CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2010 and 2009

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 10, 2011

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Stella-Jones Inc.

We have audited the accompanying consolidated financial statements of Stella-Jones Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of shareholders' equity, earnings, comprehensive income and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Stella-Jones Inc. and its subsidiaries as at December 31, 2010 and 2009 and the results of their operations and their cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP[1]

Montréal, Quebec
March 10, 2011

[1] Chartered accountant auditor permit No. 19983

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

Consolidated Balance Sheets

As at December 31, 2010 and 2009

Assets

(expressed in thousands of dollars)	2010 $	2009 $
Current assets		
Accounts receivable (notes 6, 11 and 12)	**56,315**	30,160
Derivative financial instruments (note 19)	**—**	2,196
Inventories (notes 7, 11 and 12)	**205,335**	212,590
Prepaid expenses	**4,517**	3,223
Income taxes receivable	**2,875**	4,726
Future income taxes (note 15)	**3,206**	1,683
	272,248	254,578
Capital assets (notes 8, 11, 12)	**113,956**	96,885
Intangible assets (note 9)	**54,986**	7,580
Goodwill (note 9)	**73,973**	5,494
Other assets (note 10)	**6,152**	4,878
Future income taxes (note 15)	**318**	1,380
	521,633	370,795

Liabilities and Shareholders' Equity

	2010 $	2009 $
Current liabilities		
Bank indebtedness (note 11)	**31,923**	56,119
Accounts payable and accrued liabilities	**33,266**	19,137
Customer deposits	**1,431**	2,344
Derivative financial instruments (note 19)	**44**	31
Future income taxes (note 15)	**292**	869
Current portion of long-term debt (note 12)	**10,459**	4,746
Current portion of other long-term liabilities (note 13)	**2,434**	1,235
	79,849	84,481
Long-term debt (note 12)	**115,369**	82,334
Future income taxes (note 15)	**37,956**	16,257
Employee future benefits (note 16)	**2,063**	1,716
Derivative financial instruments (note 19)	**1,335**	1,400
Other long-term liabilities (note 13)	**3,676**	4,629
	240,248	190,817
Shareholders' equity		
Capital stock (note 14)	**130,229**	52,019
Contributed surplus	**1,136**	777
Retained earnings	**158,934**	130,580
Accumulated other comprehensive loss	**(8,914)**	(3,398)
	281,385	179,978
	521,633	370,795

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, 2010 and 2009

(expressed in thousands of dollars, except number of shares in thousands)	2010 #	2009 #
Capital stock		
Number of shares outstanding – Beginning of year	**12,684**	12,565
Stock option plan	**25**	4
Exchange of subscription receipts for common shares (note 5)	**3,202**	—
Stock option agreement	**—**	100
Share purchase plan	**12**	15
Number of shares outstanding – End of year	**15,923**	12,684
	$	$
Shares outstanding – Beginning of year	**52,019**	49,910
Stock option plan	**159**	80
Exchange of subscription receipts for common shares (note 5)	**77,748**	—
Stock option agreement	**—**	1,692
Share purchase plan	**303**	337
Shares outstanding – End of year	**130,229**	52,019
Subscription receipts		
Balance – Beginning of year	**—**	—
Subscription receipts, net of underwriting and legal fees (note 5)	**76,903**	—
Future income taxes related to underwriting and legal fees	**845**	—
Exchange of subscription receipts for common shares (note 5)	**(77,748)**	—
Balance – End of year	**—**	—

	2010 $	2009 $
Contributed surplus		
Balance – Beginning of year	**777**	1,905
Stock-based compensation	**400**	292
Exercise of stock options	**(41)**	(1,420)
Balance – End of year	**1,136**	777
Retained earnings		
Balance – Beginning of year	**130,580**	105,055
Net earnings for the year	**34,395**	30,069
Dividends on common shares	**(6,041)**	(4,544)
Balance – End of year	**158,934**	130,580
Accumulated other comprehensive income (loss)		
Balance – Beginning of year	**(3,398)**	4,242
Other comprehensive loss	**(5,516)**	(7,640)
Balance – End of year	**(8,914)**	(3,398)
Shareholders' equity	**281,385**	179,978

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

Consolidated Statements of Earnings

For the years ended December 31, 2010 and 2009

(expressed in thousands of dollars, except earnings per common share)	2010 $	2009 $
Sales	**561,046**	411,119
Expenses (income)		
Cost of sales (note 7)	**457,428**	334,450
Selling and administrative	**29,644**	20,444
Foreign exchange loss (gain)	**44**	(1,435)
Gain on derivative financial instruments (note 19)	**(19)**	(2,196)
Amortization of capital assets and intangible assets	**10,355**	8,755
Impairment of assets	**2,950**	833
	500,402	360,851
Operating earnings	**60,644**	50,268
Financial expenses		
Interest on long-term debt	**8,914**	6,451
Other interest	**1,651**	2,025
	10,565	8,476
Earnings before income taxes	**50,079**	41,792
Provision for (recovery of) income taxes (note 15)		
Current	**16,996**	9,843
Future	**(1,312)**	1,880
	15,684	11,723
Net earnings for the year	**34,395**	30,069
Basic net earnings per common share (note 14(b))	**2.27**	2.38
Diluted net earnings per common share (note 14(b))	**2.26**	2.37

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

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2010 and 2009

(expressed in thousands of dollars)	2010 $	2009 $
Net earnings for the year	**34,395**	30,069
Other comprehensive income (loss)		
Net change in unrealized losses on translation of financial statements of self-sustaining foreign operations	**(8,471)**	(13,078)
Net change in unrealized gains on translation of long-term debts designated as hedges of net investment in self-sustaining foreign operations (note 12)	**3,228**	5,845
Income tax expense on change in unrealized gains on translation of long-term debts designated as hedges of net investment in self-sustaining foreign operations	**(348)**	—
Change in losses on fair value of derivatives designated as cash flow hedges	**(108)**	(272)
Reclassification to net earnings of losses (gains) on cash flow hedges	**160**	(319)
Income tax recovery on change in fair value of cash flow hedges and cash flow hedges reclassified to net earnings	**23**	184
Other comprehensive loss	**(5,516)**	(7,640)
Comprehensive income	**28,879**	22,429

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

Consolidated Statements of Cash Flows

For the years ended December 31, 2010 and 2009

(expressed in thousands of dollars)	2010 $	2009 $
Cash flows from		
Operating activities		
Net earnings for the year	**34,395**	30,069
Adjustments for		
Amortization of capital assets	**5,782**	6,872
Amortization of intangible assets	**4,573**	1,883
Amortization of deferred financing costs	**758**	68
Change in fair value of debt	**647**	850
Loss on disposal of capital assets	**36**	151
Employee future benefits	**(177)**	(156)
Stock-based compensation	**400**	292
Loss (gain) on derivative financial instruments	**2,196**	(2,196)
Impairment of assets	**2,950**	833
Future income taxes	**(1,312)**	1,880
Other	**(156)**	390
	50,092	40,936
Changes in non-cash working capital components		
Accounts receivable	**(11,560)**	9,652
Inventories	**31,282**	(1,819)
Prepaid expenses	**(304)**	2,335
Income taxes	**3,481**	(1,558)
Accounts payable and accrued liabilities	**9,793**	(8,777)
Customer deposits	**(829)**	(241)
Asset retirement obligations	**(347)**	(47)
	31,516	(455)
	81,608	40,481

	2010 $	2009 $
Financing activities		
Decrease in bank indebtedness	**(23,148)**	(21,775)
Increase in long-term debt	**66,027**	—
Repayment of long-term debt	**(103,932)**	(9,041)
Increase in deferred financing costs	**(1,144)**	—
Non-competes payable	**(1,311)**	(1,549)
Proceeds from issuance of common shares	**421**	689
Proceeds from issuance of subscription receipts	**76,903**	—
Dividends on common shares	**(6,041)**	(4,544)
	7,775	(36,220)
Investing activities		
Decrease in other assets	**31**	57
Business acquisition, net of cash (note 5)	**(83,565)**	—
Purchase of capital assets	**(6,079)**	(4,811)
Assets held for sale	**—**	360
Proceeds from disposal of capital assets	**230**	133
	(89,383)	(4,261)
Net change in cash and cash equivalents during the year	**—**	—
Cash and cash equivalents – Beginning and end of year	**—**	—
Supplemental disclosures		
Interest paid	**10,011**	9,244
Income taxes paid	**13,692**	9,977

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 pressure 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 manufactures the wood preservative creosote and other coal tar-based products and provides the railroad industry with used tie pickup and disposal services. Switching, locomotive and railcar maintenance services are also offered, as is tie-derived boiler fuel. The Company also provides treated residential lumber products and customized services to lumber retailers and wholesalers for outdoor applications. Other treated wood 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* and its common shares are listed on the Toronto Stock Exchange ("TSX").

2 SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. The significant subsidiaries are as follows: Guelph Utility Pole Company Ltd., I.P.B.-W.P.I. International Inc., 4552831 Canada Inc., Stella-Jones Canada Inc., Stella-Jones U.S. Holding Corporation ("SJ Holding"), Stella-Jones Corporation ("SJ Corp"), Stella-Jones U.S. Finance Corporation, Canadalux S.à.r.l. and Tangent Rail Corporation ("Tangent"). SJ Holding, SJ Corp, Stella-Jones U.S. Finance Corporation, Canadalux S.à.r.l. and Tangent are considered self-sustaining foreign operations for accounting purposes. The consolidated accounts of Stella-Jones Canada Inc. include the accounts of a 50% interest in Kanaka Creek Pole Company Limited ("Kanaka"), a joint venture which is accounted for under the proportionate consolidation method of accounting under the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3055. Following the close of business on December 31, 2010, Tangent was merged with SJ Corp. The surviving corporation was Tangent, which changed its name to Stella-Jones Corporation concurrently with the merger.

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") 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 and business combinations. 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, products are shipped to customers or the services are rendered, the risks and rewards related to the ownership of the product are assumed by the customer, collection is considered reasonably assured and the sales price is fixed or determinable. Revenue is net of trade or volume discounts, returns and allowances and claims for damaged goods.

The Company enters into service agreements where green tie procurement and tie treating services are offered separately. These services consist mainly of procuring, trimming, grading and treating railway ties for which revenue is recognized when the services are provided, based on contractual terms. Revenues for green tie procurement, trimming and grading services can be recognized either at the time of the green tie sale or when treating services are rendered. Storage and treating revenues are recognized at the time of treating or when the railway ties are shipped. Under certain agreements, the customer will supply the green ties and the Company will offer all of the other services. The Company capitalizes costs incurred to provide the service and reverses them to cost of goods sold when revenue is recognized.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition (continued)

The Company offers used tie pickup and disposal services. Revenue is recognized upon reaching certain points in the process of removal of the used ties from the customer's right of way.

The Company also operates timber licences to harvest logs 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 $9,433,418 for the year ended December 31, 2010 (2009 – $7,784,512).

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, 2010 and 2009, the Company had no cash and cash equivalents.

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.

	Previous useful lives	Revised useful lives
Buildings	20 to 40 years	20 to 60 years
Production equipment	5 to 40 years	5 to 60 years
Rolling stock	3 to 10 years	3 to 15 years
Anti-pollution equipment	10 to 20 years	10 to 60 years
Office equipment	2 to 10 years	2 to 10 years

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. Intangible assets with infinite useful lives are recorded at cost and are not amortized. The amortization method and estimate of the useful life of an intangible asset are reviewed on an annual basis:

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Intangible assets (continued)

Customer relationships	3 to 10 years
Non-compete agreements	6 years
Creosote registration	Infinite useful life

The creosote registration is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it might be impaired. The Company conducted its annual impairment test for 2010 and concluded that no adjustments were required.

Business combinations and goodwill

The Company accounts for its business combinations using the acquisition method. Under this method, the Company allocates the fair value 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 2010 and 2009 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 disposal. 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 that the forestry industry 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 selling and administrative 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 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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 years of 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 earnings 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 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

Revenues and expenses denominated in a foreign currency are translated by applying the monthly average exchange rates. 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.

All self-sustaining foreign operations 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 on translation are recorded in accumulated other comprehensive loss in shareholders' equity.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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, 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 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 (note 18). 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.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Hedging transactions

The Company enters into foreign exchange forward contracts to limit its exposure under contracted cash inflows and outflows of U.S. dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These contracts are treated as cash flow hedges for accounting purposes when designated 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 in which the cash flows constituting the hedged item affect earnings.

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 in 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 other comprehensive income (loss) is then reclassified in the consolidated statement of earnings.

The Company designated a portion of its U.S. 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 is calculated using the treasury stock method. Under the treasury stock method, earnings per share data are computed as if the options had been exercised at the beginning of the year (or at the time of issuance, if later) and as if the funds obtained from exercise had been 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, 2010:

- 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 applied this new standard effective January 1, 2010, as early adoption is permitted. As a result of the application of this new accounting standard, previously capitalized transaction costs of approximately $328,000 were expensed in the current period. Effective January 1, 2010, expenses of a similar nature are recorded to results in the period in which they occurred.

3 CHANGES IN ACCOUNTING POLICIES (continued)

- 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. These standards are equivalent to the corresponding provisions of International Accounting Standard 27 (Revised), "Consolidated and Separate Financial Statements". The Company applied these new standards effective January 1, 2010, as early adoption is permitted. Their adoption had no significant impact on the Company's consolidated financial statements.

4 UPCOMING CHANGES TO ACCOUNTING POLICIES

The Company will cease to prepare its financial statements in accordance with Canadian GAAP as set out in Part V of the CICA Handbook – Accounting for the periods beginning on January 1, 2011, when it will start to apply as its primary basis of accounting International Financial Reporting Standards as published by the International Accounting Standards Board and set out in Part I of the CICA Handbook – Accounting. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will normally never be applied by the Company.

5 BUSINESS ACQUISITION

On April 1, 2010, the Company completed the acquisition of 100% of the shares of Tangent, a provider of wood crosstie supply chain services to the railroad industry. Tangent served 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. The wood preservative, creosote, was produced at its distilleries in Terre Haute, Indiana and Memphis, Tennessee. Lifecycle solutions consisting of used tie pickup and disposal were carried out at three facilities, in Alabama, Minnesota and North Carolina. This acquisition expands the Company's capabilities in the U.S. railway tie industry and provides it with creosote manufacturing operations.

Total cash outlay associated with the acquisition was approximately $172.7 million (US$170.0 million), including cash on hand of $6.8 million (US$6.7 million) and excluding acquisition costs of approximately $2.0 million (US$2.0 million). This amount includes $90.4 million (US$89.0 million) paid to Tangent's shareholders, $81.3 million (US$80.1 million) used to reimburse Tangent's debts with financial institutions and $1.0 million (US$0.9 million) to pay accrued interest on these debts.

The acquisition has been accounted for using the acquisition method; 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 Tangent have been included in the Company's consolidated financial statements from the acquisition date.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

5 BUSINESS ACQUISITION (continued

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

	$
Assets acquired	
Non-cash working capital	48,603
Capital assets	22,734
Customer relationships	20,905
Customer backlog	670
Creosote registration	31,723
Non-deductible goodwill	70,239
Future income tax assets	615
	195,489
Liabilities assumed	
Accounts payable and accrued liabilities	5,290
Long-term debt	81,340
Site remediation obligation	1,311
Future income tax liabilities	23,983
Total consideration	83,565
Consideration	
Cash	172,694
Payment of accrued interest	(956)
Payment of long-term debt	(81,340)
Cash on hand	(6,833)
Purchase consideration for shares	83,565

The Company's valuation of intangible assets has identified customer relationships, a creosote registration and customer backlog. The assigned useful lives for customer relationships are between six and ten years, and three months for the customer backlog. The creosote registration is not subject to amortization as the Company considers it to have an indefinite useful life. Goodwill value is determined as the excess of the total consideration over the estimated fair value of tangible and intangible assets acquired as well as liabilities assumed. Goodwill is not amortized, not deductible for tax purposes and represents the future economic value associated with the increased railroad network access, acquired workforce and synergies with the Company's operations. Note 9 provides a roll-forward of the intangible assets and goodwill net book value balances from January 1, 2009 to December 31, 2010.

Financing for the transaction has been secured through an $80,050,000 private placement of subscription receipts which successfully closed on March 15, 2010, as well as through the issuance to the Solidarity Fund QFL of a $25,395,000 (US$25,000,000) unsecured, subordinated and non-convertible debenture, the addition of a $40,632,000 (US$40,000,000) syndicated bank term facility which successfully closed on March 24, 2010, and the increase of existing operating debt facilities. More details on financing facilities can be found in notes 11 and 12. Underwriting and legal fees related to the private placement of subscription receipts amounted to $3,147,000, generating net proceeds of $76,903,000. The subscription receipts were exchanged as at the close of business, April 1, 2010, for common shares in the share capital of the Company on the basis of one common share per subscription receipt. Holders of subscription receipts were not required to take any action in order to receive the common shares to which they were entitled. As the subscription receipts were sold on a private placement basis, these common shares were subject to regulatory restrictions on resale until July 16, 2010.

During the nine-month period ended December 31, 2010, Tangent's sales and earnings before taxes amounted to $120,456,000 and $8,923,000, respectively. On a pro forma basis, management's estimate of sales and earnings before taxes of the combined operations of the Company and Tangent for the twelve-month period ended December 31, 2010 would have been approximately $601,360,000 and $54,924,000, respectively, had the Tangent acquisition occurred as of January 1, 2010. To arrive at the pro forma estimates, management considered the financing structure resulting from the acquisition as well as other adjustments related to the acquisition.

6 ACCOUNTS RECEIVABLE

	2010	2009
	$	$
Trade	**53,633**	28,530
Other	**2,682**	1,630
	56,315	30,160

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

7 INVENTORIES

	2010	2009
	$	$
Raw materials	**149,102**	160,351
Finished goods	**56,233**	52,239
	205,335	212,590

The inventory cost included in cost of sales as at December 31, 2010 is $404,941,000 (2009 – $295,907,000).

8 CAPITAL ASSETS

	Land	Roads	Cutting rights	Standing timber	Buildings	Production and anti-pollution equipment	Rolling stock	Office equipment	Total capital assets
	$	$	$	$	$	$	$	$	$
As at January 1, 2009									
Cost	8,648	2,188	6,505	4,140	24,645	90,470	8,569	2,357	147,522
Accumulated amortization	—	(760)	(271)	(1,198)	(4,281)	(28,317)	(2,693)	(1,239)	(38,759)
Net book amount	8,648	1,428	6,234	2,942	20,364	62,153	5,876	1,118	108,763
Year ended December 31, 2009									
Opening net book amount	8,648	1,428	6,234	2,942	20,364	62,153	5,876	1,118	108,763
Additions	—	430	—	577	582	2,984	32	306	4,911
Disposals	—	—	—	—	(18)	(176)	(90)	—	(284)
Amortization	—	(94)	(84)	(468)	(883)	(4,198)	(902)	(243)	(6,872)
Transfer to assets held for sale	(1,513)	—	—	—	(489)	(390)	—	(9)	(2,401)
Exchange differences	(637)	—	—	—	(1,771)	(4,069)	(627)	(128)	(7,232)
Closing net book amount	6,498	1,764	6,150	3,051	17,785	56,304	4,289	1,044	96,885
As at December 31, 2009									
Cost	6,498	2,617	6,505	4,717	22,497	83,167	6,467	1,984	134,452
Accumulated amortization	—	(853)	(355)	(1,666)	(4,712)	(26,863)	(2,178)	(940)	(37,567)
Net book amount	6,498	1,764	6,150	3,051	17,785	56,304	4,289	1,044	96,885

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

8 CAPITAL ASSETS (continued)

	Land $	Roads $	Cutting rights $	Standing timber $	Buildings $	Production and anti-pollution equipment $	Rolling stock $	Office equipment $	Total capital assets $
Year ended December 31, 2010									
Opening net book amount	6,498	1,764	6,150	3,051	17,785	56,304	4,289	1,044	96,885
Acquisition of subsidiary	1,582	—	—	—	4,013	13,439	3,612	88	22,734
Additions	—	340	287	635	879	3,594	40	681	6,456
Disposals	—	—	—	—	—	—	(264)	—	(264)
Amortization	—	(318)	(123)	(807)	(654)	(2,489)	(980)	(410)	(5,781)
Transfer to assets held for sale	(314)	—	—	—	(1,412)	—	—	—	(1,726)
Impairments	—	—	—	—	—	(1,394)	(339)	—	(1,733)
Exchange differences	(152)	—	—	—	(565)	(1,653)	(234)	(11)	(2,615)
Closing net book amount	7,614	1,786	6,314	2,879	20,046	67,801	6,124	1,392	113,956
As at December 31, 2010									
Cost	7,614	2,957	6,792	5,352	25,284	96,691	8,856	2,722	156,268
Accumulated amortization	—	(1,171)	(478)	(2,473)	(5,238)	(28,890)	(2,732)	(1,330)	(42,312)
Net book amount	7,614	1,786	6,314	2,879	20,046	67,801	6,124	1,392	113,956

Pursuant to the Tangent acquisition, the Company has increased its production capacity and has consolidated the production of its railway tie requirements. As a result, the Spencer plant in West Virgina will be producing lower annual volumes going forward. This decision by management triggered a requirement to test the Spencer plant's long lived assets for recoverability, which concluded in a $1,733,000 impairment expense recorded in the second-quarter earnings. The Company also had impairment expenses with regard to assets held for sale (note 10).

The Company has also decided to relocate its U.S. corporate office to Pittsburgh, Pennsylvania, and sell its current corporate office located in Ripley, West Virginia. As a result, the land and building associated with the Ripley office having a carrying value of $1,726,000 have been reclassified as assets held for sale and presented on the balance sheet in other assets.

As at December 31, 2010, the Company holds no capital assets under capital leases (2009 – cost of $504,000, less accumulated amortization of $102,000).

9 INTANGIBLE ASSETS AND GOODWILL

The Company has recognized intangible assets as part of the Tangent acquisition as well as part of a previous acquisition. The acquisition cost of intangible assets, which include customer relationships, non-compete agreements and a creosote registration, 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 ten years. Intangible assets associated with ongoing business relationships are amortized over ten years.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

9 INTANGIBLE ASSETS AND GOODWILL (continued)

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 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 part of the Tangent acquisition, the Company recognized value to a creosote registration. This intangible asset has an infinite useful life and is therefore not amortized. The creosote registration was initially evaluated at fair value, which subsequently became the cost.

	Intangible assets				
	Customer relationships $	Non compete agreements $	Creosote registration $	Total $	Goodwill $
As at January 1, 2009					
Cost	5,335	6,930	—	12,265	6,367
Accumulated amortization	(626)	(866)	—	(1,492)	—
Net book amount	4,709	6,064	—	10,773	6,367
Year ended December 31, 2009					
Opening net book balance	4,709	6,064	—	10,773	6,367
Amortization	(790)	(1,093)	—	(1,883)	—
Exchange differences	(575)	(735)	—	(1,310)	(873)
Closing net book amount	3,344	4,236	—	7,580	5,494
As at December 31, 2009					
Cost	4,603	5,980	—	10,583	5,494
Accumulated amortization	(1,259)	(1,744)	—	(3,003)	—
Net book amount	3,344	4,236	—	7,580	5,494
Year ended December 31, 2010					
Opening net book balance	**3,344**	**4,236**	**—**	**7,580**	**5,494**
Addition of Tangent customer relationships	**20,905**	**—**	**—**	**20,905**	**—**
Addition of Tangent customer backlog	**670**	**—**	**—**	**670**	**—**
Addition of Tangent creosote registration	**—**	**—**	**31,723**	**31,723**	**—**
Addition of Tangent goodwill	**—**	**—**	**—**	**—**	**70,239**
Amortization	**(3,586)**	**(986)**	**—**	**(4,572)**	**—**
Exchange differences	**(473)**	**(185)**	**(662)**	**(1,320)**	**(1,760)**
Closing net book amount	**20,860**	**3,065**	**31,061**	**54,986**	**73,973**
As at December 31, 2010					
Cost	**25,482**	**5,659**	**31,061**	**62,202**	**73,973**
Accumulated amortization	**(4,622)**	**(2,594)**	**—**	**(7,216)**	**—**
Net book amount	**20,860**	**3,065**	**31,061**	**54,986**	**73,973**

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

10 OTHER ASSETS

	2010	2009
	$	$
Advances against third party cutting rights	**246**	300
Notes receivable	**290**	267
Accrued benefit asset (note 16(b))	**1,940**	1,416
Assets held for sale*	**3,318**	2,895
Other	**358**	—
	6,152	4,878

* Assets held for sale mainly represent a building that the Company owns in Ripley, West Virginia, as well as a plant in Stanton, Kentucky. During the year, management reduced the value of these assets to better reflect market value. The adjustments resulted in an impairment of $1,217,000.

11 BANK INDEBTEDNESS

	2010	2009
	$	$
Demand revolving facility (note 11(a))	**30,293**	—
Demand operating loan with a Canadian bank (notes 11(b) and 19)	**—**	28,786
Demand operating loan with a U.S. bank (notes 11(c) and 19)	**—**	24,969
Proportionate share of Kanaka demand operating loan (note 11(d))	**1,630**	2,364
	31,923	56,119

a) On March 24, 2010, the Company entered into an agreement to amend and restate, without novation, its existing revolving credit facilities. The separate Canadian and U.S. revolving bank lines of credit (note 11(b) and (c)) have been replaced by a single demand revolving facility to be made available to the Company by a syndicate of bank lenders. The amended facilities consist of Tranche A, a maximum demand operating loan of $50,000,000 made available to the Company (December 31, 2009 – $50,000,000), and Tranche B, a maximum demand operating loan of US$75,000,000 (December 31, 2009 – US$45,000,000) made available to SJ Holding. Borrowings may be obtained by the Company under Tranche A in the form of Canadian prime rate loans, Canadian bankers' acceptances ("BAs"), U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit up to a maximum of $5,000,000 of the facility. Borrowings may be obtained by SJ Holding under Tranche B in the form of U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit. The interest rate margin with respect to Canadian prime rate loans and U.S. base rate loans is 0.75% and with respect to BAs, LIBOR loans and fees for letters of credit, the interest rate margin is 2.0%. The borrowing base consisting of 75% in value of acceptable receivables and 50% in value of acceptable inventories with a maximum of $80,000,000 was $114,462,000, of which $30,293,000 was used under Tranche A and Tranche B as at December 31, 2010.

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 applied on the first US$15,000,000 of bank indebtedness under this credit facility and it is renewed every 30 days.

In November 2010, the Company terminated an interest rate swap having a notional amount of CA$15,000,000. As a result, the Company recognized a $168,000 expense to the consolidated statement of earnings.

As collateral for this demand revolving credit facility, the bank lenders hold a first ranking charge on the inventories and accounts receivable of the Company and a second ranking security interest on certain capital assets of the Company. The demand revolving facility is subject to financial and non-financial covenants which the Company was in compliance with as at December 31, 2010.

b) Previously, the Company had a credit facility with a Canadian bank which was amended and restated as part of the new credit agreement entered into on March 24, 2010 as detailed in note 11(a).

c) Previously, SJ Holding and SJ Corp (collectively, "the U.S. subsidiaries") had a credit facility with a U.S. bank which was amended and restated as part of the new credit agreement entered into on March 24, 2010 as detailed in note 11(a).

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

11 BANK INDEBTEDNESS (continued)

d) 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 0.75%, the bank's U.S. base rate plus 0.75%, LIBOR plus 2.25% or BA rate plus 2.25%. One half of the indebtedness, up to a maximum of $5,000,000, has been guaranteed by Stella-Jones Canada Inc. and the Company.

12 LONG-TERM DEBT (NOTE 20)

	2010 $	2009 $
Term facilities (note 12(a))	**55,573**	—
Revolving term loan with a Canadian bank (note 12(b))	**—**	22,098
Term loans with a Canadian bank (note 12(c))	**—**	2,539
Term loan with a U.S. bank (note 12(d))	**7,381**	8,693
Unsecured and non-convertible debenture (note 12(e))	**—**	10,000
Unsecured, subordinated and non-convertible debenture (note 12(f))	**24,865**	—
Unsecured and non-convertible debenture (note 12(g))	**24,865**	26,275
Promissory note (note 12(h))	**746**	788
Promissory note (note 12(i))	**557**	755
Subordinated note (note 12(j))	**6,112**	6,822
Bond (note 12(k))	**4,399**	4,788
Promissory note (note 12(l))	**289**	373
Promissory note (note 12(m))	**296**	356
Mortgage loans (note 12(n))	**1,717**	3,805
Obligations under capital leases (note 12(o))	**—**	275
	126,800	87,567
Deferred financing costs	**(972)**	(487)
	125,828	87,080
Less: Current portion of long-term debt	**10,780**	4,811
Less: Current portion of deferred financing costs	**(321)**	(65)
	115,369	82,334

a) On March 24, 2010, the Company entered into an agreement with a syndicate of lenders amending and restating, without novation, existing term credit agreements and made available a new five-year term facility. Under this new agreement, four facilities were made available. Credit facility A is a US$40,000,000 syndicated bank term loan used for the purpose of acquiring Tangent. The term loan bears interest at the bank's U.S. base rate plus 1.5%, or LIBOR plus 3.0%, at the Company's option. Repayment is in 19 consecutive quarterly principal instalments of US$1,425,000 starting July 1, 2010, and a balloon repayment of US$12,925,000 constituting the twentieth and final payment of the residual capital balance on April 1, 2015. In December 2010, the Company made a voluntary US$3,000,000 repayment on the term loan principal. The repayment schedule was modified to reduce the balloon repayment to US$9,925,000. This term loan was designated as a hedge of net investment in a self-sustaining foreign operation.

Credit facility B is an amendment and restatement, without novation, of the term loan defined in note 12(b) in its entirety. Credit facility B is a two-year revolving term facility in the aggregate principal amount of $27,500,000 with an outstanding balance of $25,892,864 maturing February 14, 2012, under which borrowings can be made in either Canadian or U.S. dollars. Upon the Company's request to the lender, this credit facility can be extended for additional one-year periods or converted into a five-year term loan. For loans in Canadian dollars, the credit facility bears interest at the bank's prime rate plus 1.50% or BA rate plus 3.00%, and for loans in U.S. dollars, the credit facility bears interest at the bank's U.S. base rate plus 1.50% or LIBOR plus 3.00%. A US$10,000,000 loan under this facility was designated as a hedge of net investment in a self-sustaining foreign operation. The Company entered into an interest rate swap fixing the interest rate on this US$10,000,000 term loan at a base rate of 1.53%.

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

Credit facility C is an amendment and restatement, without novation, of the term loan defined in note 12(c) in its entirety. Credit facility C is a non-revolving term facility in the aggregate principal amount of $2,142,857 comprising Tranche 1 in the amount of $1,157,143 maturing February 1, 2011 and Tranche 2 in the amount of $985,714 maturing December 28, 2010. As at December 31, 2010, the balance of Tranche 2 was $739,283 and is presented under current portion of long-term debt. The interest rates on Tranche 1 and Tranche 2 are fixed over their terms at 5.85% and 5.81% respectively.

Credit facility D is an amendment and restatement, without novation, of the term loan defined in note 12(c) in its entirety. Credit facility D is a non-revolving term facility in the aggregate principal amount of $300,000 which matured and was paid on September 30, 2010. The interest rate on this loan was fixed over its term at 5.93%.

As collateral for all four credit facilities (A, B, C, D), the bank lenders hold a first ranking charge on the land and building of the Company having a net book value of $26,443,000, a first ranking charge on the equipment of the Canadian subsidiaries having a net book value of $32,072,000, a second ranking security on the inventories and accounts receivable of the Company having a book value of $258,289,000 and a second ranking security on equipment of the U.S. subsidiaries having a net book value of $37,900,000. The credit agreement is subject to affirmative covenants, negative covenants and financial ratios which the Company was in compliance with as at December 31, 2010.

b) The Company had a two-year revolving term loan which was amended and restated on March 24, 2010 (see note 12(a)).

c) The Company had available three term loans of $2,300,000, $2,700,000 and $1,900,000 with a Canadian bank which were amended and restated on March 24, 2010 (see note 12(a)).

d) The Company's U.S. subsidiaries entered into a US$10,000,000 term loan agreement with a U.S. bank. The term loan is repayable in 84 consecutive average 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 with which the Company was in compliance as at December 31, 2010.

As collateral, the bank has a first priority security interest on land, a building and improvements thereon and on the equipment of the U.S. subsidiaries, bearing an aggregate net book value of US$37,900,000 as at December 31, 2010. The bank also has a second priority security interest on the accounts receivable and inventories of the U.S. subsidiaries having a book value of US$124,693,000 as at December 31, 2010.

e) 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. The Company repaid the debenture in its entirety on October 4, 2010.

f) Unsecured, subordinated and non-convertible debenture bearing interest at 9.75%, repayable in a single instalment on April 1, 2015. Starting on April 1, 2013, the Company may repay the debenture in full or in part in advance with a 1% penalty. This debenture was designated as a hedge of net investment in a self sustaining foreign operation.

g) 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, 2011 and a final payment of US$12,500,000 on April 1, 2018. Starting on April 1, 2011, the Company may repay the debenture in full or in part without penalty. This debenture was designated as a hedge of net investment in a self-sustaining foreign operation.

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

h) 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 U.S. subsidiaries' loans to all of its secured lenders.

i) 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.

j) Pursuant to a business acquisition on 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.

k) As part of a previous acquisition, the U.S. 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 August 2011 through July 2019 and US$400,000 starting August 2019 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 the Fulton facility, which have a net book value of US$7,893,000 as at December 31, 2010. 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 U.S. 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.

l) As part of a previous acquisition, the U.S. 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, at an annual fee of 1.0% and expiring 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.

m) As part of a previous acquisition, the U.S. 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, at an annual fee of 1.0% and expiring 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.

n) The mortgage loans bear interest at a weighted average rate of 3.8% as at December 31, 2010 (2009 – 5.7%), and certain specific assets with a net book value of $1,891,000 (2009 – $5,949,783) have been pledged as collateral. The mortgage loans include loans denominated in U.S. dollars amounting to US$1,726,000 (2009 – US$3,620,000). One of the mortgage loans is subject to an interest rate swap of US$1,000,000 fixing the rate at 4.69% over the term of its life. In December 2010, the Company reimbursed certain U.S. dollar-denominated mortgage loans having a total value of US$1,056,892. The remaining mortgage loans are repayable in monthly instalments of $21,164 (2009 – $89,311) including interest and mature at various dates to January 2018.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

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

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

Years	Principal $
2011	11,016
2012	8,345
2013	15,909
2014	10,334
2015	40,853
Thereafter	41,726
	128,183
Fair value adjustment	(1,383)
	126,800

p) The aggregate fair value of the Company's long-term debt was estimated at $127,923,000 as at December 31, 2010 (2009 – $85,715,000) based on discounted future cash flows, using interest rates available to the Company for issues with similar terms and average maturities.

13 OTHER LONG-TERM LIABILITIES

	2010 **$**	2009 $
Reforestation obligations (note 13(a))	**1,085**	1,159
Site remediation (note 13(b))	**1,109**	88
Non-competes payable (note 13(c))	**3,485**	4,602
Restricted stock units (note 13(d))	**431**	15
Other long-term liabilities	**6,110**	5,864
Less: Current portion	**2,434**	1,235
	3,676	4,629

a) Reforestation

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% (2009 – 6.6%) to approximate the present value of future expenditures. Reforestation obligations represent discounted cash flow estimates of future silviculture costs relating to areas logged that are the Company's responsibility to reforest.

	2010 **$**	2009 $
Reforestation obligations – Beginning of year	**1,159**	1,246
Changes to reforestation estimates and accretion expense	**209**	394
Expenditures	**(283)**	(481)
Reforestation obligations – End of year	**1,085**	1,159
Less: Current portion	**366**	315
	719	844

Future non-discounted reforestation expenditures are estimated at between $390,000 and $422,000 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.

b) Site remediation

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

As part of the Tangent business acquisition, the Company acquired a land lease on which certain operations are located. Under the lease, the Company is required to return the land to its original state. During the year, the Company decided to close the Terre Haute facility in Indiana. In order to restore the site to its original condition, remediation work is required and a provision of $1,311,000 was recorded.

13 OTHER LONG-TERM LIABILITIES (continued)

b) Site remediation (continued)

	2010 $	2009 $
Site remediation obligations – Beginning of year	88	48
Site remediation obligation related to business acquisition (note 5)	1,311	52
Expenditures	(290)	(12)
Site remediation obligations – End of year	1,109	88
Less: Current portion	1,109	—
	—	88

c) As part of a previous acquisition, the Company entered into non-compete agreements for which an intangible asset was recorded (note 9). The payable portion of the non-compete agreements was fair valued at a rate of 10.17%, detailed as follows:

			2010	2009
	Payable $	Fair value adjustment $	Net value $	Net value $
Short-term	1,243	(284)	959	920
Long-term	2,798	(272)	2,526	3,682
	4,041	(556)	3,485	4,602

d) On December 18, 2009, certain key executives of the Company were granted Restricted Stock Units ("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. No RSUs were granted in 2010, and the provision as at December 31, 2010 is valued at $430,566.

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.

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

b) Earnings per share

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

	2010	2009
Net earnings applicable to common shares	**$34,395**	$30,069
Weighted average number of common shares outstanding*	15,163	12,638
Effect of dilutive stock options	41	66
Weighted average number of diluted common shares outstanding*	15,204	12,704
Basic net earnings per common share**	**$2.27**	$2.38
Diluted net earnings per common share**	**$2.26**	$2.37

* Number of shares is presented in thousands.
** Basic and diluted earnings per share are presented as dollars per share.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

14 CAPITAL STOCK (continued)

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, May 3, 2007 and December 10, 2010, 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 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 ten 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.

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

	2010		2009	
	Number of options	**Weighted average exercise price $**	Number of options	Weighted average exercise price $
Outstanding – Beginning of year	**197,785**	**20.29**	147,785	18.63
Exercised	**(24,285)**	**4.83**	(4,000)	13.00
Granted	**7,500**	**28.29**	57,000	24.05
Forfeited	**—**	**—**	(3,000)	19.50
Outstanding – End of year	**181,000**	**22.70**	197,785	20.29
Options exercisable – End of year	**128,300**	**21.40**	126,185	17.49

The following options were outstanding under the Plan as at December 31, 2010:

	Options outstanding		**Options exercisable**		
Year granted	**Number of options**	**Weighted average exercise price $**	**Number of options**	**Weighted average exercise price $**	**Expiration date**
2005	**33,000**	**13.00**	**33,000**	**13.00**	**2015**
2006	**61,000**	**19.78**	**61,000**	**19.78**	**2016**
2007	**22,500**	**39.58**	**18,000**	**39.58**	**2017**
2009	**57,000**	**24.05**	**14,800**	**24.05**	**2016**
2010	**7,500**	**28.29**	**1,500**	**28.29**	**2020**
	181,000		**128,300**		

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

14 CAPITAL STOCK (continued)

c) Stock option plan (continued)

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 May 7, 2010, 7,500 options were granted at a fair value of $83,360 and the expense amortized to earnings amounted to $11,128. On December 18, 2009, 57,000 options were granted at a fair value of $530,720 and the expense amortized to earnings amounted to $4,423. The fair value was estimated with the following weighted average assumptions:

	2010	2009
Risk-free interest rate	**2.80%**	2.57%
Dividend yield	**1.60%**	1.25%
Expected lives	**10 years**	7 years
Volatility	**38.00%**	40.21%
Weighted average of fair value of options granted during the year	**$11.13**	$9.31

In 2010, the total expense relating to stock-based compensation amortized to earnings was $400,565 (2009 – $292,413).

d) 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 2010, 8,513 common shares (2009 – 10,952) were issued to Canadian resident employees at an average price of $23.45 per share (2009 – $18.37).

Under the second plan, Company employees who are U.S. 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 2010, 3,545 common shares (2009 – 4,448) were issued to U.S. resident employees at an average price of $25.81 per share (2009 – $20.00).

As at December 31, 2010, the total number of common shares issued under these plans is 169,888 (2009 – 157,830).

15 INCOME TAXES

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

	2010	2009
	$	$
Canada	**35,689**	33,122
U.S.	**14,390**	8,670
	50,079	41,792

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

	2010	2009
	$	$
Current		
Canada	**8,705**	8,128
U.S.	**8,291**	1,715
Total current expense	**16,996**	9,843
Future		
Canada	**86**	1,400
U.S.	**(1,398)**	480
Total future expense (recovery)	**(1,312)**	1,880
	15,684	11,723

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except 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:

	2010	2009
Statutory tax rate	**30.05%**	31.07%
	$	$
Income tax expense at statutory rate	**15,049**	12,985
Income tax expense (recovery) resulting from		
Future tax adjustments due to rate enactments	**88**	(293)
Manufacturing and processing credit	**(737)**	(181)
Effect of different tax rates	**684**	401
Dividend income from subsidiaries	**(1,704)**	(690)
Stock-based compensation	**235**	95
Acquisition costs	**683**	—
Tax adjustment true-up	**1,201**	—
Other	**185**	(594)
	15,684	11,723
Effective income tax rate	**31.32%**	28.05%

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

	2010	2009
	$	$
Future income tax assets due to		
Accrued liabilities	**1,815**	1,458
Employee future benefits	**554**	878
Derivative financial instruments and other	**1,155**	727
	3,524	3,063
Future income tax liabilities due to		
Capital assets	**(37,525)**	(15,922)
Derivative financial instruments	**(257)**	(869)
Other assets	**(466)**	(335)
	(38,248)	(17,126)

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 four 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:

	2010	2009
	$	$
Post-retirement benefits	**389**	207
Defined benefit pension plans	**128**	102
Contributions to multi-employer plan	**294**	294
Contributions to group registered retirement savings plans	**1,385**	1,157

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except 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 for funding purposes 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:

	2010	2009
	$	$
Accrued benefit obligation		
Balance – Beginning of year	**2,706**	1,652
Current service cost	**164**	90
Interest cost on obligation	**172**	116
Benefit payments	**(42)**	(32)
Actuarial loss	**155**	880
Balance – End of year	**3,155**	2,706
Plan assets		
Fair value – Beginning of year	**—**	—
Employer's contributions	**42**	32
Benefits paid	**(42)**	(32)
Fair value – End of year	**—**	—
Net obligation – End of year	**3,155**	2,706
Unamortized net actuarial loss	**(1,081)**	(978)
Unamortized past service costs	**(11)**	(12)
Accrued benefit obligation	**2,063**	1,716

The significant assumptions used are as follows:

	2010	2009
	%	%
Accrued benefit obligation as at December 31		
Discount rate	**5.40**	5.85
Rate of compensation increase	**2.00**	2.00
Benefit costs for the year ended 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 starting in 2009. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%. Therefore, the rate used to calculate the cost per capita of health care cost increases in 2010 was 9.0%. 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	716	(554)
Impact on benefit costs	84	(64)

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

	2010	2009
	$	$
Current service cost	**164**	90
Interest cost	**172**	116
Actuarial loss	**155**	880
Elements of employee future benefit cost before adjustments to recognize long-term nature of employee future benefit cost	**491**	1,086
Adjustments to recognize long-term nature of employee future benefit cost		
Difference between net actuarial loss and actuarial loss	**(103)**	(880)
Amortization of past service costs	**1**	1
Defined benefit costs recognized	**389**	207

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.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

16 EMPLOYEE FUTURE BENEFITS (continued)

Actuarial valuations are updated every three years, and the latest valuations performed for the four existing pension plans are as follows:

	Date of last actuarial valuation
Plan 1	December 31, 2007
Plan 2	December 31, 2007
Plan 3	December 31, 2008
Plan 4	December 31, 2009

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

	2010	2009
	$	$
Accrued benefit obligation		
Balance – Beginning of year	**8,480**	7,332
Current service cost	**309**	249
Interest cost on obligation	**550**	537
Benefit payments	**(370)**	(606)
Actuarial loss	**1,354**	968
Balance – End of year	**10,323**	8,480
Plan assets		
Fair value – Beginning of year	**10,167**	9,079
Actual return on plan assets	**930**	1,251
Employer's contributions	**664**	443
Benefits paid	**(370)**	(606)
Fair value – End of year	**11,391**	10,167
Funded status – Plan surplus	**1,068**	1,687
Unamortized net actuarial loss (gain)	**872**	(271)
Accrued benefit asset, included in other assets (note 10)	**1,940**	1,416

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:

	2010	2009
	$	$
Accrued benefit obligation	**3,924**	1,802
Fair value of plan assets	**3,537**	1,578
Funded status – Plan deficit	**(387)**	(224)

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

	2010	2009
	%	%
Equity securities	**57**	58
Debt securities	**37**	39
Short-term investments and cash	**6**	3
	100	100

The significant weighted average assumptions used are as follows:

	2010	2009
	%	%
Accrued benefit obligation as at December 31		
Discount rate	**5.50**	6.50
Expected long-term rate of return on plan assets	**7.00**	7.50
Rate of compensation increase	**3.50**	3.50
Benefit costs for the year ended December 31		
Discount rate	**6.50**	7.50
Expected long-term rate of return on plan assets	**7.00**	7.50
Rate of compensation increase	**3.50**	4.00

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

16 EMPLOYEE FUTURE BENEFITS (continued)

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

	2010	2009
	$	$
Current service cost, net of employees' contributions	**298**	238
Interest cost	**550**	537
Actual return on plan assets	**(930)**	(1,251)
Actuarial loss	**1,354**	968
Elements of employee future benefit cost before adjustments to recognize long-term nature of employee future benefit cost	**1,272**	492
Adjustments to recognize long-term nature of employee future benefit cost		
Difference between expected return and actual return on plan assets for the year	**208**	576
Difference between net actuarial loss and actuarial loss	**(1,352)**	(966)
Defined benefit costs recognized	**128**	102

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:

	2010	2009
	$	$
Assets		
Current assets		
Accounts receivable	**214**	285
Other receivable	**187**	238
Inventories	**464**	1,010
Prepaid expenses	**9**	9
	874	1,542
Capital assets	**741**	816
Other assets	**77**	73
Total assets	**1,692**	2,431
Liabilities		
Current liabilities		
Bank indebtedness (note 11(d))	**1,630**	2,364
Accounts payable and accrued liabilities	**62**	67
Total liabilities	**1,692**	2,431
Earnings		
Sales	**2,671**	6,139
Cost of sales	**2,671**	6,139
Net earnings	**—**	—
Cash flows provided by (used in)		
Operating activities	**753**	793
Financing activities	**(734)**	(728)
Investing activities	**(19)**	(65)
	—	—

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

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 in note 12, amounting to $30,722,896 (2009 – $14,583,548) 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.

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

	$
2011	5,785
2012	4,041
2013	2,852
2014	1,612
2015	516
Thereafter	8,899

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

e) 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 $727,459 (2009 – $692,430). 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.

f) 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.

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 dates 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 unless otherwise disclosed elsewhere in these financial statements. The fair value of foreign exchange forward contracts and swap agreements has been recorded using mark-to-market information.

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.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Credit risk (continued)

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

	2010 $	2009 $
Current	**31,244**	17,073
Past due 1 to 30 days	**14,910**	8,903
Past due 31 to 60 days	**4,671**	2,392
Past due more than 60 days	**3,087**	658
Total accounts receivable	**53,912**	29,026
Allowance for doubtful accounts	**(279)**	(496)
	53,633	28,530

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:

	2010 $	2009 $
Balance – Beginning of year	**496**	244
Provision (recovery)	**(180)**	396
Bad debt writeoff	**(13)**	(88)
Foreign exchange adjustments	**(24)**	(56)
Balance – End of year	**279**	496

In 2010, the Company had one customer representing 16% of its sales (2009 – 20%). As at December 31, 2010, the accounts receivable balance from this customer was $2,025,439 (2009 – $1,720,898).

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.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Liquidity risk (continued)

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, 2010:

	Carrying amount $	Contractual cash flows $	Less than 1 year $	Between 1 and 3 years $	Between 3 and 5 years $	More than 5 years $
Bank indebtedness*	31,923	32,736	32,736	—	—	—
Accounts payable and accrued liabilities	33,266	33,266	33,266	—	—	—
Long-term debt obligations*	125,828	160,148	17,903	36,741	59,689	45,815
Interest rate swaps						
Outflow	—	2,635	1,136	1,042	457	—
Inflow	—	(1,443)	(433)	(595)	(415)	—
Non-competes payable	4,041	4,041	1,243	2,486	312	—
	195,058	231,383	85,851	39,674	60,043	45,815

* Including capital and interest

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 U.S. dollars by its Canadian-based operations and to U.S. dollar-denominated long-term debt held by its Canadian companies. The Company monitors its transactions in U.S. dollars generated by Canadian-based operations. Prior to January 1, 2009, the Company engaged in hedging activity to mitigate its currency risk. Its basic hedging activity consisted of entering into foreign exchange forward contracts for the sale of U.S. dollars and the purchase of certain goods and services in U.S. dollars. The Company also considered foreign exchange forward contracts for the purchase of U.S. dollars for significant purchases of goods and services that were not covered by natural hedges.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Currency risk (continued)

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 was recognized in earnings over the designated underlying period of foreign exchange forward contracts from March 2009 to December 2010.

The Company had no foreign exchange forward contracts as at December 31, 2010. The following table summarizes 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

The contracts matured at various dates up to December 31, 2010, and the fair value was determined by obtaining mark-to-market values as at December 31, 2009. This type of measurement falls under Level 2 in the fair value hierarchy as per CICA Handbook Section 3862, "Financial Instruments – Disclosures". 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.
- 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 U.S. dollar against the Canadian dollar would not have a significant impact on the net gain on foreign exchange forward contracts recognized in earnings for the year ended December 31, 2010 (2009 – decrease of $219,621). For a 10% weakening of the U.S. dollar against the Canadian dollar, there would be an equal and opposite impact on gain.

The following table provides information on the impact of a 10% strengthening of the U.S. dollar against the Canadian dollar on net earnings for the years ended December 31, 2010 and 2009. For a 10% weakening of the U.S. dollar against the Canadian dollar, there would be an equal and opposite impact on net earnings and comprehensive income (loss):

	2010	2009
	$	$
Gain to net earnings and comprehensive income	**(112)**	(281)

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Currency risk (continued)

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

	2010 $	2009 $
Assets		
Accounts receivable	**2,060**	1,430
Foreign exchange forward contracts	**—**	2,196
	2,060	3,626
Liabilities		
Accounts payable and accrued liabilities	**939**	811

The foreign exchange impact for the U.S. 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 U.S. subsidiary.

Interest rate risk

As at December 31, 2010, the Company has limited exposure to interest rate risk on long-term debt after giving effect to its interest rate swaps; 65% (2009 – 86%) 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 U.S. 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 $39,310 for the year ended December 31, 2010 (2009 – $161,321).

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

			2010
Notional amount	**Fixed rate %**	**Maturity date**	**Notional equivalent CA$**
CA$2,700	**5.81**	**February 2011**	**2,700**
US$10,000	**1.53**	**April 2011**	**9,946**
US$15,000	**2.57**	**June 2012**	**14,919**
US$5,000	**5.80**	**July 2015**	**4,973**
US$5,000	**5.54**	**July 2015**	**4,973**
US$1,000	**4.69**	**December 2015**	**995**
US$5,600	**2.99**	**December 2015**	**5,570**

			2009
Notional amount	Fixed rate %	Maturity date	Notional equivalent CA$
CA$2,300	5.85	December 2010	2,300
CA$2,700	5.81	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

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

19 FINANCIAL INSTRUMENTS (continued)

Interest rate risk (continued)

The fair value of these financial instruments has been determined by obtaining mark-to-market values as at December 31, 2010 from a financial institution. This type of measurement falls under Level 2 in the fair value hierarchy as 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, 2010 is a loss of $1,379,048 (2009 – loss of $1,430,952), of which $43,914 and $1,335,134 respectively are recorded in current and long-term liabilities under derivative financial instruments. A 10% decrease in interest rates as at December 31, 2010 would have increased the loss recognized in other comprehensive income (loss) by approximately $137,905 (2009 – $143,095). 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.

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

	2010	2009
	$	$
Long-term debt, including current portion	**125,828**	87,080
Shareholders' equity	**281,385**	179,978
Total capital	**407,213**	267,058
Long-term debt to equity ratio	**0.45:1**	0.48:1

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 bank indebtedness. 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 funded debt to earnings before interest, taxes and amortization, funded debt to capitalization and fixed charge coverage. The Company monitors the ratios on a quarterly 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:

	2010	2009
	$	$
Parent company		
Marketing and technical service fees paid	**200**	200
Interest on promissory note	**32**	52
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.

December 31, 2010 and 2009 (tabular amounts expressed in thousands of dollars, except as otherwise indicated)

21 RELATED PARTY TRANSACTIONS (continued)

As at December 31, 2010, the consolidated balance sheet includes the following amounts with related parties:

	2010	2009
	$	$
Accounts payable to parent company	**12**	68
Accounts payable to ultimate shareholders	**—**	25

22 SEGMENT INFORMATION

The Company operates within one business segment: the production and sale of pressure treated wood and related services. Operating plants are located in the Canadian provinces of Nova Scotia, Quebec, Ontario, Alberta and British Columbia, and the states of Pennsylvania, Virginia, West Virginia, Kentucky, Wisconsin, Alabama, Indiana, Louisiana, Tennessee, Minnesota, North Carolina and Washington in the U.S. 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:

	2010	2009
	$	$
Canada	**215,327**	187,993
U.S	**345,719**	223,126
	561,046	411,119

Sales by product as at December 31 are as follows:

	2010	2009
	$	$
Railway ties	**283,192**	185,112
Utility poles	**166,681**	149,664
Industrial products	**81,401**	44,801
Residential lumber	**29,772**	31,542
	561,046	411,119

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

	2010	2009
	$	$
Canada	**54,941**	54,079
U.S.	**59,015**	42,806
	113,956	96,885

Intangible assets having a net book value of $54,986,000 (2009 – $7,580,000) and goodwill having a value of $73,973,000 (2009 – $5,494,000) are attributed to the Company's U.S. operations.

23 COMPARATIVE FIGURES

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