Ongoing growth

"We took significant strides in our objective to steadily increase shareholder value in Stella-Jones by increasing both our top and bottom line results and completing a strategic acquisition that has opened important new markets for us in the United States."

Brian McManus
President and CEO

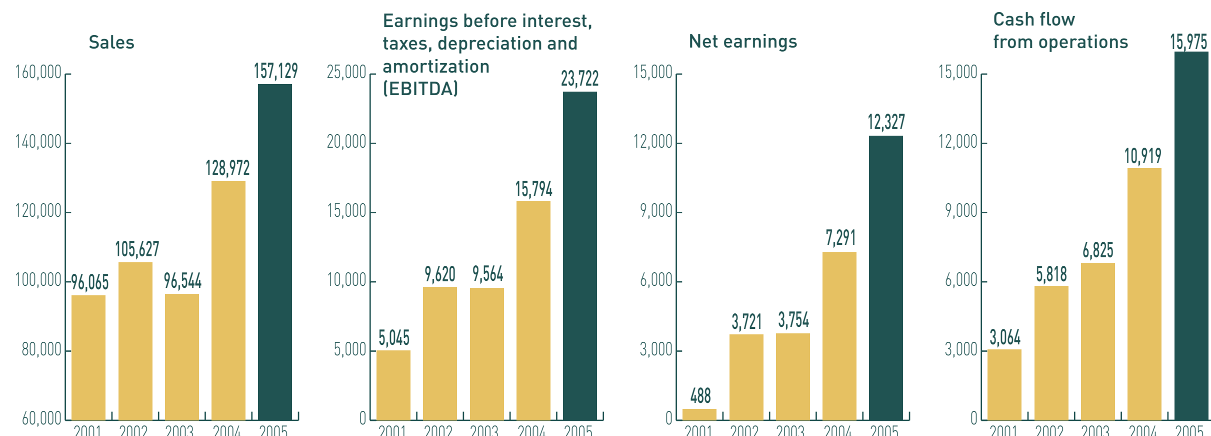
Annual Report 2005

5-year Review

(thousands of dollars, except per share data and ratios)	**2005** $	2004 $	2003 $	2002 $	2001 $
	For the years ended December 31				
Operating results					
Sales[1]	**157,129**	128,972	96,544	105,627	96,065
EBITDA[2]	**23,722**	15,794	9,564	9,620	5,045
Net earnings	**12,327**	7,291	3,754	3,721	488
Cash flow from operations[3]	**15,975**	10,919	6,825	5,818	3,064
Financial position					
Working capital	**55,485**	36,582	25,874	21,418	20,669
Total assets	**137,891**	98,200	93,351	69,436	80,854
Long-term debt[4]	**25,201**	16,184	12,783	7,028	11,843
Shareholders' equity	**65,630**	49,285	42,286	35,355	31,615
Per share data					
Net earnings per common share	**1.18**	0.72	0.40	0.41	0.05
Diluted net earnings per common share	**1.13**	0.70	0.39	0.41	0.05
Cash flow from operations[2,3]	**1.47**	1.07	0.68	0.64	0.34
Book value	**6.03**	4.82	4.22	3.91	3.50
Working capital	**5.10**	3.57	2.58	2.37	2.29
Average number of shares outstanding (000s)	**10,451**	10,082	9,456	9,048	9,002
Shares outstanding at year end (000s)	**10,881**	10,235	10,013	9,053	9,043
Average number of diluted shares outstanding (000s)	**10,883**	10,355	9,628	9,078	9,015
Dividend per share	**0.10**	0.08	0.08	–	0.07
Financial ratios					
Return on average equity	**21.5 %**	15.9 %	9.7 %	11.1 %	1.5 %
Long-term debt[4] to equity	**0.38:1**	0.33:1	0.30:1	0.20:1	0.37:1

1 Since 2004, freight costs are no longer included as a reduction from sales; accordingly, sales for 2001 to 2003 have been restated to reflect this change.
2 Earnings before interest, taxes, depreciation and amortization ("EBITDA") and cash flow from operations per share are financial measures not prescribed by Canadian generally accepted accounting principles ("GAAP") and are not likely to be comparable to similar measures presented by other issuers. Management considers them to be useful information to assist knowledgeable investors in evaluating the cash generating capabilities of the Company. EBITDA is derived from the Company's consolidated financial statements without adjustment for unusual or non-recurring items.
3 Before changes in non-cash working capital components.
4 Including current portion.

(In thousands of dollars)



Achievements for 2005

- Sales increased 21.8% to $157.1 million
- Improved gross margin from 18.0% to 20.4%
- Increased net earnings by 69.1% to $12.3 million
- Strategic acquisition opened important new markets in the United States

Expansion breeds efficiency

The two major elements of Stella-Jones' growth approach have been strategic acquisitions and organic growth in its core markets. As we continue to expand, we are focused on reducing our cost structure through economies-of-scale, making Stella-Jones a larger, yet much more efficient organization.

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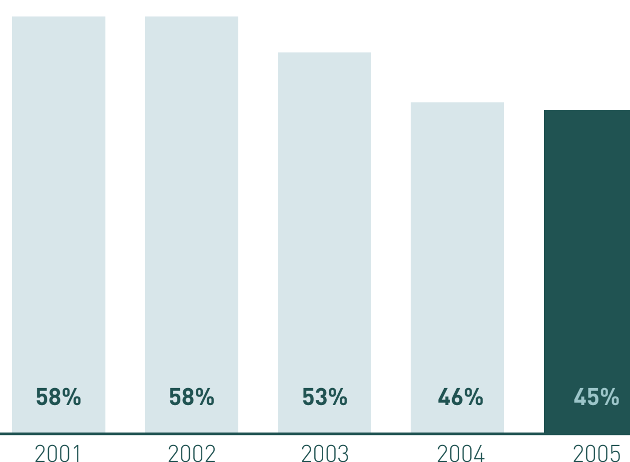
Performance

Utility poles

TSX: SJ | Total Sales: $157.1 M | 2005: Sales ▲ 21.8% | Gross Margin: 20.4%



$71.1M

Sales in 2005 — Utility poles

Utility poles are used by electrical utility and telecommunications companies to support transmission and distribution lines, electrical transformers and a range of communication networking equipment. While alternatives such as steel, composites and cement exist, treated wood poles remain the preferred choice because they are more economical to manufacture, transport and maintain.

Stella-Jones is the only producer of pressure treated wood poles operating on a national scale in Canada. Our extensive network of suppliers provides us access to high-quality timber, which enables our peeling and treating plants to provide a diverse selection of wood utility poles to our customers across the country. Stella-Jones has nurtured long-term relationships with electrical and telecommunication utility companies and is solidly established as one of the leading suppliers of wood utility poles in North America.

Stella-Jones has experienced sustained growth in this sector and this trend is expected to continue. There are currently 12 to 14 million wooden utility poles in service in Canada, with an average age of between 35 and 40 years. Given the useful life of these poles is 40 to 50 years, there is a significant level of pent-up demand to replace existing infrastructure.

Opportunities

Railway ties

TSX: SJ | Net earnings: $12.3 M | 2005: Net earnings ▲ 69.1% | EPS: $1.18

$58.8M

Sales in 2005 — Railway ties

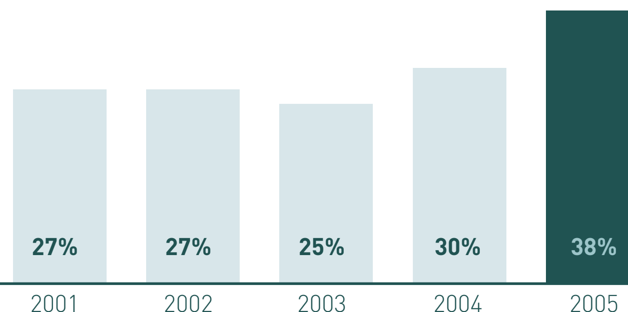
Treated wood railway ties have played an essential role in North America's rail infrastructure since the dawn of the railroad industry. The dependability and long service life of treated wood have made it the material of choice for railway ties throughout the industry. In fact, of the over 20 million railway ties that are expected to be sold in North America in 2006, approximately 90% will be treated wood.

The North American railroad industry is carrying record levels of traffic, which is requiring railroads to invest heavily to increase their capacity in congested areas and to properly maintain their existing infrastructure. This is creating strong demand for railway ties.

Stella-Jones is one of the industry's leading producers of wood railway ties, with a reliable wood sourcing network developed over many years. Our plants are strategically located in Canada and, with the addition of our new plant in Wisconsin through the Webster Wood Preserving Company acquisition in 2005, we now enjoy greater access to the American market.

The 2006 outlook for railway ties is very positive—for the first time in Stella-Jones' history, railway ties are expected to be our largest product segment.

RAILWAY TIES — % OF SALES



Market presence

Industrial lumber

TSX: SJ | Railway Ties: 38% of sales | Utility Poles: 45% of sales

INDUSTRIAL LUMBER — % OF SALES

$17.3M

Sales in 2005 — Industrial lumber

One of the oldest and most commonly used construction materials, wood is one of the world's most plentiful and economical building resources. In industrial applications, which often subject the wood to harsh environmental conditions, pressure treatment with a variety of preservatives is extensively used. Pressure treatment preserves wood's structural soundness and significantly extends its service life by protecting it from natural predators.

Pressure treated wood has proven to be an ideal material for construction in and around aquatic environments. It is resilient enough to withstand battering by the ocean and ships, yet resistant to the destructive forces of salt water, decay-causing fungi and wood-destroying marine organisms.

Stella-Jones' industrial lumber products include marine pilings and timbers, construction timbers, highway guide rail posts and bridge timbers. Based on our strategic plant locations and our diverse selection of wood species and preservatives, Stella-Jones has established a significant market share for wharfs and marine pilings on both the East and West coasts.

With the high price of alternative materials such as steel, the demand for treated wood pilings has further increased. Industrial lumber is therefore expected to continue as a growth market for Stella-Jones.

Natural building material

Consumer lumber

TSX: SJ | Industrial Lumber: 11% of sales | Consumer lumber: 6% of sales

Pressure treated wood is a cost-effective, durable and aesthetically pleasing choice for many exterior home renovation projects, such as patios, decks and fences. The treating process protects the wood from fungus, insects and bacteria, and can extend its productive service life by five to ten times.

Stella-Jones has established a strong supplier relationship with major lumber retail chains in Canada. We supply these retail outlets with pressure treated wood board, lattice, fence board, plywood and dimensional lumber for use in outdoor applications. In addition, Stella-Jones has developed a strategic alliance with a major lumber wholesaler, allowing us to leverage their expertise in the dimensional lumber market.

The consumer lumber industry has benefited significantly over the past few years from record housing sales, as homeowners typically undertake outdoor renovation projects within the first few years of buying a home. Going forward, the consumer lumber sector is expected to be a growth area for Stella-Jones, as the home renovation market continues to expand and new retail outlets are added to our clients' distribution network.

$9.9M

Sales in 2005 — Consumer lumber

CONSUMER LUMBER — % OF SALES

Chairman's Message

We are reporting on another highly satisfactory year for Stella-Jones. Year-over-year, sales in 2005 increased almost 22% and net earnings per share were up 64% to $1.18 per share compared to $0.72 in 2004.

While those are the headline figures, it is the significant events which occurred in 2005 that have lifted our company to a new level. We have always been, and remain, justifiably proud of being a pan-Canadian company with sales in all of the Canadian provinces. We have, for many years, also sold a meaningful percentage of our production into certain regions of the United States. However, our acquisition, in August 2005, of Webster Wood Preserving Company with its railway tie treatment plant in Bangor, Wisconsin gave Stella-Jones its first operating site in the US and a combined North American market share in ties of approximately 12%. This business has been renamed Stella-Jones Corporation and is a wholly-owned subsidiary of Stella-Jones Inc. As with earlier acquisitions in Canada, its systems were quickly and seamlessly integrated into those of the parent company. I pay tribute to our senior management and to the local personnel in Bangor for this achievement. We have become increasingly efficient through our acquisitions, both in the field and at the head office and I would add that our senior management team and its support staff number exactly the same as they did prior to this acquisition and to those of Cambium and Légaré in 2003 and 2004 respectively.

ENVIRONMENTAL COMPLIANCE

Many of our shareholders will be aware that a significant portion of the Company's capital expenditures over a number of years have been spent on environmental related matters. This was partly to satisfy our own insistence that Stella-Jones should be a leader on environmental issues in our industry sector, and also to meet the requirements of Environment Canada in response to their Technical Recommendations Documents ("TRD") baseline assessments carried out on all Canadian wood preserving plants in the year 2000. I commend our staff at all levels for their work in monitoring progress toward TRD compliance and I thank the members of the Environmental Committee of our Board of Directors, and in particular its Chairman, Arthur Earle, for their guidance and diligence in overseeing this project. We can now dedicate a larger proportion of our capital expenditure budget to operational investments and productivity improvements.

"Stella-Jones' future is bright. We are enthusiastic about our growth potential, both in

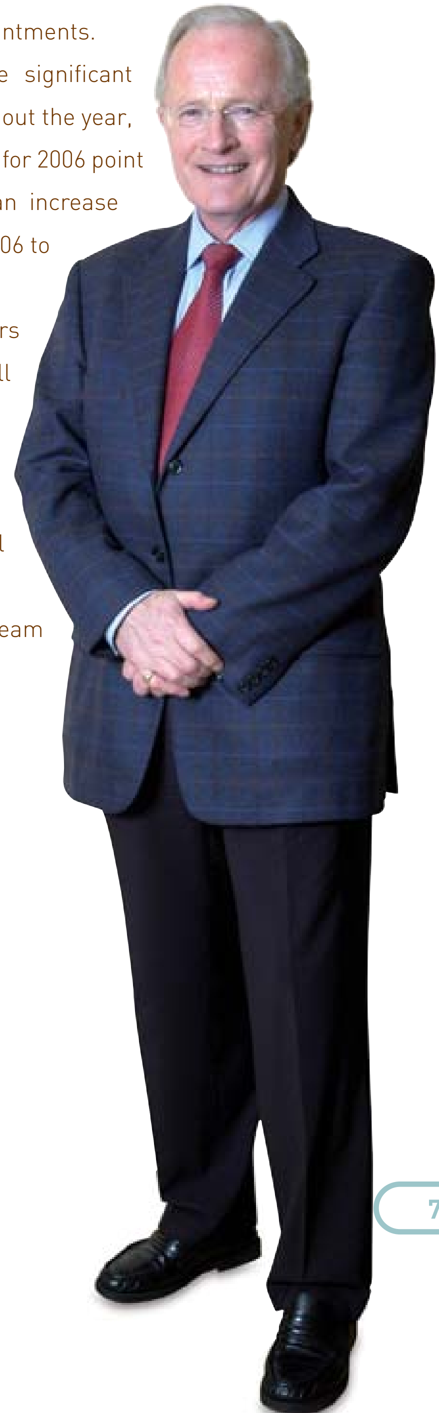
STRENGTHENED LEADERSHIP

During 2005, Marla Eichenbaum, General Counsel and Secretary, was promoted to Vice-President and we welcomed Doug Fox, whose previous career was spent in the North American railroad industry, to the Stella-Jones senior management team. Doug is headquartered at Bangor, Wisconsin and is responsible for our US wood tie operations. I would like to congratulate both Marla and Doug on their appointments.

The record results which we announced each quarter in 2005, coupled with the significant developments outlined above, kept our share price moving encouragingly higher throughout the year, from $5.70 in early January to $14.00 at year end. Current order books and forecast sales for 2006 point to another excellent year, and the Board of Directors is therefore recommending an increase in the Corporation's next semi-annual dividend to $0.06 per share, payable on May 16, 2006 to shareholders of record on April 4, 2006.

On February 9, 2006 we announced that we were in discussions with the shareholders of Bell Lumber & Pole Company ("Bell") with respect to a possible acquisition of Bell by Stella-Jones. With annual sales of approximately US$60 million, Bell manufactures wood utility poles in Canada and the United States and is also involved in the remanufacturing and treating of dimensional lumber in Alberta. We believe that Bell's operations and geographical locations are an excellent fit for Stella-Jones and will provide us additional avenues to enhance our market coverage.

On behalf of the Board, I congratulate Brian McManus and each and every one on his team for an outstanding performance throughout 2005.



Tom A. Bruce Jones, CBE
Chairman of the Board

the short and longer term due to the strength of our core markets, the efficiency we have...

President's Message

Over the last several years, our overriding objective has been to steadily increase shareholder value in Stella-Jones through a managed-growth approach. I am pleased to report that we took significant strides in this regard in 2005, a year in which we increased both our top line and bottom line results and made a strategic acquisition that has opened important new markets for us in the United States.

Indeed, 2005 was a very satisfying year for Stella-Jones and its shareholders. We continued to build on the previous year's momentum as revenues reached a record $157.1 million, up 22% from $129.0 million in 2004. Net earnings also rose significantly to $12.3 million, or $1.18 per share, from the $7.3 million, or $0.72 per share that we reported last year.

Stella Jones' performance was particularly strong given the impact of external economic factors on our daily business. Throughout the year, we experienced a substantial escalation in petroleum costs, which increased procurement and delivery expenditures. The economy was affected by the significant rise of the Canadian dollar and ongoing interest rate increases, and we absorbed a higher amount of environmental expenses in meeting and exceeding the recommendations made by Environment Canada for our wood preserving plants.

Despite these challenges, we maintained our focus on organizational efficiency and managed to control our overall costs. These efficiencies, combined with the solid sales growth we achieved in our key domestic railway tie and utility pole markets, contributed considerably to our healthy bottom line.

MANAGED ONGOING GROWTH

Our strategy of growing our Company both organically and through strategic acquisitions has proven to be successful. While top line growth is encouraging, we believe that shareholder value is built from the bottom line. So, when we consider a possible business acquisition, we first look for the fit with our existing core product lines and then evaluate how much it will contribute to our bottom line.

That's precisely what we saw in Webster Wood Preserving Company. Webster, a profitable organization with annual sales of approximately US$25.0 million in 2004, produced and marketed treated railway ties. Through this transaction, we gained immediate access to Webster's strong customer base in the American railway industry. We view this as a new and exciting phase for Stella-Jones as we continue to profitably grow our market share in the United States.

Each of our acquisitions, combined with the organic growth in our core markets, has provided us additional leverage to reduce our cost structure through economies-of-scale. In short, the larger we get, the more efficient we become.

As we continue to expand, we are building stronger relationships with our suppliers, who in turn benefit from a steadier stream of orders. Similarly, on the client side, our customers recognize the advantages of working with a financially stable vendor such as Stella-Jones. As such, we are building real partnerships with our customers.

CONTINUING OPPORTUNITIES

While each of our four core markets has performed well, the majority of our sales growth in 2005 resulted from the continued strength in our two key domestic markets, railway ties and utility poles. We expect that trend will continue in 2006.

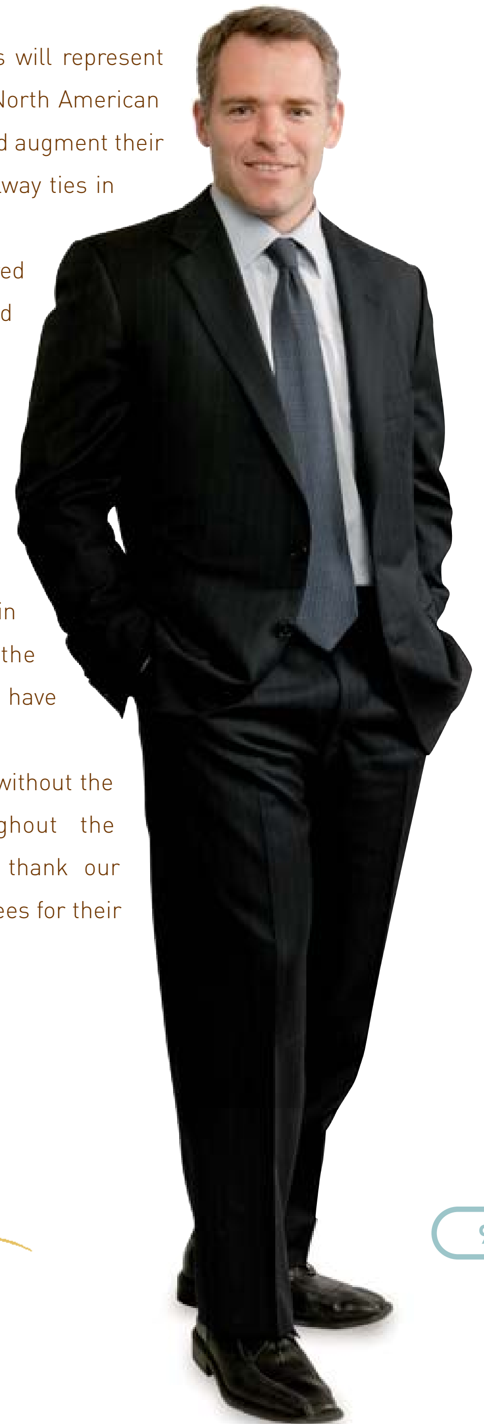
For the first time in Stella-Jones' history, we anticipate that treated railway ties will represent our largest market segment in 2006, surpassing utility poles. Investment in the North American railway industry is expected to be strong in 2006, as railway companies upgrade and augment their existing infrastructure. Stella-Jones is well-positioned as a market leader for railway ties in Canada and is now a major supplier in the United States.

We continue to see pent-up demand for utility poles as major upgrades are required to replace aging wood poles that are currently installed. Growth is also anticipated in our industrial and consumer lumber businesses.

While we are pleased with our 2005 results, we will actively continue to seek out new opportunities to grow our markets and will persist in fostering a culture of superior client service at the lowest possible cost. At the same time, synergistic acquisitions will continue to be the cornerstone of our growth strategy going forward, particularly in the United States.

Stella-Jones' future is bright. We are enthusiastic about our growth potential, both in the short and longer term due to the strength of our core markets, the efficiency we have built within our organization and the beneficial relationships we have established with suppliers and customers.

The outstanding success we have achieved in 2005 would not have been possible without the leadership of our executive team and management personnel throughout the organization and the groundwork performed by our employees. I'd like to thank our customers, suppliers, Board of Directors, shareholders and especially our employees for their invaluable support in making the past year a rewarding one.



Brian McManus
President and Chief Executive Officer

suppliers and customers." (Brian McManus, President and Chief Executive Officer)

Strategic...

In August 2005, Stella-Jones acquired Webster Wood Preserving Company in Bangor, Wisconsin. This acquisition, which was immediately accretive to earnings, provides Stella-Jones with its first manufacturing facility for treated railway ties in the United States and direct entry into the American railroad market through Webster's established customer base.

Stella-Jones Corporation

Bangor, Wisconsin (U.S.A.)
- Stella-Jones' first manufacturing facility in the United States
- Specializes in treated railway ties
- Strong existing customer base provides direct access to important U.S. railway market
- Immediately accretive to sales and earnings

"Synergistic acquisitions will continue to be the cornerstone of our growth strategy going

... Acquisition

NUNAVUT
RTHWEST RRITORIES
MANITOBA
ONTARIO
SASKATCHEWAN
QUÉBEC
NEWFOUNDLAND AND LABRADOR
P.E.I.
NEW BRUNSWICK
NOVA SCOTIA
WISCONSIN
1
2
3
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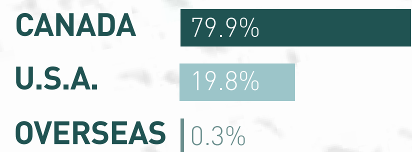
11

With our strategically-located treating facilities, we have the treating capacity, sources of supply and purchasing power to respond to increased demands in all of our product sectors.



1. New Westminster (BC), Plant and Sales Office
2. Prince George (BC), Plant and Sales Office
3. Guelph (ON), Plant and Sales Office
4. Gatineau (QC), Plant and Sales Office
5. Belleville (ON), Distribution Yard
6. Delson (QC), Plant and Sales Office
7. Westmount (QC), Head Office
8. Sorel-Tracy (QC), Plant
9. Truro (NS), Plant and Sales Office
10. Clarenville (NF), Distribution Centre and Sales Office
11. Bangor (WI), Plant and Sales Office

forward, particularly in the United States." (Brian McManus, President and Chief Executive Officer)

Winning market share... growing profits

As Canada's only national supplier of industrial treated wood products, Stella-Jones has established itself as a leader in its core markets. Our focus on efficiency, along with the significant infrastructure spending in the railway industry, pent-up demand in utility poles and our entry into the US market are clear indicators of Stella-Jones' strong growth potential.

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

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") dated March 15, 2006 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2005 compared with the fiscal year ended December 31, 2004. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2005 and the notes thereto. The audited consolidated financial statements and MD&A have been reviewed by the Company's Audit Committee and, upon its recommendation, have been approved by the Board of Directors.

The MD&A contains statements that are forward-looking in nature. Such statements involve known and unknown risks and uncertainties that may cause the actual results of the Company to be materially different from those expressed or implied by such forward-looking statements. Such items include, among others: general economic and business conditions, product selling prices, raw material and operating costs, changes in foreign currency rates and other factors referenced herein and in the Company's continuous disclosure filings.

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

OUR BUSINESS

Stella-Jones is a leading North American producer of industrial pressure treated wood products and a major supplier of custom pressure treating services to the Canadian residential lumber market.

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

The Company operates eight wood treating plants and two distribution centres. These ten facilities are located in the provinces of British Columbia, Ontario, Québec, Nova Scotia, Newfoundland and the state of Wisconsin. The Company's workforce currently numbers approximately 280 employees.

OUR MISSION

Stella-Jones' objective is to be the performance leader in the wood preserving industry and a model corporate citizen, exercising environmental responsibility and integrity.

Stella-Jones will achieve these goals by focusing on customer satisfaction, core products, key market segments, innovative work practices and the optimal use of its resources.

Stella-Jones is committed to providing a safe, respectful and productive environment for its employees, where problem solving, initiative and high standards of performance are rewarded.

2005 OVERVIEW

Stella-Jones posted strong operating results for the year ended December 31, 2005, highlighted by sales growth of 21.8%, improved gross margins, and a net earnings increase of 69.1% compared to the prior year.

Sales grew organically by 14.2%, mostly the result of significant growth in the core utility pole and railway tie markets, while sales in overseas export poles as well as industrial and consumer treated wood declined. For the third consecutive year, the Company also grew by acquisition, which was responsible for sales growth of 7.6%.

In August 2005, the Company's wholly-owned U.S. subsidiary, Stella-Jones Corporation, acquired the assets of Webster Wood Preserving Company, a Minnesota Limited Partnership ("Webster"), a profitable, privately held producer of pressure treated wood railway ties based in Bangor, Wisconsin with annual sales of approximately US$25.0 million (see Business Acquisition section below). The total purchase price was $18.1 million (US$15.6 million), including approximately $16.3 million (US$14.0 million) in inventory and receivables. The transaction, which was immediately accretive to the Company's earnings, established Stella-Jones' first manufacturing facility in the United States and provides greater access to the U.S treated crosstie market.

Stella-Jones carried its positive momentum from previous years by once again improving its cash flows from operations (before changes in non-cash working capital components), which increased from $10.9 million in 2004 to $16.0 million in 2005. The Company's balance sheet as at December 31, 2005 remains strong, with a long-term debt to equity ratio of 0.38:1. Going forward, Management is enthusiastic about the growth prospects in its core businesses in 2006 and remains focused on maximizing bottom-line results through efficiencies within the organization. The Company also possesses the financial capacity and resources to allow it to actively consider additional acquisitions that meet its investment criteria.

Selected annual information

For the years ended December 31 (thousands of dollars, except per share data)	2005 $	2004 $	2003 $
Sales	157,129	128,972	96,544
Net earnings	12,327	7,291	3,754
Net earnings per common share	1.18	0.72	0.40
Diluted net earnings per common share	1.13	0.70	0.39
Total assets	137,891	98,200	93,351
Total long-term debt*	25,201	16,184	12,783
Dividend per share	0.10	0.08	0.08

*Including current portion

OPERATING RESULTS

Sales

Sales for the year ended December 31, 2005 reached a record $157.1 million, an increase of $28.1 million, or 21.8%, from last year's sales of $129.0 million. This significant rise is the result of robust sales in the Company's two major product categories—railway ties and utility poles—and the contribution during the fourth quarter of the Webster acquisition. The 2005 sales increase was tempered by a decline in sales in the Company's overseas utility pole exports, industrial lumber and consumer lumber categories.

Sales by product group

Utility poles

Domestic utility pole sales reached $70.7 million in 2005, an increase of $13.3 million or 23.1% over the 2004 sales of $57.4 million. This increase comes as a result of growing demand for transmission poles, coupled with solid growth in large transmission pole sales from several special projects and from projects involving wind farms. Distribution pole sales remain historically below what the Company believes are appropriate replacement requirements. The Company considers that the replacement demand for distribution poles continues to lag real maintenance requirements as a result of the perceived policy of a number of major Canadian utilities over the last decade to replace poles only when inspection determines that a pole's reliability has been compromised, either by extreme age or visual decay. There are currently 12 to 14 million treated wood utility poles in service in Canada, with an average age of between 35 to 45 years. Given the estimated useful life of these poles is 40 to 50 years, and a growing number of poles in suburban and urban locations are either overloaded or near their capacity, a significant level of pent-up demand exists in this market. Management believes the current pole replacement policies are not sustainable and that the

1. Sales by product (% of revenues)	2005	2004
Utility poles	**45%**	46%
Railway ties	**38%**	30%
Industrial lumber	**11%**	15%
Consumer lumber	**6%**	9%

2. Sales by geographic region (% of revenues)	2005	2004
Canada	**79.9%**	83%
United States	**19.8%**	15%
Overseas	**0.3%**	2%

industry will return to a preventive maintenance model, which would eventually result in higher annual demand for utility poles. Stella-Jones currently sells about 125,000 poles each year in Canada, representing approximately 45% of its total revenues.

Export utility pole sales, which exclude sales from the Canadian based facilities to the United States discussed separately below, totalled $409,000 in 2005, compared to $2.8 million in the prior year. This decline is in line with the Company's strategic decision to concentrate on the higher-margin domestic pole market, as reported in previous MD&A's. Overseas export sales will therefore not be a target core market going forward, although Management will continue to monitor export trends through its international contacts and affiliations. The Company has a small but growing market on the West Coast for large transmission poles destined for the overseas export market, but they are sold through local contractors and agents and these sales are included in domestic operations.

Railway ties

Railway tie sales for the year totalled $58.8 million, a 52.3% increase over 2004 sales of $38.6 million. These results reflect the strong performance of the rail transport sector, which continues to report record growth in traffic levels, as well as the inclusion of revenues from the newly-acquired operations in Bangor, Wisconsin (discussed further below). Maintenance requirements, installation of double tracking and new siding construction have all contributed to the increase in demand for railway ties. The Company's growth in this sector has not been confined to Class 1 (major) railroads; it has also been successful in increasing its sales to short line customers and to operators of dedicated lines in the mining sector. The Company's ability to service clients from multiple plants, a capital structure that allows the Company to stockpile and air-season green wood for major long-term contracts, and a long-standing stable source of wood supply are seen as the key growth drivers in this product category. Additionally, plant specialization and increased volumes through dedicated production facilities have enabled the Company to maintain competitive pricing. Based on ongoing growth in the rail transport sector and the Company's increased market share in the United States as a result of the Webster acquisition, Management anticipates that railway ties will become Stella-Jones' largest product category for the first time in the Company's history in 2006.

Industrial lumber

Industrial lumber sales declined by 6.9% to $17.3 million in 2005 from the $18.6 million reported in 2004. The majority of the decline occurred in the fourth quarter in comparison to an unusually strong performance in the fourth quarter last year. With a strong presence on both coasts, Management is confident that Stella-Jones will remain the dominant player in the piling and marine markets.

Consumer lumber

Sales in the consumer lumber custom treating category totalled $9.9 million in 2005, down from $11.5 million in the prior year, a 13.9% decline. The consumer treated lumber market was down overall in Canada by over 15% mainly due to the slow start of the summer renovation period in Eastern Canada, as a result of an unusually wet spring. There were numerous new retail outlets opened in mid 2005 that the Company serves; however, this was too late in the season to positively impact annual sales. Management nonetheless sees this as a growth category based on the Company's expanding network of retail outlets that carry its products as well as its strategic alliance with a major lumber wholesaler that supplies the wood and manages the retail distribution channels.

Stella-Jones has four plants—Delson (QC), Sorel-Tracy (QC), Guelph (ON) and Truro (NS)—that have at least two cylinders for treating wood with waterborne preservatives, one of which can be dedicated to treatment for residential lumber customers. The Company provides Amine Copper Quaternary ("ACQ") treating services to the Québec, Ontario and Maritime markets. ACQ is a waterborne preservative that has captured a major portion of the market share for preservatives approved for residential lumber treating. Its introduction followed the December 2003 Canadian and U.S. wood treating industry's voluntary phase-out of the use of Chromated Copper Arsenate ("CCA") as a preservative for treating lumber used in consumer applications. In the Maritimes, the Company provides full service programs, including supplying dimensional lumber as well as ACQ treatment for the residential housing market. However, the vast majority of sales in this product category are for treating services only.

Sales by destination

Of the total 2005 sales, 79.9% were made in Canada, 19.8% in the United States, and 0.3% were overseas.

Sales of products exported to the United States from the Canadian based facilities totalled $21.3 million in 2005, an increase of $2.2 million or 11.5% over the $19.1 million recorded in 2004. This excludes sales associated with the Webster assets acquired in August 2005 (see below). In terms of volume, sales increased at a higher rate, but sales figures were impacted by the changing currency conversion rate, which reflected the relative strength of the Canadian dollar in 2005. Management believes this market presents opportunities for additional growth, particularly in its West Coast operations where the Company's access to Douglas fir, a large pole species, is a competitive advantage when bidding on transmission projects. However, in other product sectors such as distribution poles and piling, a strong Canadian dollar does put the Company at a competitive disadvantage versus U.S. producers. The Company's low cost structure can compensate for some revenue erosion and still provide satisfactory margins, but further weakness in the U.S. dollar may affect the Company's ability to grow this market.

The Company's wholly-owned U.S. subsidiary, Stella-Jones Corporation, acquired the assets of Webster located in Bangor, Wisconsin, in August 2005. The acquisition established Stella-Jones' first manufacturing facility in the United States and provides greater access to the U.S treated crosstie market. Sales for the newly-acquired operations were $9.8 million, which reflects activities during only the last four months of the year. Management is enthusiastic about the growth opportunities in this market.

Gross margin

Gross margins improved significantly in 2005, both in dollar terms and as a percentage of sales. For 2005, gross margins rose to $32.0 million, or 20.4% of sales, compared to $23.2 million, or 18.0% of sales in 2004. The improvement in gross margins is due to overhead cost containment, plant specialization, higher average selling prices and economies-of-scale from the increase in overall volume in the Company's core markets.

Expenses

Selling and administrative expenses for 2005 were $8.4 million, an increase of $1.1 million over the $7.3 million incurred the prior year. The increase in these expenses is related to the additional provision required for the Company's employee profit sharing pool, selling and administrative expenses at the new Bangor facility, as well as one-time expenses related to the final year of an environmental compliance program.

In 2005, the Company absorbed a higher amount of environmental expenses in preparation for the audits of its seven Canadian treating plants by Environment Canada. Baseline assessments, known as Technical Recommendations Documents ("TRD's"), were carried out by environmental consultants in 2000 on all wood preserving plants in Canada on behalf of Environment Canada. In conformity with this government initiative, the Company submitted plans of action to respond to all recommendations. The compliance deadline for completing the plans of action was December 31, 2005 and the Company expects to receive confirmation in 2006 that it has met this deadline. While the majority of the compliance costs associated with this program have been capital in nature, certain one-time expenses were incurred in this final year.

The Company realized a foreign exchange gain of $151,000 for the year, compared to last year's foreign exchange loss of $360,000. The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to its sales and purchases in U.S. dollars by its Canadian based operations. The Company's wholly owned U.S. subsidiary is a self-sustaining foreign operation and unrealized foreign exchange gains and losses are deferred in shareholders' equity. The Company monitors its transactions in

U.S. dollars generated by Canadian based operations. Its basic hedging activity consists of entering into forward exchange contracts for the sale of U.S. dollars and purchasing certain goods and services in U.S. dollars. The Company will also consider forward exchange contracts for the purchase of U.S. dollars for significant purchases of goods and services that are not covered by natural hedges. On December 31, 2005, the Company had on hand foreign exchange contracts for the future sale of U.S. dollars totalling $4,000,000, at rates ranging from C$1.6040 to C$1.6125/US$1.00 (average – C$1.6084/US$1.00) and expiry dates ranging from July 2006 to December 2007. The unrealized net foreign exchange gain on these contracts totalled approximately $1.5 million as at December 31, 2005.

Amortization of property, plant and equipment totalled $3.3 million for the year, an increase of approximately $200,000 over the same period in 2004. This increase results from the significant capital expenditure made with respect to the TRD compliance program mentioned above, the Company's ongoing investment in plant and equipment improvements, and the additional capital assets acquired with the Webster acquisition.

Financial expenses for 2005 totalled $1.9 million, an increase of approximately $200,000 over the financial expenses of $1.7 million incurred in 2004. The increase is related to the short and long-term debt incurred to finance the Webster acquisition on August 31, 2005. Prior to that period, the Company's short and long-term debt levels were lower than last year.

Income tax expense totalled $6.2 million in 2005 versus $3.8 million in 2003, an increase of $2.4 million, reflecting the Company's vastly improved earnings before tax. The effective tax rate for 2005 was 33.4%, compared to 34.0% in the prior year. Capital and other non-income based corporate taxes now represent a lower percentage component of the Company's total tax burden.

Net earnings

Net earnings for the year totalled $12.3 million, or $1.18 per share, compared to $7.3 million, or $0.72 per share, in 2004. This represents a year-over-year net earnings increase of $5.0 million, or 69.1%.

BUSINESS ACQUISITION

On August 31, 2005, the Company's wholly owned U.S. subsidiary, Stella-Jones Corporation, acquired the assets of Webster. Webster was a privately-held producer and marketer of pressure treated wood railway ties based in Bangor, Wisconsin, U.S.A. The total purchase price was $18.1 million (US$15.6 million). Assets acquired include the Webster production plant in Bangor, Wisconsin, as well as all related inventories and accounts receivables. In addition to being accretive to earnings, this acquisition represents Stella-Jones' first manufacturing facility in the United States and provides the Company greater access to the U.S. market. As well, the Company's new wholly owned U.S. subsidiary creates a vehicle to capitalize on future acquisition opportunities in the United States.

The acquisition has been accounted for using the purchase method and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as of the acquisition date. The detail of the assets acquired and the liabilities assumed can be found in note 4 of the Company's audited consolidated financial statements for the year ended December 31, 2005. The results of operations of the Bangor plant have been included in the consolidated financial statements from the acquisition date.

Stella-Jones Corporation is considered a self-sustaining foreign operation and the assets and liabilities are translated into Canadian dollars at the period-end exchange rate. Revenue and expenses are translated at the weighted average exchange rate for the period. Unrealized gains and losses on the net investment are deferred and included in cumulative translation adjustment in shareholders' equity. As at December 31, 2005, the cumulative translation adjustment was an unrealized loss of approximately $202,000.

Financing for the transaction was provided by a $5.0 million private equity placement with the Company's majority shareholder, Stella Jones International S.A., at a price of $9.00 per common share, $4.0 million in new term loans arranged with the Company's Canadian bankers, and a $1.3 million (US$1.1 million) term loan with Stella-Jones Corporation's U.S. banker. The balance of the purchase price was temporarily financed by the Company's existing demand operating loan in Canada, with working capital provided by a new available operating line of credit of $11.6 million (US$10.0 million) from Stella-Jones Corporation's U.S. banker.

QUARTERLY RESULTS

Consistent with the Company's history, sales followed a seasonal pattern, with pole, tie and industrial lumber shipments strongest in the second and third quarters to provide industrial end users with product for their summer maintenance projects. Consumer lumber treatment sales also follow a similar seasonal pattern. In the fall and winter seasons there tends to be less activity, thus the first and fourth quarters are typically characterized by relatively lower sales levels.

The Company posted sales gains and increases in net earnings in each of the four quarters in 2005, compared to the corresponding periods in 2004. However, sales and earnings growth in the fourth quarter were particularly strong due to the performance of assets acquired by the Company in August 2005.

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

Quarterly results

2005

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
Sales	30,904	46,017	42,845	37,363	157,129
Operating earnings before amortization of property, plant and equipment [1]	3,427	7,336	6,665	6,294	23,722
Operating earnings [1]	2,671	6,535	5,818	5,421	20,445
Net earnings	1,543	4,093	3,521	3,170	12,327
Net earnings per common share	0.15	0.40	0.34	0.29	1.18
Diluted net earnings per common share	0.15	0.39	0.32	0.27	1.13

2004

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
Sales	24,947	41,894	35,677	26,454	128,972
Operating earnings before amortization of property, plant and equipment [1]	2,764	5,964	4,204	2,862	15,794
Operating earnings [1]	2,016	5,203	3,478	2,020	12,717
Net earnings	1,008	3,038	1,966	1,279	7,291
Net earnings per common share	0.10	0.30	0.20	0.12	0.72
Diluted net earnings per common share	0.10	0.29	0.19	0.12	0.70

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

FOURTH QUARTER RESULTS

Sales for the fourth quarter of 2005 increased to $37.4 million, up 41.1% from the $26.5 million reported for the same period in 2004. The Company's two core markets, railway ties and domestic utility poles, accounted for all of the $10.9 million quarterly sales increase, while sales declined in the export pole, consumer lumber and industrial lumber sectors. Railway ties sales increased significantly during the fourth quarter compared to the fourth quarter of the prior year, primarily as a result of the contribution from the Company's newly-acquired plant in Bangor, Wisconsin. The decline in export pole sales is in line with the Company's decision to focus on the domestic pole market, while the decrease in industrial lumber sales is in comparison to last year's fourth quarter, which saw unusually strong sales on the East coast that were not repeated this year.

Gross margins as a percentage of sales increased by approximately 3.5% in the fourth quarter of 2005 compared to the fourth quarter of the prior year, primarily the result of higher margins on domestic utility pole and railway tie sales. This improvement also reflects the Company's focus on improving plant efficiencies and the benefits of economies-of-scale as it grows.

The net earnings for the fourth quarter of 2005 were $3.2 million, or $0.29 per share, compared to net earnings of $1.3 million, or $0.12 per share in the fourth quarter of 2004.

LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital at December 31, 2005 was $55.5 million, an increase of $18.9 million over last year's working capital balance of $36.6 million at the same date. The increase in current assets of $33.2 million is primarily related to the additional trade accounts receivable, inventories and prepaid expenses carried by Stella-Jones Corporation, the Company's wholly owned US subsidiary that holds the assets acquired in the Webster acquisition. The balance of the increase in accounts receivable reflects the strong sales in the fourth quarter of 2005 compared to 2004, while the increase in inventories is required to meet anticipated demand growth in both railway ties and utility poles in 2006.

Bank indebtedness at year end totalled $21.3 million, an increase of $9.9 million over the bank indebtedness of $11.4 million at the end of the prior year. Bank indebtedness includes the outstanding operating line of credit of $7.3 million (US$6.3 million) with the US bankers of Stella-Jones Corporation. Total availability under the Company's US operating line of credit is US$10.0 million. During the second quarter of the year, the Company's Canadian bankers reviewed their credit facilities and renewed them for an indefinite period, subject to periodic reviews. The terms and conditions remained basically unchanged, with the exception of the margin applicable to prime rate advances being reduced by 0.25% per annum, without the prior requirement to meet certain ratios. In December 2005, the Company refinanced certain of its long-term credit facilities to take advantage of lower long-term rates, to simplify security arrangements and to better match its short and long-term debt levels with the assets being financed. The Company arranged to borrow $10.0 million from its Canadian bankers under 60 month term loans, and $5.0 million from the *Fonds de solidarité des travailleurs du Québec (FTQ)* ("Fonds") by way of a new unsecured and non-convertible 7-year debenture bearing interest at 7.0%. The total proceeds were used to repay existing bank term loans of $6.2 million, the outstanding $2.5 million, 5-year debenture owing to the Fonds, and the $900,000 loan from ultimate shareholders that bore interest at 8.5%. The balance of $5.4 million served to reduce the Company's outstanding Canadian operating line of credit. The interest on the new Canadian bank term loans is fixed for their term at rates of approximately 5.9%. In the case of the $5.0 million debenture, the loan is payable in six (6) annual capital repayments of $333,333 starting in December 2006, with a final payment of $3.0 million payable at maturity. The Canadian bank term loans are payable in 20 quarterly capital instalments of $358,000, with the remaining balance of approximately $2.8 million payable at maturity. The increase in accounts payable and accrued liabilities of $3.6 million from December 31, 2004 to December 31, 2005 is consistent with the increases in operating activities, inventory levels and the addition of the Bangor operations.

Long-term debt increased by $9.0 million to reach $25.2 million as at December 31, 2005, compared to $16.2 million as at the prior year end. In addition to the $12.7 million of additional long-term debt drawn down on the loans arranged with its Canadian bankers and the Fonds, during the year the Company borrowed $4.0 million in additional term loans from its Canadian bankers to assist in the financing of the Webster acquisition. In addition, Stella-Jones Corporation (SJ Corp) arranged a $1.3 million (US$1.1 million) term loan with its US bankers to fund fixed assets. The U.S. term loan is fixed for its 5-year term at 7.2%. SJ Corp also

borrowed $872,250 (US$750,000) from Stella Jones International S.A. by way of a long-term note as part of the Webster acquisition financing. SJ Corp also assumed an unsecured note payable of $1.4 million (US$1.2 million) to a former general partner of Webster, pursuant to the acquisition.

Cash flow from operating activities was $16.0 million for the year ended December 31, 2005, compared to $10.9 million for the prior year. After taking into account the changes in non-cash working capital components, total cash generated for the twelve months ended December 31, 2005 was $2.1 million, versus $8.9 million a year earlier. The Company's net financing activities, consisting of increases in short and long-term bank and other borrowings, the proceeds of the private equity placement related to the business acquisition and issues of shares under the employee share purchase plan, less repayments of long-term debt and the payment of annual dividends, generated another $21.6 million of cash. The primary uses of cash were for the Webster acquisition ($18.0 million – See business acquisition above) and for capital acquisitions ($6.1 million). Of the $6.1 million disbursed for capital acquisitions in 2005, $3.8 million was spent on environmental investments required to complete the Technical Recommendations Documents ("TRD") baseline assessments undertaken by Environmental Canada in the year 2000. The Company expects to receive confirmation in 2006 that all of its Canadian treating plants are TRD compliant. The remainder of the capital acquisitions were for equipment upgrades, major renovations and repairs.

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

CONTRACTUAL OBLIGATIONS

Payments due by period

(thousands of dollars)	Total $	Less than 1 year $	1-3 years $	4-5 years $	After 5 years $
Long-term debt	25,201	4,003	7,453	7,952	5,793
Capital lease obligations	112	64	48	—	—
Operating leases	4,458	920	1,236	597	1,705
Total contractual obligations	29,771	4,987	8,737	8,549	7,498

YEAR 2004 COMPARED TO 2003

Fiscal 2004 was marked by an impressive 33.6% growth in sales to $129.0 million from $96.5 million in 2003. This significant increase is, in part, a result of a full year's sales contribution from the operations of the three treating plants acquired from Cambium Group Inc. in July 2003, compared to the five-month contribution included in the prior year's sales. All four major product categories posted sales increases in 2004 compared to the prior year, with the majority of the increases coming from the Company's core domestic utility pole and railway tie markets.

The Company demonstrated its commitment to the wood preserving industry and its objective to act as an industry consolidator with the April 2004 acquisition of certain wood treating assets of Québec-based *Les Industries Légaré (1998) Ltée* ("Légaré"), a privately held producer and marketer of pressure treated wood products primarily serving the industrial market. Assets acquired consisted of inventories of green and treated wood poles and certain production equipment related to the pressure treated wood operations. All wood treating production equipment purchased was removed and transferred to several of the Company's other treating facilities. No other assets were purchased and Légaré retained ownership of its previous operating site. The total purchase price was approximately $2.0 million, with $1.4 million allocated to inventories, and $600,000 to property, plant and equipment. The consideration was cash, except for a balance of sale of $150,000 payable one year from the date of acquisition, and was financed through the Company's existing bank operating line.

Net earnings for the year ended December 31, 2004 totalled $7.3 million, or $0.72 per share, up 94.2% from $3.8 million, or $0.40 per share in 2003, reflecting the Company's focus on reducing costs through economies-of-scale and plant specialization.

SHARE AND STOCK OPTION INFORMATION

As at March 14, 2006, the capital stock issued and outstanding consisted of 10,911,710 common shares (10,234,639 as at December 31, 2004 and 10,880,840 as at December 31, 2005).

As at March 14, 2006, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 241,355 (December 31, 2005 – 272,225) of which 185,355 (December 31, 2005 – 210,225) were exercisable. On May 6, 2003, the Company granted to its President and Chief Executive Officer, under a Stock Option Agreement, 300,000 options to acquire an equivalent number of common shares at an exercise price of $2.99 per share. The Stock Option Agreement also provides the President with the option of receiving cash in lieu of shares. These options become exercisable on May 6, 2008, or earlier, upon the occurrence of certain triggering events.

DIVIDENDS

On March 18, 2003, the Board of Directors adopted a modification to the Company's dividend policy whereby a dividend would be considered on a semi-annual rather than on an annual basis. On March 16, 2005, and August 9, 2005, the Board of Directors declared semi-annual dividends of $0.05 per common share. In light of the Company's strong financial performance in fiscal 2005 and solid expectations for 2006, on March 15, 2006, the Board of Directors resolved to increase the next semi-annual dividend to $0.06 per common share.

The declaration, amount and date of any future dividends will continue to be considered by the Board of Directors of the Company based upon and subject to the Company's earnings and financial requirements, any covenants in its loan documentation and other conditions prevailing at the time. There can be no assurance as to the amount or timing of such dividends in the future.

RISKS AND UNCERTAINTIES

Management considers that the Company may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. Nevertheless, the Company's overall competitiveness in this industry is strengthened by its access to a high quality timber supply provided by its long-term cutting licenses and it long-standing relationships with private woodland owners and other suppliers.

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

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

Under various federal, provincial and local laws and regulations, the Company could, as the owner, lessor or operator, be liable for the costs of removal or remediation of contamination at its sites. The remediation costs and other costs required to clean up or treat contaminated sites could be substantial. However, in certain cases, the Company benefits from indemnities from the former owners of its sites.

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

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

OFF-BALANCE SHEET ARRANGEMENTS AND FINANCIAL INSTRUMENTS

For details pertaining to off-balance sheet arrangements and financial instruments, refer to note 14 to the Company's audited consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's significant accounting policies are described in note 1 to the December 31, 2005 audited consolidated financial statements.

The Company prepares its consolidated financial statements in conformity with Canadian generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates and such differences could be material. Estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

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

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

CHANGES IN ACCOUNTING POLICIES
IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

Financial instruments

In January 2005 and subsequently updated in November 2005, the CICA issued new accounting proposed standards in relation with financial instruments: Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", Section 1530, "Comprehensive Income" and Section 3251, "Equity". Standards 3855, 3865, 1530 and 3251 apply to fiscal years beginning on or after October 1, 2006. These proposals are more fully described in note 3 to the December 31, 2005 audited consolidated financial statements.

Non-monetary transactions

In June 2005, the CICA issued a new standard to measure an asset or liability exchanged or transferred in a non-monetary transaction at fair value. This standard enhances existing Standard 3830. The new standard is effective for transactions initiated in periods beginning on or after January 1, 2006.

The application of the new accounting standards for financial instruments and non-monetary transactions is not expected to have a significant effect on the Company's financial position or results of operations. It may require the Company to present a new financial statement entitled "Comprehensive Income".

DISCLOSURE CONTROLS

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures for the Company. A disclosure committee has been established and mandated to assure the reliability and timeliness of Company information disclosed to investors and the public.

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer, following an evaluation of the disclosure controls and procedures as of December 31, 2005, concluded that the controls and procedures are adequate and effective in assuring that all material information relating to the Company and its subsidiaries has been disclosed.

RELATED PARTY TRANSACTIONS

In 2005, the Company paid a total of $300,000 (2004 - $300,000) to its parent company and ultimate shareholders with respect to marketing and technical services fees and incurred interest expense of $105,190 (2004 - $76,500) with respect to loans to the same parties, as detailed in note 15 to the December 31, 2005 audited consolidated financial statements.

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

On July 29, 2005, the Company's wholly owned U.S. subsidiary, Stella-Jones Corporation, borrowed $872,000 (US$750,000) from Stella Jones International S.A. ("SJ International") by way of a subordinated term loan, repayable in full on August 3, 2011. The loan bears interest at LIBOR plus 4.5%. On August 31, 2005, by way of a private equity placement, the Company issued 555,556 common shares to its parent company, SJ International, at a price of $9.00 per common share. SJ International now owns 6,910,556 common shares of the Company's outstanding common shares, or 63.3%, on an undiluted basis. On December 20, 2005, as part of the refinancing discussed above in the capital and liquidity resources section, the Company repaid the $900,000 loan from its ultimate shareholders.

OUTLOOK

Given the strength of the Company's core markets, Management is optimistic about the Company's organic growth potential in 2006. The Company has a strong base of contracted sales and continues to benefit from its focus on optimizing its efficiency as it grows. With its strategically-located treating facilities, Stella-Jones has the treating capacity, sources of supply, and the purchasing power to respond to increased demands in all of its product sectors.

For many years, Stella-Jones has been firmly established as a leading supplier of railway ties in Canada. With the addition of its new plant in Bangor, Wisconsin, the Company is now well-positioned to grow its market share in the United States as well. The North American railroad industry is in a strong growth phase, with many national and short line railroads reporting record rail traffic. This trend is translating into increased demand for railway ties as railroads expand their capacity in busy corridors and maintain their existing infrastructure. For the first time in the Company's history, Management expects railway ties to become its largest product category in 2006.

Stella-Jones is the dominant player in the Canadian utility pole market, with an annual volume of about 125,000 wooden poles for use by electrical and telecommunications companies in transmission (larger poles) and distribution (smaller poles) projects. In addition to these annual volumes, pent-up demand continues to be strong in this segment as the average age of poles currently installed in Canada increases. Management anticipates that utilities will return to a full maintenance program for their pole infrastructure, which would eventually lead to a sales increase in poles.

Industrial lumber sales are typically strongest on the East and West coasts, where marine applications predominate. Despite soft demand in the fourth quarter of 2005, Management continues to see industrial lumber as a growth category going forward.

Continued growth in housing starts and the home renovation market are expected to benefit the Company's sales volumes for consumer lumber in 2006. The Company added several locations to the network of retail outlets carrying its products in late 2005 and Management anticipates an increased level of shipments in this segment.

Strategic acquisitions will also continue to be an important part of Management's growth plan for Stella-Jones. The Company has the financial capability to act as an industry consolidator and Management will continue to pursue acquisition opportunities that meet its stringent investment criteria. In that regard, subsequent to year-end, the Company announced that it is currently in discussions to acquire Bell Lumber & Pole Company. Bell is a privately-held manufacturer of wood utility poles in Canada and the United States with annual sales of approximately US$60 million. It is also involved in the remanufacturing and treating of dimensional lumber in Alberta.

March 15, 2006

Consolidated Financial Statements

December 31, 2005 and 2004

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, BDO Dunwoody 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 three 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

Westmount, Québec
March 15, 2006

Auditors' Report

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheet of Stella-Jones Inc. as at December 31, 2005 and the consolidated statements of earnings, retained earnings and cash flows for the year then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Comparative figures for the year ended December 31, 2004 were audited by other auditors.

Chartered Accountants
Montréal, Québec
March 15, 2006

Consolidated Balance Sheets

As at December 31	2005	2004
Assets		
Current		
Accounts receivable (Note 5)	$ 21,059,721	$ 13,205,649
Inventories (Note 6)	77,316,420	52,769,898
Prepaid expenses	1,611,755	857,582
Future income taxes (Note 10)	550,000	522,000
	100,537,896	67,355,129
Property, plant and equipment (Note 7)	37,003,106	30,543,495
Future income taxes (Note 10)	350,000	301,000
	$ 137,891,002	$ 98,199,624
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness (Note 8)	$ 21,311,735	$ 11,420,760
Accounts payable and accrued liabilities	17,452,438	13,878,043
Income taxes	2,227,785	1,774,917
Current portion of long-term debt (Note 8)	4,061,370	3,699,048
	45,053,328	30,772,768
Long-term debt (Note 8)	21,139,874	12,485,436
Future income taxes (Note 10)	5,089,000	4,784,000
Employee future benefits (Note 11)	978,649	872,380
	72,260,851	48,914,584
Shareholders' equity		
Capital stock (Note 9)	26,228,300	20,954,892
Cumulative translation adjustment (Note 12)	(201,646)	—
Retained earnings	39,603,497	28,330,148
	65,630,151	49,285,040
	$ 137,891,002	$ 98,199,624

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

On behalf of the Board

Tom A. Bruce Jones, CBE
Director

Richard Bélanger, FCA
Director

Consolidated Statements of Retained Earnings

For the years ended December 31	2005	2004
Balance – beginning of year	$ 28,330,148	$ 21,846,564
Net earnings for the year	12,326,861	7,291,109
	40,657,009	29,137,673
Dividends on common shares	(1,053,512)	(807,525)
Balance – end of year	$ 39,603,497	$ 28,330,148

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

Consolidated Statements of Earnings

For the years ended December 31	2005	2004
Sales	$ 157,128,551	$ 128,972,067
Expenses (income)		
Cost of sales	125,100,344	105,745,054
Selling and administrative	8,439,612	7,319,579
Foreign exchange (gain) loss	(150,768)	360,008
Amortization of property, plant and equipment	3,277,093	3,076,849
Write-down of property, plant and equipment	—	273,956
Loss (gain) on disposal of property, plant and equipment	17,383	(520,320)
	136,683,664	116,255,126
Operating earnings	20,444,887	12,716,941
Financial expenses (Note 8)	1,946,026	1,668,832
Earnings before income taxes	18,498,861	11,048,109
Provision for income taxes (Note 10)		
Current	5,944,000	3,064,000
Future	228,000	693,000
	6,172,000	3,757,000
Net earnings for the year	$ 12,326,861	$ 7,291,109
Net earnings per common share (Note 9)	$ 1.18	$ 0.72
Diluted net earnings per common share (Note 9)	$ 1.13	$ 0.70

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

Consolidated Statements of Cash Flows

For the years ended December 31	2005	2004
Cash provided by (used in)		
Operating activities		
Net earnings for the year	$ 12,326,861	$ 7,291,109
Adjustments for		
Amortization of property, plant and equipment	3,277,093	3,076,849
Write-down of property, plant and equipment	—	273,956
Loss (gain) on disposal of property, plant and equipment	17,383	(520,320)
Employee future benefits	106,269	86,863
Stock-based compensation	18,955	17,244
Future income taxes	228,000	693,000
	15,974,561	10,918,701
Changes in non-cash working capital components		
Accounts receivable	(5,217,107)	(1,231,826)
Inventories	(11,280,636)	(2,734,331)
Prepaid expenses	(746,628)	(324,657)
Accounts payable and accrued liabilities	2,921,435	631,023
Income taxes	452,868	1,638,439
	2,104,493	8,897,349
Financing activities		
Increase (decrease) in bank indebtedness	9,890,975	(8,106,832)
Increase in long-term debt	20,379,008	5,759,829
Repayment of long-term debt	(12,826,522)	(2,358,201)
Proceeds from issuance of common shares	5,254,453	498,460
Dividends on common shares	(1,053,512)	(807,525)
	21,644,402	(5,014,269)
Investing activities		
Business acquisitions	(17,953,798)	(1,883,704)
Purchase of property, plant and equipment	(6,107,522)	(2,914,542)
Proceeds from disposal of property, plant and equipment	231,000	915,166
	(23,830,320)	(3,883,080)
Effect of translation adjustment	81,425	—
Net change in cash and cash equivalents during the year	—	—
Cash and cash equivalents – beginning and end of year	$ —	$ —
Supplemental disclosures		
Interest paid	$ 1,770,887	$ 1,668,924
Income taxes paid	$ 5,168,398	$ 1,433,060

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

Notes to Consolidated Financial Statements
December 31, 2005 and 2004

1. DESCRIPTION OF THE BUSINESS

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

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries, Guelph Utility Pole Company Ltd., I.P.B. – W.P.I. International Inc., and since August 31, 2005, (Note 4) the accounts of Stella-Jones Corporation ("SJ Corp"), using the purchase method.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. It is reasonably possible that actual results could differ in the near term 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.

Fair market value of financial instruments

The Company has estimated the fair market value of its financial instruments based on current interest rates, market value and current pricing of financial instruments with similar terms. Unless otherwise disclosed herein, the carrying value of these financial instruments, especially those with current maturities such as accounts receivable and accounts payable and accrued liabilities, approximates their fair market value.

Revenue recognition

Sales are recognized upon delivery of the products if the payment terms are not subject to acceptance criteria. If an acceptance period is stipulated, revenues are recognized upon customer acceptance.

Revenue from treatment service is recognized when the service is rendered.

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.

Inventories

Inventories of raw materials are valued at the lower of average cost and replacement cost. 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.

Property, plant and equipment

Property, plant and equipment 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 which are generally as follows:

Buildings	up to 40 years
Production equipment	10 to 20 years
Rolling stock	5 to 10 years
Anti-pollution equipment	10 to 20 years
Office equipment	2 to 5 years

Impairment of long-lived assets

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

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 enacted income tax rates to be in effect when these differences are expected to reverse. Future tax assets are recognized when it is more likely than not that the assets will be realized.

Employee future benefits

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

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-based compensation and other stock-based payments

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

Contributed surplus related to stock-based compensation is presented with capital stock.

Foreign currency transactions

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

The financial statements of Stella-Jones Corporation, a self-sustaining foreign operation, are translated using the rate in affect at the balance sheet date for assets and liabilities, and using the average exchange rates during the year for revenues and expenses. Adjustments arising from this translation are recorded in the cumulative translation adjustment in shareholders' equity.

Derivative financial instruments

Derivative financial instruments are utilized by the Company in the management of its foreign currency and interest rate exposures. The Company does not enter into financial instruments for trading or speculative purposes.

The Company enters into foreign exchange forward contracts to limit its exposure under contracted net 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 hedges for accounting purposes.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company assesses, both at the hedge's inception and on an ongoing basis, whether hedging relationships will be highly effective. Gains and losses on hedges of existing assets and liabilities are deferred. Unrealized gains or losses on anticipated transactions are not recorded in the consolidated financial statements until the transaction occurs. In the event a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized in income.

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 were exercised at the beginning of the year (or at the time of issuance, if later) and as if the funds obtained from exercise were used to purchase common shares of the Company at the average market price during the year.

3. CHANGES IN ACCOUNTING POLICIES

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

Financial instruments

In January 2005 and subsequently updated in November 2005, the CICA issued new accounting proposed standards in relation with financial instruments: Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", Section 1530, "Comprehensive Income" and Section 3251, "Equity". Standards 3855, 3865, 1530 and 3251 apply to fiscal years beginning on or after October 1, 2006.

Standard 3855 expands on Section 3860, "Financial Instruments – Disclosure and Presentation", by prescribing when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented.

Standard 3865 provides alternative accounting treatments to Standard 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline AcG-13, "Hedging Relationships", and the hedging guidance in Section 1650, "Foreign Currency Translation", by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

Standard 1530 introduces a new requirement to present certain revenues, expenses, gains and losses that otherwise would not be immediately recorded in income, in a comprehensive income financial statement with same prominence as other financial statements that constitute a complete set of financial statements.

Standard 3251 clarifies and establishes guidance for the presentation of equity and changes in equity during a reporting period.

Non-monetary transactions

In June 2005, the CICA issued a new standard to measure an asset or liability exchanged or transferred in a non-monetary transaction at fair value. This standard enhances existing Standard 3830. The new standard is effective for transactions initiated in periods beginning on or after January 1, 2006.

The application of the new accounting standards for financial instruments and non-monetary transactions may have a significant effect on the Company's financial position or results of operations. It will require the Company to present a new financial statement entitled "Comprehensive Income".

4. BUSINESS ACQUISITION

a) On August 31, 2005, the Company's wholly owned U.S. subsidiary, Stella-Jones Corporation, acquired the assets of Webster Wood Preserving Company, a Minnesota Limited Partnership ("Webster"). Webster was a privately held producer and marketer of pressure treated wood railway ties based in Bangor, Wisconsin, U.S.A. The assets acquired include the Webster production plant in Bangor, Wisconsin, as well as all related inventories and accounts receivable. The acquisition has been accounted for using the purchase method and accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as of the acquisition date. The results of operations of the Bangor plant have been included in the consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired at fair value (all amounts are expressed in Canadian dollars unless indicated otherwise):

Assets acquired	
Current assets	$ 16,331,198
Property, plant and equipment	3,997,577
	20,328,775
Liabilities assumed	
Current liabilities	744,428
Long-term debt	1,475,590
	2,220,018
	$ 18,108,757
Consideration	
Cash, including transaction costs of $787,642	$ 17,953,798
Reserve amount, included in accounts payable	154,959
	$ 18,108,757

Financing for the transaction was provided by a $5.0 million private equity placement with the Company's majority shareholder, Stella Jones International S.A., at a price of $9.00 per common share, $4.0 million in new term loans arranged with the Company's Canadian bankers, and a $1.3 million (US$1.1 million) term loan with Stella-Jones Corporation's U.S. banker. The balance of the purchase price was financed by the Company's existing demand operating loan in Canada, with ongoing working capital financing for the U.S. operations provided by a new operating line of credit of $11.6 million (US$10.0 million) with Stella-Jones Corporation's U.S. banker.

b) On April 26, 2004, the Company acquired certain wood-treating assets of Les Industries Légaré (1998) Ltée, a privately held producer and marketer of pressure-treated wood products, primarily serving the industrial market. Assets acquired consisted of inventories and certain production equipment related to the pressure-treated wood operations. The total purchase price was $2,033,704. The consideration was cash, except for a balance of sale of $150,000 payable in one year from the date of acquisition, and was financed through the Company's existing bank operating line. The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired based on their estimated fair values as of the acquisition date, as follows:

Assets acquired	
Inventory	$ 1,456,652
Equipment	577,052
	$ 2,033,704
Consideration	
Cash, including transaction costs of $40,000	$ 1,883,704
Debt assumed included in liabilities	150,000
	$ 2,033,704

5. ACCOUNTS RECEIVABLE

	2005	2004
Trade	$ 20,671,727	$ 12,548,708
Other	387,994	656,941
	$ 21,059,721	$ 13,205,649

6. INVENTORIES

	2005	2004
Raw materials	$ 57,743,165	$ 38,763,858
Finished goods	19,573,255	14,006,040
	$ 77,316,420	$ 52,769,898

7. PROPERTY, PLANT AND EQUIPMENT

			2005
	Cost	Accumulated Amortization	Net
Land	$ 1,429,233	$ —	$ 1,429,233
Buildings	7,866,930	2,149,053	5,717,877
Production equipment	33,302,338	14,183,159	19,119,179
Rolling stock	1,726,458	1,591,067	135,391
Anti-pollution equipment	14,124,827	3,698,292	10,426,535
Office equipment	897,655	722,764	174,891
	$ 59,347,441	$ 22,344,335	$ 37,003,106

			2004
	Cost	Accumulated Amortization	Net
Land	$ 959,472	$ —	$ 959,472
Buildings	6,534,795	1,814,111	4,720,684
Production equipment	29,989,708	12,452,318	17,537,390
Rolling stock	1,517,482	1,416,787	100,695
Anti-pollution equipment	10,297,520	3,102,264	7,195,256
Office equipment	668,718	638,720	29,998
	$ 49,967,695	$ 19,424,200	$ 30,543,495

8. LONG-TERM DEBT

	2005	2004
Term loans (Note 8(a))	$ 14,960,013	$ 8,555,556
Unsecured and non-convertible debenture bearing interest at 7%, repayable after December 31, 2006 in six consecutive annual instalments of $333,333 and a last payment of $3,000,000 on December 21, 2012	5,000,000	—
Unsecured and non-convertible debenture, bearing interest at 8%, repayable by July 31, 2008	—	2,500,000
Loans from ultimate shareholders, unsecured and subordinated, bearing interest at 8.5%, repayable on demand after the repayment of the debenture, the capital loan and the term loans	—	900,000
Promissory note (Note 8(b))	872,250	—
Promissory note (Note 8(c))	1,443,590	—
Promissory note (Note 8(e))	—	136,250
Mortgage loans (Note 8(d))	2,589,260	3,570,836
Obligations under capital leases (Note 8(h))	103,779	197,825
Term note unsecured, bearing interest at 4.75%, payable in monthly instalments of $8,333 and maturing in March 2008	232,352	324,017
	25,201,244	16,184,484
Less: Current portion	4,061,370	3,699,048
	$ 21,139,874	$ 12,485,436

a) The Company has available three bank credit facilities: two arranged with Canadian banks to fund Canadian operations, and a third arranged with a US bank to fund the operations of the Company's wholly owned US subsidiary, Stella-Jones Corporation ("SJ Corp").

The primary Canadian facility comprises a demand operating loan of $30,000,000 which includes a bid and performance bond guarantee facility of up to a maximum of $5,000,000, a term loan facility of $5,000,000 to assist in refinancing short and long-term debt, a term loan of $2,000,000 to assist in financing the August 31, 2005 business acquisition (See Note 4(a)), a $3,512,289 capital lease facility, a demand revolving line of credit in the amount of $6,562,000 for the purchase of forward exchange contracts with an aggregate nominal value of $25,000,000, and an interest rate swap facility for up to the full amount outstanding under the term loans of $7,000,000.

The second Canadian facility comprises a term loan of $1,900,000 to assist in financing the August 31, 2005 business acquisition (See Note 4 (a)), a term loan of $5,000,000 to refinance existing credit facilities and for general corporate purposes and an amount not exceeding US $5,000,000 to purchase foreign currency exchange contracts.

The US bank credit facility comprises a US $10,000,000 operating line of credit and a US $1,100,000 term loan to fund fixed assets.

The Canadian demand operating loan of $30,000,000 bears interest at the bank's prime rate. The term loan of $2,000,000 was disbursed on September 30, 2005 and bears interest at a fixed rate of 5.9% until maturity. It is repayable in 20 equal consecutive quarterly instalments of $100,000 beginning December 30, 2005 and matures September 30, 2010. An amount of $2,300,000 was drawn down against the term loan facility of $5,000,000 on December 28, 2005. Subsequent to year end, the balance was drawn down on February 1, 2006 to repay the balance of an outstanding term loan of $2,666,000, from a prior $4,000,000 term loan facility. All amounts owing under the $5,000,000 term loan are repayable in 19 equal consecutive principal repayments of $178,571 on each three-month anniversary of the date upon which the initial advance was made (December 28, 2005), and two balloon repayments of $739,286 and $867,865 constituting the 20th and final payment of the residual capital balance on December 28, 2010 and February 1, 2011 respectively. The loan bears interest at a fixed rate of 5.8% over the term of the loan.

The term loan of $1,900,000 in the second Canadian facility is repayable in 19 quarterly capital payments of $100,000 and matures on October 2, 2010. It bears interest at a fixed rate of 5.9% over its term. The term loan of $5,000,000 in the second Canadian facility was disbursed on December 28, 2005. It is repayable in 20 quarterly capital payments of $179,000 beginning 90 days after the disbursement, with the remaining balance payable on maturity date of December 21, 2010. The loan bears interest at a fixed rate of 5.9% over the term of the loan.

The US $10,000,000 operating line of credit bears interest at the US prime rate plus 0.25%. The US$1,100,000 term loan was disbursed on September 1, 2005 and is repayable in 59 consecutive monthly instalments of US$18,333, and one final payment of the remaining capital balance on September 1, 2010. The interest rate on the term loan is fixed at 6.79% over its term.

8. LONG-TERM DEBT (CONTINUED)

As collateral for the Canadian demand operating loan, the bank holds moveable hypothecs and general security agreements over the universality of the Company's Canadian assets, creating a first charge over all of the Company's Canadian current assets and a shared first charge with the second Canadian bank over all of the balance of the Canadian assets, subject to prior loans approved by the Canadian bankers. The bank also holds a first ranking security under Section 427 of the Bank Act over the Company's Canadian inventories. The collateral for the Canadian term loans is a moveable hypothec over the universality of the Company's Canadian assets, creating a first charge over all the Company's Canadian fixed assets and a second ranking charge over the Company's Canadian current assets. This security is held *pari passu* by the Company's Canadian bankers.

As collateral for the US operating line of credit and the US term loan, the US bank holds a first security interest in all non-real estate assets of SJ Corp pursuant to the uniform commercial code covering all accounts receivable, inventory, equipment, furniture, documents, chattel paper and general intangibles presently owned and hereafter acquired, wherever located. There is no recourse to the Canadian parent company in the event of default by the US subsidiary. The Canadian parent company has signed an inventory repurchase agreement with the US banker whereby the parent company has agreed to purchase any or all inventory of the US subsidiary, at book value, upon any event of default by the US subsidiary, if requested by the US bank.

The Company must also respect certain covenants and ratios relating to its three bank credit facilities.

b) On July 29, 2005, SJ Corp borrowed $872,250 (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 6th annual anniversary of the date of disbursement or August 3, 2011. The note is unsecured and subordinated in right of payment to the prior payment in full of the US subsidiaries loans to all of its secured lenders.

c) Pursuant to the business acquisition on August 31, 2005 (See Note 4(a)), SJ Corp assumed an unsecured note payable to a former general partner of Webster Wood Preserving Company Ltd. The imputed interest rate of the note is 8% and is payable in quarterly instalments of US$52,891 including interest through October 2013.

d) The mortgage loans bear interest at a weighted average rate of 5.6% as at December 31, 2005 (December 31, 2004 – 5.6%) and certain specific property, plant and equipment with a net book value of $5,062,874 (December 31, 2004 – $6,769,023) have been pledged as collateral. The loans are repayable in monthly instalments of $97,501 including interest and mature at various dates to November 2008.

e) Pursuant to the acquisition of Guelph Utility Pole Company Ltd. in 2000, the Company issued to the vendor a promissory note bearing interest at prime rate, subject to a floor of 5% and a ceiling of 7%, repayable in quarterly instalments of $136,250 and maturing in March 2005.

f) The aggregate fair value of the Company's long-term debt was estimated at $ 28,427,904 as at December 31, 2005 (December 31, 2004 – $16,363,838) based on discounted future cash flows using interest rates available to the Company for issues with similar terms and average maturities.

g) The aggregate amount of the principal portion of the long-term debt payments, excluding the obligation under capital leases, required in each of the next five years to meet retirement provisions is as follows:

2006	$ 4,002,576
2007	3,656,541
2008	3,796,365
2009	3,156,019
2010	4,796,017

h) Future minimum payments under capital leases are as follows:

2006	$ 63,987
2007	20,448
2008	27,737
Total future minimum lease payments	112,172
Less: Interest (weighted average rate of 6.9%)	8,393
Balance of obligation	103,779
Less: Current portion	58,794
	$ 44,985

8. LONG-TERM DEBT (CONTINUED)

i) Financial expenses are detailed as follows:

	2005	2004
Interest on long-term debt	$ 1,005,647	$ 943,631
Other interest	940,379	725,201
	$ 1,946,026	$ 1,668,832

9. CAPITAL STOCK

a) Capital stock includes the following:

Authorized

An unlimited number of preferred shares issuable in series;

An unlimited number of common shares.

Issued

	2005		2004	
	Shares		Shares	
Balance – beginning of year	10,234,639	$ 20,920,348	10,012,961	$ 20,421,888
Private placement (Note 4(a))	555,556	5,000,000	—	—
Stock option plan	83,450	195,620	211,278	457,388
Share purchase plan	7,195	58,833	10,400	41,072
	10,880,840	26,174,801	10,234,639	20,920,348
Stock-based compensation – contributed surplus (Note 9(f))	—	53,499	—	34,544
Balance – end of year	10,880,840	$ 26,228,300	10,234,639	$ 20,954,892

b) Net earnings per common share are calculated using the weighted average number of common shares outstanding during the year. Diluted net earnings per common share are calculated using the weighted average number of common shares outstanding during the year based on the application of the treasury stock method for the calculation of the dilutive effect of stock options, warrants and other dilutive securities.

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

	2005	2004
Net earnings applicable to common shares	$ 12,326,861	$ 7,291,109
Weighted average number of common shares outstanding	10,451,098	10,082,082
Effect of dilutive stock options and warrants	431,723	273,367
Weighted average number of diluted common shares outstanding	10,882,821	10,355,449
Net earnings per common share	$ 1.18	$ 0.72
Diluted net earnings per common share	$ 1.13	$ 0.70

c) Stock Option Plan

The Company has a stock option plan for directors, officers and employees whereby the Board of Directors or a committee appointed for such purpose 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 or such committee. The stated purpose of the Stock Option 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 Stock Option Plan adopted on June 13, 1994 and amended on May 3, 1995 and on March 15, 2001, the aggregate number of common shares in respect of which options may be granted is 800,000, and no optionee is able to hold options to purchase common shares exceeding 5% of the number of common shares outstanding from time to time. One-fifth of the options granted may be exercised within each year following the grant date. The exercise price of an option shall not be lower

9. CAPITAL STOCK (CONTINUED)

than the closing price of the common shares on the Toronto Stock Exchange on the last trading day preceding the granting of the option 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, 180 days following the date on which such optionee ceases to be a director of the Company.

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

	2005		2004	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding – beginning of year	285,675	$ 2.21	499,810	$ 2.19
Exercised	83,450	2.34	211,278	2.16
Granted	70,000	13.00	—	—
Cancelled	—	2.15	2,857	2.15
Outstanding – end of year	272,225	$ 4.94	285,675	$ 2.21
Options exercisable – end of year	210,225	$ 2.88	214,890	$ 2.23

The following options were outstanding under the Stock Option Plan as at December 31, 2005:

	Options outstanding		Options exercisable		
Year granted	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price	Expiration date
1996	9,300	$ 2.10	9,300	$ 2.10	2006
2001	186,925	2.16	186,925	2.16	2011
2002	6,000	2.00	—	2.00	2012
2005	70,000	13.00	14,000	13.00	2015
	272,225		210,225		

d) Warrants

Warrants outstanding allow for the subscription to 190,000 common shares at an exercise price of $4.10 per share before July 31, 2008.

e) Stock Option Agreement

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

The Stock Option Agreement provides that the options are exercisable at a price of $2.99 in whole or in part, commencing on May 6, 2008, or earlier in the event of a loss or change in control of the Company, the closing of a going private transaction, or the occurrence of termination without cause (each one being a "Triggering Event"). The Stock Option Agreement also provides the President with the option of receiving cash in lieu of shares. The right to exercise these options terminates on May 6, 2013 or, in the case of a Triggering Event, within thirty days of the event.

9. CAPITAL STOCK (CONTINUED)

f) Stock-based compensation

The Company records expenses for the fair value of the stock options granted under the Stock Option Plan and the Stock Option Agreement 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.

In 2005, 70,000 options (2004 – nil) were granted, their fair value was $187,040 (2004 – nil) and the expense amortized to earnings was $18,955 (2004 – $17,244). The fair value was estimated with the following weighted average assumptions:

		2005
Risk-free interest rate		4.0 %
Dividend yield		1.0 %
Expected lives (years)		8.6
Volatility		4.05 %
Weighted average of fair value of options granted during the year	$	2.67

g) Employee Share Purchase Plan

The aggregate number of common shares reserved for issuance under the Employee Share Purchase Plan is 180,000. Under this plan, employees are eligible to purchase common shares from the Company at a price of 90% of the market value. In 2005, 7,195 shares (2004 – 10,400) were issued under this plan at an average price of $8.18 per share (2004 – $3.95). As at December 31, 2005, the total number of shares issued under this plan is 121,785 (December 31, 2004 – 114,590).

10. INCOME TAXES

a) Current future income tax assets relate mainly to accrued liabilities, whereas long-term future income tax assets relate mainly to employee future benefits. Long-term future income tax liabilities relate mainly to property, plant and equipment.

b) The effective income tax rate differs from the basic Federal and Provincial rates due to the following:

	2005 %	2004 %
Basic Federal rate less Provincial deduction	22.59	22.12
Combined Provincial tax rates	12.15	12.55
	34.74	34.67
Manufacturing and processing profit deduction	(0.67)	(0.40)
Other	(0.71)	(0.26)
Effective income tax rate	33.36	34.01

11. EMPLOYEE FUTURE BENEFITS

The Company offers employees benefits consisting of group health and dental care, life insurance and complementary retirement benefits. These plans are not funded.

a) The following information pertains to the Company's plans as established by independent actuaries:

	2005	2004
Change in accrued benefit obligation		
Balance – beginning of year	$ 913,978	$ 846,363
Current year service costs	62,688	59,139
Interest on obligation	58,126	52,154
Benefit payments	(15,772)	(14,806)
Curtailment loss (gain)	—	(28,872)
Actuarial loss	242,670	—
Balance – end of year	$ 1,261,690	$ 913,978
Net obligation – End of year	$ 1,261,690	$ 913,978
Less: Unamortized net actuarial loss	266,103	23,433
Unamortized past service costs	16,938	18,165
Accumulated benefit obligation	$ 978,649	$ 872,380
Component of net benefit cost for the year		
Current year service cost	$ 62,688	$ 59,139
Interest on obligation	58,126	52,154
Actuarial loss (gain)	242,670	(10,860)
Elements of employee future benefits cost before adjustments to recognize the long-term nature of employee future cost	363,484	100,433
Adjustments to recognize the long-term nature of employee future benefits cost:		
Difference between net actuarial loss (gain) and actuarial loss (gain)	(242,670)	9
Amortization of past service costs	1,227	1,227
Benefit cost recognized	$ 122,041	$ 101,669

Cash payments for employee future benefits for the year ended December 31, 2005, amounted to $15,772 (2004 – $14,806).

b) The significant actuarial assumptions for the accrued benefit obligation and the benefit cost are the following:

	2005 %	2004 %
Discount rate	6.00	6.00
Salary escalation rate	4.00	4.00

For measurement purposes, a 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2005. This rate is assumed to decrease gradually by 0.5% per year, to reach 5%.

An increase or decrease of 1% in this rate would have the following impact:

	Increase of 1%	Decrease of 1%
Impact on accrued benefit obligation	$ 264,450	$ 218,651
Impact on benefit cost	28,754	23,220

12. CUMULATIVE TRANSLATION ADJUSTMENT

The cumulative translation adjustment represents the unrealized gain or loss on the Company's net investment in Stella-Jones Corporation, a self-sustaining foreign operation.

13. CONTINGENCIES AND COMMITMENTS

a) The Company has issued guarantees amounting to $638,740 (December 31, 2004 – $956,771) under various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on and, as such, no provisions have been recorded in the financial statements.

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

2006	$ 920,131
2007	718,464
2008	517,489
2009	363,206
2010	233,472
Thereafter	1,704,752

c) 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.

14. FINANCIAL INSTRUMENTS

Currency risks

The Company is exposed to currency risks due to its export of goods manufactured in Canada. These risks are partially covered by purchases. The Company also uses foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars. Sale prices on export contracts are generally established well in advance of shipment dates and, in order to protect margins from currency fluctuations, the company sells forward the U.S. dollars to be received. Purchase prices for goods sourced from American suppliers are usually established at the order date and are also subject to currency fluctuations in the period from the date ordered to the date received. To manage this risk, the Company purchases forward the U.S. dollars required to pay these suppliers. As at December 31, 2005, the forward exchange sales contracts aggregate a nominal amount of US$4,000,000 (December 31, 2004 – US$6,000,000), with expiry dates ranging from July 2006 to December 2007, and contracted rates ranging from 1.6040 to 1.6125. As at December 31, 2005, there were no forward exchange purchase contracts (December 31, 2004 – nil). As at December 31, 2005, the net unrealized foreign exchange gain on these contracts was $1,493,268 (December 31, 2004 – $1,916,023), which have not been recorded in these financial statements.

Interest rate risks

As at December 31, 2005, the Company had limited exposure to interest rate risk on long-term debt as only 3% (December 31, 2004 – 54%) of the Company's long-term debt is at variable rates.

The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

The Company had interest rate swap contracts that exchanged a notional amount of $2,300,000 and US$1,100,000 of debt from a floating to a fixed interest rate of 5.8% and 7.2% respectively and maturing on December 28, 2010 and September 1, 2010 respectively.

Credit risks

The geographic distribution of customers and procedures regarding commercial risk management limit the concentration of credit risks.

Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. The Company reduces this risk by dealing primarily with utility and telecommunications companies and other major corporations.

15. RELATED PARTY TRANSACTIONS

The Company had the following transactions with related parties:

	2005	2004
Parent company		
Marketing and technical service fees paid	$ 200,000	$ 200,000
Interest on promissory note	30,786	—
Ultimate shareholders		
Marketing and technical service fees paid	100,000	100,000
Interest on loans	74,404	76,500

15. RELATED PARTY TRANSACTIONS (CONTINUED)

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

As at December 31, the balance sheets include the following amounts with related parties:

	2005	2004
Accounts payable to parent company	$ 80,786	$ 50,000
Accounts payable to ultimate shareholders	25,000	63,774

16. SEGMENT INFORMATION

The Company operates within one dominant business segment, the production and sale of pressure treated wood. Operating plants are located in Nova Scotia, Quebec, Ontario, British Columbia, and the state of Wisconsin (USA). The Company also operates a distribution centre in the province of Newfoundland.

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

	2005	2004
Geographic sales information:		
Canada	$ 125,607,119	$ 107,056,120
U.S.A.	31,112,891	19,081,141
Other, primarily Mexico	408,541	2,834,806
	$ 157,128,551	$ 128,972,067

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

	2005	2004
Canada	$ 32,902,359	$ 30,543,495
U.S.A.	4,100,747	—
Total	$ 37,003,106	$ 30,543,495

In 2005, the Company had one customer representing 19% of its sales (2004 – 13% of sales).

17. SUBSEQUENT EVENT

On February 9, 2006, the Company announced that it was currently in discussions with the shareholders of Bell Lumber & Pole Company ("Bell") with respect to a possible acquisition by the Company or an affiliate of all of the shares of Bell. A privately-held company, Bell is a manufacturer of wood utility poles in Canada and the United States and is also involved in the remanufacturing and treating of dimensional lumber in Alberta. Bell has annual sales of approximately US$60 million.

The Company and the shareholders of Bell have entered into a non-binding letter of intent relating to the proposed acquisition. The transaction is subject to customary conditions, including the entering into of definitive agreements and the completion of due diligence by Stella-Jones. It is anticipated that the proposed transaction, if finalized, would close by June 30, 2006.

18. COMPARATIVE FIGURES

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

Directors & Officers

BOARD OF DIRECTORS

Richard Bélanger, FCA [1]
President,
Toryvel Group Inc.
(Holding company)
President,
Theseus Capital Inc.
(Capital pool company)
Québec, Québec
Director since March 1997

Tom A. Bruce Jones, CBE
Chairman of the Board,
Stella-Jones Inc.
Chairman of the Board,
James Jones & Sons Limited
(Forest products company)
Larbert, Scotland
Director since July 1993

George J. Bunze [1][2]
Vice-Chairman and Director,
Kruger Inc.
(Manufacturer of specialty wood and paper products)
Montréal, Québec
Director since May 2001

Gianni Chiarva [2]
Vice-Chairman of the Board,
Stella-Jones Inc.
President,
Stella S.p.A.
(Manufacturer of utility poles)
Chairman of the Board,
Sirti S.p.A.
(Designs, maintains and installs telecommunications, transmission and electrical systems)
Milan, Italy
Director since July 1993

Arthur P. Earle, C.M., F.E.I.C. [1][3]
Corporate Director,
Beaconsfield, Québec
Director since October 1992

Brian McManus
President and
Chief Executive Officer,
Stella-Jones Inc.
Westmount, Québec
Director since June 2001

Nycol Pageau-Goyette [2][3]
President,
Pageau Goyette et associés limitée
(Management services firm)
Chairperson,
Sorinco Inc.
(Pharmaceutical and cosmetic product recycling)
Montréal, Québec
Director since July 1993

Daniel Picotte [3]
Partner,
Fasken Martineau DuMoulin LLP (Law firm)
Montréal, Québec
Director since July 1993

(1) Member of the Audit Committee
(2) Member of the Remuneration Committee
(3) Member of the Environmental Committee

A full report of Stella-Jones' corporate governance practices is set out in the Proxy Circular for the May 4, 2006 Annual Meeting of Shareholders.

OFFICERS

Tom A. Bruce Jones, CBE
Chairman of the Board

Gianni Chiarva
Vice-Chairman of the Board

Brian McManus
President and
Chief Executive Officer

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

Marla Eichenbaum
Vice-President, General
Counsel and Secretary

Gordon Murray
Vice-President, Environment and Technology and General Manager, Atlantic Region

Martin Poirier
Vice-President and
General Manager,
Central Region

Rémi Godin, CGA
Comptroller

SUBSIDIARIES

Rick Thompson
Vice-President,
Guelph Utility Pole Company Ltd.

Robert Tilley
General Manager,
I.P.B. – W.P.I. International Inc.
dba Newfoundland Hardwoods

Douglas J. Fox
Manager, Engineering
and Operations
Stella-Jones Corporation

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.

AUDITORS

BDO Dunwoody LLP

LEGAL COUNSEL

Fasken Martineau DuMoulin LLP

Corporate information

ANNUAL MEETING OF SHAREHOLDERS

May 4, 2006
10:00 A.M.
Hôtel InterContinental Montréal
Salon Saint-Jacques
360 Saint-Antoine Street West
Montréal, Québec

STOCK INFORMATION

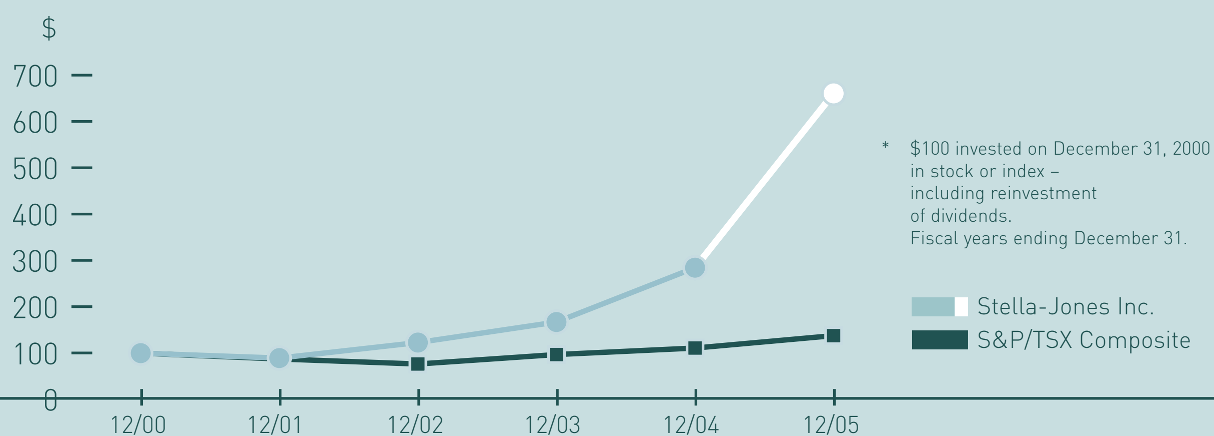
Shares listed: Toronto Stock Exchange
Ticker symbol: SJ
Initial public offering: 1994
Majority shareholder: Stella Jones International S.A. (63.3%)
52-week high/low (Jan. 1 – Dec. 31, 2005): $14.25/$5.70
Share price at March 15, 2006: $15.95
Common shares outstanding as at December 31, 2005: 10.88 million

DIVIDEND POLICY

The Board of Directors considers a dividend on a semi-annual basis, conditional upon the Company's financial performance and cash requirements. On March 15, 2006, in light of the Company's strong financial performance in fiscal 2005 and solid expectations for 2006, the Board of Directors resolved to increase the next semi-annual dividend to $0.06 per common share.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN*

Between Stella-Jones Inc. and the S&P/TSX Composite Index



* $100 invested on December 31, 2000 in stock or index – including reinvestment of dividends. Fiscal years ending December 31.

CUMULATIVE TOTAL RETURN

	2001	2002	2003	2004	2005
Close	$2.00	$2.75	$3.65	$6.10	$14.00
Price / earnings	40.0	6.7	9.1	8.5	11.9
Price / book value	0.57	0.70	0.86	1.27	2.32

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