500	39.58	2017
2009	57,000	24.05	7,400	24.05	2016
	197,785		126,185		

d) Stock option agreement

On May 6, 2003, with the objective of assisting the Company in recognizing the significant contributions that its President and Chief Executive Officer ("President") has made to the Company, and in order to provide incentives for him to continue to make significant contributions to the Company, 300,000 options were granted to the President under a stock option agreement ("Agreement").

The Agreement provides that the options are exercisable at a price of $2.99 in whole or in part commencing on May 6, 2008, or earlier in the event of a triggering event, that is, a loss or change in control of the Company, the closing of a going private transaction, or the occurrence of termination without cause. The right to exercise these options terminates on May 6, 2013 or, in the case of a triggering event, within 30 days of the event.

In 2006, the President, on his own initiative, unconditionally and irrevocably waived his right under the Agreement to settle stock options for cash. As a result, the amount recorded as a long-term liability of $3,480,000 net of the related future income taxes of $1,218,000 was eliminated and a corresponding amount was included in contributed surplus.

On May 6, 2008, the options under the Agreement became fully vested and shortly thereafter, 200,000 options were exercised. On May 13, 2009 the remaining 100,000 options were exercised. The total stock-based compensation expenses for 2009 relating to the Agreement was nil (2008 – $433,936).

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

14 CAPITAL STOCK (continued)

e) Stock-based compensation

The Company records expenses for the fair value of the stock options granted under the Plan using the Black-Scholes option pricing model. This model determines the fair value of stock options granted and amortizes it to earnings over the vesting period.

On December 18, 2009, 57,000 options were granted, their fair value was $530,720, and the expense amortized to earnings was $4,423. No options were granted during 2008. The fair value was estimated with the following weighted average assumptions:

	2009	2008
Risk-free interest rate	2.57%	—
Dividend yield	1.25%	—
Expected lives	7 years	—
Volatility	40.21%	—
Weighted average of fair value of options granted during the year	$9.31	—

In 2009, the total expense relating to stock-based compensation amortized to earnings was $292,413 (2008 – $307,264).

f) Employee share purchase plans

The aggregate number of common shares reserved for issuance under the Company's two employee share purchase plans is 200,000.

Under the first plan, Company employees who are Canadian residents are eligible to purchase common shares from the Company at an amount equal to 90% of the market price. Employees who hold common shares in the employee share purchase plan for 18 months following the date of acquisition of such shares receive additional common shares of the Company equivalent to 10% of the amount of their contributions made on the date of acquisition. In 2009, 10,952 common shares (2008 – 7,517) were issued to Canadian resident employees at an average price of $18.37 per share (2008 – $22.30).

Under the second plan, Company employees who are US residents are eligible to purchase common shares from the Company at market price. Employees who hold common shares in the employee share purchase plan for 18 months following the date of acquisition of such shares receive additional common shares of the Company equivalent to 10% of the amount of their contributions made on the date of acquisition. In 2009, 4,448 common shares (2008 – 2,035) were issued to US resident employees at an average price of $20.00 per share (2008 – $24.20).

As at December 31, 2009, the total number of common shares issued under these plans is 157,830 (2008 – 142,430).

g) On November 13, 2007 and December 22, 2008, the Company granted stock appreciation rights to senior management with the base price being the trading price per share on the TSX at the close of trading on November 13, 2007 and December 22, 2008 respectively. Details are as follows:

Grant date	November 13, 2007	December 22, 2008
Number of rights granted	300,000	15,000
Base price	$39.74	$15.60

On December 18, 2009, in consideration of a long-term incentive plan adopted by the Company for senior management, which included the granting of stock options and Restricted Stock Units ("RSUs"), members of senior management agreed to cancel the November 13, 2007 stock appreciation rights in their entirety.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

14 CAPITAL STOCK (continued)

On December 26, 2009, the December 22, 2008 stock appreciation rights were enforced in their entirety, and the Company recorded an expense of $165,555.

h) On December 18, 2009, certain key executives of the Company were granted RSUs as part of a long-term incentive plan. This plan had been approved by the Company's Board of Directors on December 10, 2009. The number of RSUs initially granted was based on a percentage of the executive's salary, divided by the average trading price of the Company's common shares on the TSX for the five days immediately preceding the grant date. In the case of the President, the number of RSUs initially granted was a fixed number recommended by the Remuneration Committee. Additional RSUs may be issued annually on the anniversary date of the initial grant conditional upon the Company attaining a minimum 12.5% return on capital employed. The number of additional RSUs to be issued on the anniversary dates will be calculated in the same manner as the initial grant.

The RSUs are a full-value phantom share payable in cash on the third anniversary of their issue, provided the executive is still in the employ of the Company. The amount to be paid is determined by multiplying the number of RSUs by the six-month average trading price of the Company's common shares on the TSX immediately preceding the anniversary date.

15 INCOME TAXES

The earnings before income taxes computed for the years ended December 31 were as follows:

	2009 $	2008 $
Canada	33,122	27,917
US	8,670	13,313
	41,792	41,230

The provision for income taxes includes the following current and future amounts:

	2009 $	2008 $
Current		
Canada	8,128	7,412
US	1,715	3,559
Total current expense	9,843	10,971
Future		
Canada	1,400	909
US	480	803
Total future expense	1,880	1,712
	11,723	12,683

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

15 INCOME TAXES (continued)

The effective income tax rate differs from the basic Canadian federal and provincial statutory tax rate due to the following:

	2009	2008
Statutory tax rate	31.07%	31.62%
	$	$
Income tax expense at statutory rate	12,985	13,037
Income tax expense (recovery) resulting from		
Future tax adjustments due to rate enactments	(293)	(162)
Manufacturing and processing credit	(181)	(242)
Effect of different tax rates	401	695
Dividends deductible from a related party	(690)	(545)
Stock-based compensation	95	234
Non-deductible portion of foreign exchange loss	—	70
Unrecorded tax benefit on foreign exchange loss	—	61
Other	(594)	(465)
	11,723	12,683
Effective income tax rate	28.05%	30.76%

Significant components of the future income tax assets and liabilities are as follows:

	2009 $	2008 $
Future income tax assets due to		
Accrued liabilities	1,458	2,255
Employee future benefits	878	414
Derivative financial instruments and other	727	515
	3,063	3,184
Future income tax liabilities due to		
Capital assets	(15,922)	(16,260)
Derivative financial instruments	(869)	(226)
Other assets	(335)	(257)
	(17,126)	(16,743)

16 EMPLOYEE FUTURE BENEFITS

The Company recognizes cost for several types of employee future benefits. Post-retirement benefits are offered to certain retired employees and consist of group health and dental care, life insurance and complementary retirement benefits. Stella-Jones Canada Inc. contributes to a multi-employer plan for certain hourly employees and to three defined benefit pension plans for salaried and certain non-union hourly wage employees. All other active employees are entitled to a group registered retirement savings plan to which the Company matches 1.5 times employee contributions to a maximum of 4%. The recognized cost for employee future benefits was as follows:

	2009 $	2008 $
Post-retirement benefits	207	256
Defined benefit pension plans	102	136
Contributions to multi-employer plan	294	322
Contributions to group registered retirement savings plans	1,157	1,145

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

16 EMPLOYEE FUTURE BENEFITS (continued)

a) The post-retirement benefits program is not funded. For its defined benefit pension plan, the Company measures its accrued benefit obligations for accounting purposes as at December 31 of each year. The most recent actuarial valuation of this plan was as at January 1, 2009, and the next required valuation will be as at January 1, 2012. The following information as established by independent actuaries pertains to the Company's defined benefit plan:

	2009 $	2008 $
Accrued benefit obligation		
Balance – Beginning of year	1,652	1,974
Current service cost	90	118
Interest cost on obligation	116	109
Benefit payments	(32)	(30)
Actuarial loss (gain)	880	(519)
Balance – End of year	2,706	1,652
Plan assets		
Fair value – Beginning of year	—	—
Employer contributions	32	30
Benefits paid	(32)	(30)
Fair value – End of year	—	—
Net obligation – End of year	2,706	1,652
Unamortized net actuarial loss	(978)	(98)
Unamortized past service costs	(12)	(13)
Accrued benefit obligation	1,716	1,541

The significant assumptions used are as follows:

	2009 %	2008 %
Accrued benefit obligation and benefit cost as at December 31		
Discount rate	5.85	6.75
Rate of compensation increase	2.00	4.00

For measurement purposes, a 9.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2009. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%. An increase or decrease of 1% in this rate would have the following impact:

	Increase of 1%	Decrease of 1%
Impact on accrued benefit obligation	544	426
Impact on benefit cost	48	37

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

16 EMPLOYEE FUTURE BENEFITS (continued)

The elements of the Company's defined benefit plan costs recognized during the year are as follows:

	2009 $	2008 $
Current service cost	90	118
Interest cost	116	109
Actuarial loss (gain)	880	(519)
Elements of employee future benefit cost before adjustments to recognize the long-term nature of employee future benefit cost	1,086	(292)
Adjustments to recognize the long-term nature of employee future benefit cost		
Difference between net actuarial loss (gain) and actuarial loss (gain)	(880)	547
Amortization of past service costs	1	1
Defined benefit costs recognized	207	256

b) The Stella-Jones Canada Inc. defined benefit pension plans base the benefits on the length of service and final average earnings. The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of one of the pension plans for funding purposes was as at December 31, 2007, which will be updated December 31, 2010. The actuarial valuation date for the other two pension plans is December 31, 2008, which will be updated December 31, 2011.

Information about Stella-Jones Canada Inc.'s defined benefit plans other than the multi-employer defined benefit plan, in aggregate, is as follows:

	2009 $	2008 $
Accrued benefit obligation		
Balance – Beginning of year	7,332	10,686
Current service cost	249	406
Interest cost on obligation	537	558
Benefit payments	(606)	(505)
Actuarial loss (gain)	968	(3,813)
Balance – End of year	8,480	7,332
Plan assets		
Fair value – Beginning of year	9,079	10,933
Actual return on plan assets	1,251	(1,803)
Employer contributions	443	455
Benefits paid	(606)	(506)
Fair value – End of year	10,167	9,079
Funded status – Plan surplus	1,687	1,747
Unamortized net actuarial gain	271	661
Accrued benefit asset, included in other assets (note 10)	1,416	1,086

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

16 EMPLOYEE FUTURE BENEFITS (continued)

Included in the above accrued benefit obligation and fair value of plan assets at year-end are the following amounts in respect of benefit plans that are not fully funded:

	2009 $	2008 $
Accrued benefit obligation	1,802	1,577
Fair value of plan assets	1,578	1,415
Funded status – Plan deficit	(224)	(162)

The percentage of plan assets consists of the following for the year ended December 31:

	2009 %	2008 %
Equity securities	58	55
Debt securities	39	40
Short-term investments and cash	3	5
	100	100

The significant weighted average assumptions used are as follows:

	2009 %	2008 %
Accrued benefit obligation as at December 31		
Discount rate	6.50	7.50
Rate of compensation increase	3.50	4.00
Benefit costs for the year ended December 31		
Discount rate	7.50	5.25
Expected long-term rate of return on plan assets	7.50	7.50
Rate of compensation increase	4.00	4.00

The elements of Stella-Jones Canada Inc.'s defined benefit plan costs recognized during the year are as follows:

	2009 $	2008 $
Current service cost, net of employee contributions	238	392
Interest cost	537	558
Actual return on plan assets	(1,251)	1,803
Actuarial loss (gain)	968	(3,813)
Elements of employee future benefit cost before adjustments to recognize the long-term nature of employee future benefit cost	492	(1,060)
Adjustments to recognize the long-term nature of employee future benefit cost		
Difference between expected return and actual return on plan assets for the year	576	(2,621)
Difference between net actuarial loss (gain) and actuarial loss (gain)	(966)	3,817
Defined benefit costs recognized	102	136

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

17 INTEREST IN JOINT VENTURE

The consolidated financial statements include the Company's 50% proportionate share, as indicated below, of the revenues, expenses, assets and liabilities of its Kanaka joint venture:

	2009 $	2008 $
Assets		
Current assets		
Accounts receivable	285	121
Other receivable	238	200
Inventories	1,010	1,942
Prepaid expenses	9	20
	1,542	2,283
Capital assets	816	842
Other assets	73	67
Total assets	2,431	3,192
Liabilities		
Current liabilities		
Bank indebtedness	2,364	3,092
Accounts payable and accrued liabilities	67	100
Total liabilities	2,431	3,192
Earnings		
Sales	6,139	5,011
Cost of sales	6,139	5,011
Net earnings	—	—
Cash flows provided by (used in)		
Operating activities	793	(101)
Financing activities	(728)	355
Investing activities	(65)	(254)
	—	—

18 COMMITMENTS AND CONTINGENCIES

a) The Company is involved from time to time 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.

b) The Company has issued guarantees, other than those disclosed elsewhere in these financial statements, amounting to $14,583,548 (2008 – $14,788,448) 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. As a result, no provisions have been recorded in the consolidated financial statements.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

18 COMMITMENTS AND CONTINGENCIES (continued)

c) Future minimum payments under operating leases related to land, equipment and rolling stock are as follows:

	$
2010	3,236
2011	2,499
2012	1,794
2013	1,402
2014	801
Thereafter	9,954

d) The Company's operations are subject to Canadian federal and provincial as well as US 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.

e) The Company has contracts whereby third party licensees that harvest certain areas assume the responsibility for reforestation. Should the third licensees fail to perform, the Company is responsible for these additional future reforestation costs, which are currently estimated to be $692,430 (2008 – $507,082). Payments, if any, required as a result of this contingency will be expensed in the period in which they are determined and are not included in the provision for reforestation noted above.

19 FINANCIAL INSTRUMENTS

Financial instruments, carrying values and fair values

The Company has determined that the fair value of its short-term financial assets and financial liabilities approximates their carrying amounts as at the balance sheet date because of the short-term maturity of those instruments. The fair values of the long-term receivables and interest-bearing financial liabilities also approximate their carrying amounts. The fair value of foreign exchange forward contracts and swap agreements has been recorded using mark-to-market information as supplied by a financial institution.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's receivables from customers.

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Management believes that the credit risk of accounts receivable is limited because the Company deals primarily with utility and telecommunication companies and other major corporations.

The following table summarizes the age of trade receivables as at December 31:

	2009 $	2008 $
Past due less than 30 days	17,073	23,374
Past due 31 to 60 days	8,903	10,204
Past due 61 to 90 days	2,392	4,457
Past due more than 90 days	658	2,278
Total accounts receivable	29,026	40,313
Allowance for doubtful accounts	(496)	(244)
	28,530	40,069

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

CREDIT RISK (CONTINUED)

Management has established a credit policy under which each new customer is analyzed individually for creditworthiness before the Company's standard payment and delivery terms and conditions are offered. The Company's review includes external ratings, where available, and credit references from other suppliers. Purchase limits are established for each customer, which represent the maximum open amount not requiring additional approval from management. A monthly review of the accounts receivable aging is performed by management for each selling location. Customers that fail to meet the Company's benchmark creditworthiness may transact with the Company only on a prepayment basis. As at December 31, details of the allowance for doubtful accounts are as follows:

	2009 $	2008 $
Balance – Beginning of year	244	229
Provision	396	458
Bad debt writeoff	(88)	(480)
Foreign exchange adjustments	(56)	37
Balance – End of year	496	244

In 2009, the Company had one customer representing 20% of its sales (2008 – 19%). As at December 31, 2009, the accounts receivable balance from this customer was $1,720,898 (2008 – $6,103,420).

LIQUIDITY RISK

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, on a long-term basis, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring losses or risking damage to its reputation.

The Company ensures that it has sufficient credit facilities to support working capital, meet expected operational expenses and service financial obligations. Inventories are a significant component of working capital because of the long periods required to air-season wood, which can occasionally exceed nine months before a sale is made. Details regarding the Company's operating lines of credit can be found in note 11.

The Company monitors all financial liabilities and ensures it will have sufficient liquidity to meet these future payments. Bank indebtedness consists of demand operating facilities that are subject to periodic review by the Company's bankers at intervals of no greater than one year. The following table details the maturities of the financial liabilities as at December 31, 2009:

	Carrying amount $	Contractual cash flows $	Less than 1 year $	1 to 3 Years $	4 to 5 Years $	More than 5 years $
Bank indebtedness	56,119	57,109	57,109	—	—	—
Accounts payable and accrued liabilities	19,152	19,152	19,152	—	—	—
Long-term debt[(a)]	85,786	111,328	9,112	17,918	23,694	60,604
Capital lease obligations[(a)]	1,584	1,584	203	192	317	872
Derivative financial instruments	1,431					
Outflow	—	6,274	1,859	1,766	1,371	1,278
Inflow	—	(2,712)	(1,007)	(734)	(620)	(351)
Non-competes payable	4,602	5,585	1,314	2,628	1,643	—
	168,674	198,320	87,742	21,770	26,405	62,403

(a) Including capital and interest

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimizing the return on risk.

Currency risk

The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to sales and purchases in US dollars by its Canadian-based operations and to US dollar-denominated long-term debt held by its Canadian companies. The Company monitors its transactions in US dollars generated by Canadian-based operations. Its basic hedging activity consists of entering into foreign exchange forward contracts for the sale of US dollars and purchasing certain goods and services in US dollars. The Company will also consider foreign exchange forward contracts for the purchase of US dollars for significant purchases of goods and services that are not covered by natural hedges.

The following tables summarize the Company's derivative financial instruments relating to the sale of foreign currencies through forward foreign exchange contracts as at December 31:

					2009
	Foreign exchange forward contract	Notional amount US$	Average exchange rate	Notional equivalent CA$	Fair value CA$
Short-term asset	Sell US$/Buy CA$	12,800	1.2240	15,667	2,196

					2008
	Foreign exchange forward contracts	Notional amount US$	Average exchange rate	Notional equivalent CA$	Fair value CA$
Short-term asset	Sell US$/Buy CA$	10,000	1.2538	12,538	381
Long-term asset	Sell US$/Buy CA$	10,000	1.2433	12,433	347
Short-term liability	Sell US$/Buy CA$	4,600	1.1563	5,319	(266)
Long-term liability	Sell US$/Buy CA$	2,800	1.1550	3,234	(144)
		27,400	1.2235	33,524	318

On January 1, 2009, the Company ceased hedge accounting on its foreign exchange forward contracts. As these contracts were designated as cash flow hedges, their fair value increment was recorded under accumulated other comprehensive income (loss) and will be recognized in earnings over the designated underlying period of foreign exchange forward contracts from March 2009 to December 2010.

The contracts mature at various dates up to December 31, 2010, and the fair value has been determined by obtaining mark-to-market values as at December 31, 2009 from a financial institution. This type of measurement falls under Level 2 in the fair value hierarchy per CICA Handbook Section 3862. A description of each level of the hierarchy is as follows:

- Level 1: Inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

- Level 2: Inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

CURRENCY RISK (CONTINUED)

- Level 3: Inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

A 10% strengthening of the US dollar against the Canadian dollar would have decreased the net gain on foreign exchange forward contracts recognized in earnings by approximately $219,621 as at December 31, 2009 (2008 – $31,878). For a 10% weakening of the US dollar against the Canadian dollar, there would be an equal and opposite impact on the gain.

The following table provides information on the impact of a 10% strengthening of the US dollar against the Canadian dollar on net earnings for the years ended December 31, 2009 and 2008. For a 10% weakening of the US dollar against the Canadian dollar, there would be an equal and opposite impact on net earnings and comprehensive income (loss):

	2009 $	2008 $
Loss (gain) to net earnings and comprehensive income (loss)	(281)	53

This analysis considers the impact of foreign exchange variance on financial assets and financial liabilities denominated in US dollars which are on the balance sheet of the Canadian entities:

	2009 $	2008 $
Assets		
Accounts receivable	1,430	2,037
Foreign exchange forward contracts	2,196	728
	3,626	2,765
Liabilities		
Accounts payable and accrued liabilities	811	2,884
Foreign exchange forward contracts	—	410
	811	3,294

The foreign exchange impact for the US dollar-denominated long-term debt, in the Canadian entities, has been excluded from the sensitivity analysis for other comprehensive income (loss), as the long-term debt is designated as a hedge against the investment in the self-sustaining US subsidiary.

INTEREST RATE RISKS

As at December 31, 2009, the Company has limited exposure to interest rate risk on long-term debt after giving effect to its interest rate swaps; 86% (2008 – 93%) of the Company's long-term debt is at fixed 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 cash flow hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

Bank indebtedness comprises demand operating loans as defined in note 11. The financing of these loans is tied to the Canadian bank's prime rate, the US bank's base rate or LIBOR. The impact of a 10% increase in these rates on the average annual balance of the bank indebtedness would have increased interest expense by $161,321 for the year ended December 31, 2009 (2008 – $247,166).

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

INTEREST RATE RISKS (CONTINUED)

The following tables summarize the Company's interest rate swap agreements as at December 31:

			2009
Notional amount	Fixed rate %	Maturity date	Notional equivalent CA$
CA$2,300	5.81	December 2010	2,300
CA$2,700	5.85	February 2011	2,700
US$10,000	1.53	April 2011	10,510
US$15,000	2.57	June 2012	15,765
CA$15,000	2.19	June 2012	15,000
US$5,000	5.80	July 2015	5,255
US$5,000	5.54	July 2015	5,255
US$1,000	4.69	December 2015	1,051
US$5,600	2.99	December 2015	5,886

			2008
Notional amount	Fixed rate %	Maturity date	Notional equivalent CA$
CA$2,300	5.81	December 2010	2,300
CA$2,700	5.85	February 2011	2,700
US$5,000	5.80	July 2015	6,090
US$5,000	5.54	July 2015	6,090
US$1,000	4.69	December 2015	1,218

The fair value of these financial instruments has been determined by obtaining mark-to-market values as at December 31, 2009 from a financial institution. This type of measurement falls under Level 2 in the fair value hierarchy per CICA Handbook Section 3862 and is defined in the currency risk section.

The fair value of the interest rate swap agreements based on cash settlement requirements as at December 31, 2009 is a loss of $1,430,952 (2008 – loss of $1,159,153), of which $30,618 and $1,400,334 respectively are recorded in current and long-term liabilities under derivative financial instruments. A 10% decrease in interest rates as at December 31, 2009 would have increased the loss recognized in other comprehensive income (loss) by approximately $143,095 (2008 – $115,915). For a 10% increase in the interest rates, there would be an equal and opposite impact on the loss.

20 CAPITAL DISCLOSURES

The Company's objective in managing capital is to ensure sufficient liquidity to pursue its organic growth strategy and undertake selective acquisitions, while at the same time taking a conservative approach to financial leverage and management of financial risk. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or acquire or sell assets to improve its financial performance and flexibility.

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

20 CAPITAL DISCLOSURES (continued)

The Company's capital is composed of long-term debt and shareholders' equity which includes capital stock.

	2009 $	2008 $
Long-term debt, including current portion	87,080	105,759
Shareholders' equity	179,978	161,112
Total capital	267,058	266,871
Long-term debt to equity ratio	0.48:1	0.66:1

The Company's primary uses of capital are to finance increases in non-cash working capital and capital expenditures for capacity expansion as well as acquisitions. The Company currently funds these requirements out of its internally generated cash flows and operating lines of credit. However, future corporate acquisitions may require new sources of financing.

The primary measure used by the Company to monitor its financial leverage is the long-term debt to equity ratio, which it aims to maintain within a range of 0.30:1 to 0.75:1. The long-term debt to equity ratio is defined as long-term debt including the current portion divided by shareholders' equity.

The Company is subject to certain covenants on its bank indebtedness and on certain long-term debt. The covenants include a working capital ratio, debt to tangible net worth ratio, a minimum fixed charge coverage ratio and a minimum requirement for earnings before interest, taxes and amortization. The Company monitors the ratios on a monthly basis. The ratios are also reviewed by the Company's Audit Committee and Board of Directors on a quarterly basis. Other than the covenants required for the credit facilities, the Company is not subject to any externally imposed capital requirements.

21 RELATED PARTY TRANSACTIONS

The Company had the following transactions with related parties:

	2009 $	2008 $
Parent company		
Marketing and technical service fees paid	200	200
Interest on promissory note	52	64
Ultimate shareholders		
Marketing and technical service fees paid	100	100

These transactions occurred in the normal course of operations and have been measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

As at December 31, 2009, the consolidated balance sheet includes the following amounts with related parties:

	2009 $	2008 $
Accounts payable to parent company	68	79
Accounts payable to ultimate shareholders	25	25

(tabular amounts expressed in thousands of dollars, exept as otherwise indicated)

22 SEGMENT INFORMATION

The Company operates within one business segment: the production and sale of pressure treated wood. Operating plants are located in the Canadian provinces of Nova Scotia, Quebec, Ontario, Alberta and British Columbia, and in the US states of Pennsylvania, Virginia, West Virginia, Kentucky, Wisconsin and Washington. The Company also operates a distribution centre in the province of Newfoundland and Labrador.

Sales attributed to countries based on location of customer are as follows:

	2009 $	2008 $
Canada	187,993	180,052
US	223,126	204,770
	411,119	384,822

Sales by product as at December 31 are as follows:

	2009 $	2008 $
Railway ties	185,112	181,176
Utility poles	149,664	137,836
Industrial treated wood	44,801	33,062
Residential lumber	31,542	32,748
	411,119	384,822

Capital assets attributed to the countries based on location are as follows:

	2009 $	2008 $
Canada	54,079	55,124
US	42,806	53,639
	96,885	108,763

Intangible assets having a net book value of $7,580,075 (2008 – $10,773,515) and goodwill having a value of $5,494,436 (2008 – $6,367,481) are attributed to the Company's US operations.

23 SUBSEQUENT EVENT

On February 24, 2010, the Company announced that it had entered into an underwriting agreement with a syndicate of underwriters led by RBC Capital Markets, pursuant to which such underwriters have agreed to purchase from treasury, on an underwritten private placement basis, 2,402,000 subscription receipts of the Company (the "Subscription Receipts") at a price of $25 per Subscription Receipt for aggregate gross proceeds to the Company of $60,050,000 (the "Underwriters' Private Placement").

In addition to the Underwriters' Private Placement, the Company has received firm commitments from Stella Jones International S.A. ("SJ International") and the Solidarity Fund QFL (the "Fund") whereby such shareholders have agreed to purchase Subscription Receipts under the same terms as the Underwriters' Private Placement for gross proceeds of $15 million and $5 million respectively (the "Shareholders' Private Placement").

The closing date of the Underwriters' Private Placement and the Shareholders' Private Placement (collectively, the "Private Placements") is expected to occur on or about March 15, 2010. Completion of the Private Placements is subject to certain conditions, including receipt of the approval of the Toronto Stock Exchange and all other necessary regulatory approvals.

23 SUBSEQUENT EVENT (continued)

Net proceeds from the Private Placements will be used by the Company to partially fund the proposed acquisition of Tangent Rail Corporation (“Tangent”) (the “Acquisition”), for which the Company entered into a non-binding letter of intent on December 14, 2009.

The Subscription Receipts will be exchangeable, without additional payment, into common shares of the Company on a one-for-one basis upon completion of the Acquisition. If the Acquisition is not completed by April 30, 2010 at the latest, then the Subscription Receipts shall be automatically terminated and cancelled and the principal amount subscribed plus accrued interest will be returned to the holders of Subscription Receipts.

An aggregate of 3,202,000 common shares could be issued upon exchange of the Subscription Receipts to be sold under the Private Placements, representing 25.2% of the number of outstanding common shares, on a non-diluted basis.

Tangent serves the railroad industry with treated wood products, mainly railway ties, through facilities located in Warrior, Alabama; Terre Haute and Winslow, Indiana; Alexandria, Louisiana; and McAlisterville, Pennsylvania. It also operates two creosote manufacturing facilities located in Terre Haute, Indiana, and Memphis, Tennessee. Lifecycle solutions, consisting of tie pickup and tie disposal, are carried out at three facilities located in Alabama, Minnesota and North Carolina.

The value of the transaction is estimated at US$165 million subject to post-closing adjustments. The Company plans to finance the acquisition through a combination of equity and debt, subject to prevailing market conditions.

The transaction received antitrust clearance in the United States on February 4, 2010, and remains subject to customary closing conditions, including entry into a definitive purchase agreement and satisfactory due diligence. The non-binding letter of intent signed on December 14, 2009 between the Company and Tangent provides an exclusive right to negotiate and execute a definitive purchase agreement during the period leading up to April 1, 2010 (the “Termination Date”). The parties intend to close the transaction by the Termination Date.

24 COMPARATIVE FIGURES

Certain comparative figures have been reclassified in order to comply with the basis of presentation adopted in the current year.