Stella-Jones

Annual Report 2006

Building on Success

"The effective execution of our well defined business model can again claim principal credit for our Company's record-breaking performance. We remain rigorously committed to our core business, as well as to ongoing expansion and acquisition within our traditional target markets. It is a strategy that has consistently rewarded our shareholders."

Brian McManus
President and CEO

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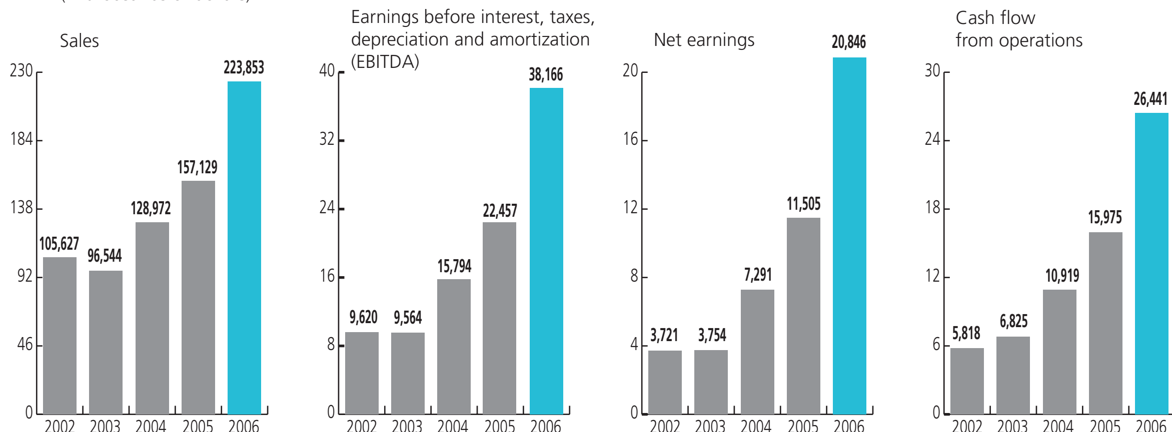
5-year Review

(thousands of dollars, except per share data and ratios)	2006 $	2005 $	2004 $	2003 $	2002 $
	For the years ended December 31				
Operating results					
Sales[1]	**223,853**	157,129	128,972	96,544	105,627
EBITDA[2]	**38,166**	22,457	15,794	9,564	9,620
Net earnings	**20,846**	11,505	7,291	3,754	3,721
Cash flow from operations[3]	**26,441**	15,975	10,919	6,825	5,818
Financial position					
Working capital	**79,966**	55,485	36,582	25,874	21,418
Total assets	**213,675**	137,891	98,200	93,351	69,436
Long-term debt[4]	**31,893**	26,466	16,184	12,783	7,028
Shareholders' equity	**105,822**	64,808	49,285	42,286	35,355
Per share data					
Net earnings per common share	**1.81**	1.10	0.72	0.40	0.41
Diluted net earnings per common share	**1.76**	1.08	0.70	0.39	0.41
Cash flow from operations[2,3]	**2.15**	1.47	1.07	0.68	0.64
Book value	**8.60**	5.96	4.82	4.22	3.91
Working capital	**6.50**	5.10	3.57	2.58	2.37
Average number of shares outstanding (000's)	**11,541**	10,451	10,082	9,456	9,048
Shares outstanding at year end (000's)	**12,298**	10,881	10,235	10,013	9,053
Average number of diluted shares outstanding (000's)	**11,868**	10,681	10,355	9,628	9,078
Dividend per share	**0.14**	0.10	0.08	0.08	—
Financial ratios					
Return on average equity	**24.4 %**	20.2%	15.9%	9.7%	11.1%
Long-term debt to equity[4]	**0.30:1**	0.41:1	0.33:1	0.30:1	0.20:1

1 Since 2004, freight costs are no longer included as a reduction from sales; accordingly, sales for 2002 and 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.



A Record Breaking Year

Stella-Jones is a leading manufacturer of treated wood utility poles and railway ties, as well as a treater and supplier of industrial and consumer lumber. At year end, the Company operated nine treating facilities in North America. In 2006, Stella-Jones reported the highest revenues in its history, commenced expansion of its Bangor, Wisconsin plant, acquired an important utility pole and consumer lumber treater in Alberta, and continued its consolidation of the industry by announcing its intention to purchase a tenth treating facility in the state of Washington and a pole peeling operation in the State of Idaho.

Highlights 2006

February

- The Company announced that it was in discussions with the shareholders of Bell Lumber & Pole Company ("Bell") with respect to a possible acquisition of Bell, and that the parties had entered into a non-binding letter of intent relating to the proposed acquisition.

March

- The Company declared a semi-annual dividend of $0.06 per share on the outstanding common shares of the Company.
- To partially fund the acquisition of Bell, the Company entered into an agreement with Acumen Capital Finance Partners Limited, pursuant to which Acumen agreed to purchase 265,000 subscription receipts of the Company for aggregate gross proceeds of $4,505,000. In addition, the Company entered into agreements with Stella Jones International S.A. and the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)* to purchase, respectively, 677,353 and 117,647 subscription receipts under the same terms.

May

- The Company closed the private placement of subscription receipts, previously announced in March.
- Announcing first quarter results, the Company reported strong ongoing growth in core railway tie and utility pole categories, with sales up 45% over the previous year's first quarter to $44.9 million, and net earnings up by 166% to $3.5 million.

June

- The Company completed, through a wholly-owned subsidiary, the acquisition of substantially all of the assets and operations of Bell Pole Company, an Alberta-based manufacturer of wood utility poles which is also involved in the remanufacturing and treating of dimensional lumber.
- Announcing second quarter results, the Company reported strong sustained growth in core railway tie and utility pole categories, with sales up 33% over the previous year's second quarter to $61.4 million, and net earnings up 38% to $5.4 million.

August

- The Company declared a semi-annual dividend of $0.08 per share on the outstanding common shares of the Company.

October

- Announcing third quarter results, the Company cited increased sales as a result of both acquisition and organic growth, with revenues up 59% over the previous year's third quarter to $68.1 million, and net earnings up more than double to $6.8 million.

November

- The Company announced it had entered into a non-binding letter of intent with respect to the acquisition of certain assets of the wood utility pole business of J.H. Baxter & Co. ("Baxter") in the state of Washington, as well as its pole peeling facility in Juliaetta, Idaho. Baxter's sales from its pole product group were approximately US$30million for the fiscal year ended December 31, 2005.

Chairman's Message

I am pleased and proud to report another record year for Stella-Jones. It has been a year of significant further achievement. Sales revenues reached $223.9 million from $157.1 million in 2005, and net earnings were $20.8 million, or $1.81 per share compared to $11.5 million and $1.10 per share in 2005.

During the year we acquired the assets of Bell Pole Company with operations in Alberta and British Columbia. Their results were consolidated into Stella-Jones for the final six months of 2006. We also had the benefit of the first full year's impact of Stella-Jones Corporation, our wholly-owned USA subsidiary in Bangor, Wisconsin. Some 80% of our revenue growth can be attributed to these two acquisitions, indicating also very positive organic growth in the rest of our business. It was especially encouraging that we achieved growth in all of our main business sectors.

The acquisition of Bell Pole Company was strategically important for Stella-Jones, firstly in geographical terms with its treatment plant at Carseland, Alberta; and secondly and crucially, in giving our group for the first time access to extensive cutting rights in British Columbia and Alberta for high quality cedar poles which are in heavy demand in electricity transmission lines. Our management, together with an experienced team at Bell Pole, achieved a rapid and almost seamless integration of the Bell business into the Stella-Jones group. Significant benefits and synergies have already been demonstrated.

I referred in my Chairman's Message last year to the importance of our first acquisition in the United States, and we followed this up with the announcement in November, 2006 that we were in negotiations with J.H. Baxter & Co. to acquire their pole assets in Washington and Idaho, USA. We closed this transaction at the end of February, 2007. This aquisition will give Stella-Jones Corporation a strong and well-balanced portfolio of wood pole and railway tie business in the West and Midwest of the United States.

During 2006, all our Canadian treatment plants were certified to the baseline requirements of the Technical Recommendations Documents of Environment Canada. I commend Gordon Murray, our VP Environment, for his work across the country in achieving these certifications. In the past five years, over half of our total authorised capital expenditures in Canada have gone into environmental projects and improvements at our plants. We can now concentrate a much higher proportion of our capital expenditures on productivity developments, and, in 2007, the major part of our capital budget will be for a new treating cylinder in Bangor, Wisconsin to help meet the rising demand for railway ties in the USA.

During the year, Rémi Godin, the Company's Comptroller and Wayne Hingley, Stella-Jones' General Manager, Western Region, were promoted to Vice-President. The Company also welcomed Ian Jones and Glen Ritchie to the senior management team in their roles respectively as Vice-President and General Manager, and Vice-President, Fibre of Bell Pole Canada Inc.

Nycol Pageau-Goyette has been a Director of Stella-Jones since 1993 and, in 2006, the Board approved her appointment as Lead Director in accordance with best practices of Corporate Governance. I thank Nycol for her sterling and on-going contribution to the Company.

The strong results in the first half of 2006 allowed the Board to announce, in August, an increase in the semi-annual dividend to 8 cents per share from the previous level of 6 cents. This was further increased to 10 cents per share in March 2007 reflecting confidence in the prospects for the business in 2007.

Our share price moved during the year from $13.80 to $34.50 at year end and traded volumes increased encouragingly. We now therefore have many new shareholders whom I welcome to our Company. To them I repeat a message I have referred to regularly in the past: Stella-Jones is linked for investment purposes with "forest products" companies. This is correct in so far as our base raw materials come from renewable forests,

but our main core products are totally unlike standard commodity products such as lumber, pulp or paper. Our products play a vital and integral part in the operation of power networks and of transportation and infrastructure systems. There are relatively few North American manufacturers of these products and only a small handful of these operate on such a broad geographical and multi-plant scale as Stella-Jones. We have great confidence in our future prospects and in our ability to expand our business in these core sectors whilst improving still further the full range of services and products we can offer to our customers.

On behalf of the Board I wish to thank our shareholders, customers, and suppliers for their continuing support and all of our employees for their excellent performance in 2006.

Tom A. Bruce Jones, CBE
Chairman of the Board

Last year we foresaw continued solid growth in the demand for railway ties and utility poles. Our calculation was borne out in both cases. We also anticipated additional opportunities for Stella-Jones in the U.S. market. Again, the forecast has been validated by impressive results in both our top and bottom lines.

President's Message

Building on success

In 2006, we continued to follow the well defined business model that has sustained our Company's growth over many years. The effective execution of this model can again claim principal credit for our record breaking performance this past year.

We remained rigorously committed to our core business, as well as to expansion and acquisition within our traditional target markets. This strategy was maintained because it has consistently succeeded in responding to industry challenges while generating increased revenue and profit, in addition to rewarding our shareholders. Results have once more proved that there is no better course for Stella-Jones to follow than doing what the Company does best, and doing progressively more of it.

While it may appear that Stella-Jones is simply in the business of treating harvested wood and transforming it into valuable product in the form of utility poles, railway ties, and consumer lumber, this is not the entire story. In fact, the business of Stella-Jones is linked in many ways to the global economy. As world trade, communications and energy transmission expand, so does demand for the products of Stella-Jones.

Here is the essential connection: the utility poles and railway ties that we manufacture help underpin the physical infrastructure of North America. Our business model, while basic, reflects the nature of our marketplace. We participate in general economic growth by enabling the distribution of energy and communications, and by helping to transport goods.

As our sales growth in 2006 showed, Stella-Jones is increasingly the supplier of choice for North American companies in those infrastructure-heavy fields. The Company's gross revenues grew to $223.9 million, up 42.5% from 2005. Net earnings also rose substantially to $20.8 million, a 81.2% improvement over the previous year.

A number of reasons account for that performance, and for our six years of uninterrupted growth. In regard to utility poles, for example, few competitors can match our range of product. We can supply the full gamut of pole sizes because of our extensive cutting rights, our financial capabilities, and our strong relationships with private wood suppliers. We bring uncommon strength into the bidding arena with our ability to offer 35-foot poles, 120-foot poles, and poles of any size in between – along with the production capacity to satisfy substantial orders from many of the largest users. Accordingly, we have become widely recognized as a powerful one-stop shop in our industry.

Our Company's steadily increasing revenues have resulted from both organic growth and the clients we gain through acquisitions – as well as from the multiplier effect afforded by the acquisitions. When we acquire a company, the addition of its local market represents only the immediate accretion. Its plant, products and expertise render us a stronger, more capable player generally; the acquired company extends our continental network, enriches our product line, and deepens our capacity to respond to clients. Customarily too, while an acquisition assists the Company as a whole to win new business, the synergy functions the other way as well – the Company enables the acquired asset to capture additional business in its own local market.

Benefits precisely like these came to fruition in 2006 as a result of our previous year's acquisition of the U.S. railway tie business of Webster Wood Preserving Company of Wisconsin. True to form for our acquired assets, the facility has substantially grown its market, such that we have begun a plant expansion. The addition of a treatment cylinder, slated to come on line in May of 2007, will increase our Wisconsin capacity by over a third.

We have similarly begun to unlock the potential of our most recent acquisition, Bell Pole Company of Alberta, which we acquired in July of 2006. This producer of utility poles and consumer lumber, now an important link in our coast-to-coast Canadian network and steadily expanding North American footprint, earned revenues of approximately $50 million in its last fiscal year. The acquisition has given us a plant in Canada's fastest growing province, where oil sands projects are driving the need for upgrades in all kinds of infrastructure – including the housing market, where consumer lumber sales are thriving.

Modern technological responses to the demand for energy rely heavily upon the basic components that Stella-Jones contributes to infrastructure. At the end of the day, for example, our railway ties play a role in the life of ethanol plants, and our utility poles are fundamental to the delivery function of wind farms. Although we may be relatively "low tech," we prosper in tandem with much high-tech innovation.

The acquisition has also brought us outstanding cutting rights in British Columbia and Alberta, and has strengthened our Company on the species side. We now have major access to cedar. Stella-Jones has always been strong in fir and pine, but less so in cedar. This widening of our offering is significant, because many utilities require not only different pole sizes, but poles of different species, or poles treated with different preservatives. The ability to satisfy the spectrum of demand with our own production allows us to engage new markets and, equally importantly, enlarge our relationships with existing clients.

Our Company's ongoing acquisition program remains methodical, unhurried, and highly strategic. As our advance into the U.S. market continues, we are not leapfrogging geographically nor diverging from our core businesses. We are staying within our scope of influence even as we extend its radius, and we are ensuring real synergies through strict selection of acquisition targets.

Our announcement late in 2006 in reference to our intended acquisition of the wood utility pole and pole peeling businesses of J.H. Baxter & Co. – with facilities in the northern states of Washington and Idaho – fits our expansion pattern perfectly. I am pleased to report that as announced, this transaction was succesfully closed on February 28, 2007.

We will continue to pursue only those companies whose assets would forcefully complement our core competence and supplement our traditional markets. It is this approach that has made Stella-Jones one of the largest suppliers on the continent of wood utility poles and wood railway ties. Still, vast scope remains for us, especially in the American market. It is there that we see our greatest growth, both organically and through acquisition. Given our Company's deep roots and already established position in Canada, the opportunity exists for Stella-Jones, over time, to consolidate the industry on a continental scale.

I wish to take this opportunity to thank our Board of Directors for their expertise and guidance, and to acknowledge the confidence of our shareholders, whose support has proven fundamental to the Company's growth. The tribute for that growth belongs in very large part to the people of Stella-Jones. Adhering to an entrepreneurial culture of continuous improvement, our talented managers, professionals and support staff all contributed importantly to this latest dynamic chapter in our history. I thank them, and look forward to reporting their achievements as they further build on the Company's success.

Brian McManus
President and
Chief Executive Officer

In this age of increasing environmental awareness, we are proud that all of our wood treatment plants in Canada have been fully certified by Canadian environmental authorities.

Products

SIGNIFICANT GROWTH IN CORE UTILITY POLE AND RAILWAY TIE MARKETS

Our record breaking sales figures in 2006 were a function of both organic growth and acquisition. The organic growth was particularly noteworthy in our two largest product categories, utility poles and railway ties. We can attribute the performance to robust positive momentum in the markets served by Stella-Jones, along with increased efficiency throughout our organization and the reliability of the widespread sourcing network we have built over many years. The extent of our wood sourcing is matched by no other producer in Canada. We are able to produce poles and railway ties to client specifications in all required species. These factors, together with strong contracted sales, signal solid growth for the foreseeable future.

Products

UTILITY POLES. Sustained growth and pent-up demand

Upwards of 150 million wood utility poles are currently in use in North America, lining the streets of cities and towns, and weaving through the rural landscape. They support the lines that transmit and distribute our communications and energy. Utility poles form a vital and ubiquitous component of the economy's physical infrastructure. While steel and cement alternatives exist, treated wood poles remain by far the favoured option. Their versatility and durability make them cost-effective. They are less expensive to produce, and more economical to transport. Another critical factor, wood poles are easier to service and maintain.

The utility pole category posted solid gains over the previous year, with sales rising 34.4%.

Stella-Jones is the premier producer of pressure treated wood poles in Canada, and one of the largest in North America. We are the only manufacturer of pressure treated wood poles operating on a national scale in Canada, and we have secure access to the full range of species. Nearly every utility in Canada, and increasing numbers of electrical and telecommunications companies in the U.S., are using poles produced by Stella-Jones.

Whatever the needs of our clients may be in terms of treated wood poles, we can satisfy them. Stella-Jones maintains the highest production standards, starting with the highest quality timber and culminating with state-of-the-art preservative treatments. Our custom manufacturing can provide exactly the length, class, and framing requirements our clients may require for their projects anywhere across the continent or abroad. As a partner to our clients, we are committed to meet the challenge of their cost constraints, while our production expertise must answer to their particular preservative needs. Since we have consistently met those challenges and requirements, increasingly, we are becoming many of our clients' single source supplier.

The addition of our new facilities in western Canada will reinforce our position in the wood pole market, where we are supplying a steadily-growing number of poles each year to electrical and telecommunications companies. We also see substantial pent-up demand for replacements of existing wood poles that are aging to the point where they must be retired; this is a supplementary market that promises to further enhance sales over the next few years.

➔ Utility Poles. Sustained growth and pent-up demand
➔ Railway Ties. Serving the foundation of a booming industry

RAILWAY TIES. Serving the foundation of a booming industry

The treated raw material that forms one of the most enduring components of the railroad industry – the wood crosstie – came close to surpassing wood utility poles as the largest product category at Stella-Jones in 2006.

Responding to increased expenditures in the railway industry generally, a healthy portion of the credit for that accomplishment was due to organic growth. The principal credit, however, is owed to the market muscle of our acquired treating facility in Wisconsin. Stella-Jones has long been established as a railway tie market leader in Canada; we are now a major and growing supplier in the United States as well.

This product category posted a most impressive sales gain in 2006, with revenues growing by 54.9% over the previous year.

Wood railway ties are an environmentally wise choice. Wood is the only renewable resource used as tie material. Compared to concrete, steel and plastic, wood ties are considerably less energy-intensive to produce than crossties of alternate materials. It is important to note as well that when the working life of a railway tie comes to an end, the wood makes one of the world's best and cleanest sources of biomass fuel.

The record levels of traffic being conducted by national and short-line railroads are driving demand for crossties as the railroads upgrade and expand their capacity.

The treated raw material that forms one of the most enduring components of the railroad industry – the wood crosstie – came close to surpassing wood utility poles as the largest product category at Stella-Jones in 2006.

UTILITY POLES : $95.6 M of sales in 2006 = 42.7% of sales in 2006
RAILWAY TIES : $91.1 M of sales in 2006 = 40.7% of sales in 2006

→ **Industrial Lumber.** Treated wood products for construction and maritime applications

→ **Consumer Lumber.** Treated wood products for the residential market

INDUSTRIAL LUMBER. Treated wood products for construction and maritime applications

As a construction material, wood is a common and valued component of many industrial projects. Pressure treatment of the wood is indispensable to its use in this regard. Different species are suited for different tasks, and various preservatives must be used to prepare the wood for protection against the expected environmental conditions.

The species selection, preservative range, broad expertise and plant capacity of Stella-Jones readily satisfy the requirements of this market. Our abilities have made us a major supplier of marine pilings and timbers, foundation pilings, construction timbers, highway guide rail posts, and bridge timbers.

The Company's capture of market share in this category results from our strategic plant locations, our economies of scale, and from the confidence of our customers in the reliability of our delivery. This security of supply, together with our historic reputation as a quality wood treater, has steadily enhanced the competitive position of Stella-Jones in this market.

CONSUMER LUMBER. Treated wood products for the residential market

The home renovation market and its requirement for pressure treated wood for outdoor decks, fences, patios and the like represents a solid market for Stella-Jones.

It has been only several years since we initiated a partnership with a large lumber wholesaler to build a presence in the retail marketplace. Within that short time, largely due to the standards of quality we bring with our treated wood, we have made this category a significant contributor to the Company's sales.

Sales in 2006 of consumer lumber reached $17.0 millon, a 71.9% increase over the previous year.

We expect to sustain growth as we service an increasing number of retail outlets and as we benefit significantly from the addition of our new facility in Carseland, Alberta.

As a construction material, wood is a common and valued component of many industrial projects. Pressure treatment of the wood is indispensable to its use in this regard.

Treated wood

INDUSTRIAL LUMBER:
$20.1 M of sales in 2006
= 9.0% of sales in 2006

CONSUMER LUMBER:
$17.0 M of sales in 2006
= 7.6% of sales in 2006

The home renovation market and its requirement for pressure treated wood for outdoor decks, fences, patios and the like represents a solid market for Stella-Jones.

products

Major Value Drivers of Stella-Jones

Organic growth from infrastructure spending

Globalization and increased trade

Alternative energy development

Industry consolidation

As the economy grows, Stella-Jones grows

Stella-Jones is one of the largest North American producers of treated wood utility poles and treated wood railway ties, and the only such producer working on a national scale in Canada. The Company is directly benefiting from increased spending and investment on the part of its many clients in the energy, telecommunications, and railway industries – all of which rely upon the products of Stella-Jones to support their physical infrastructures.

As international trade expands, Stella-Jones benefits

As a result of globalization, world trade is flourishing and the volume of imported and exported goods is steadily increasing. Those goods, once they reach the shores of their intended markets, require transshipment, much of which takes place by rail. In North America, our primary market, the capital expenditure of railways for double-tracking, upgrades and new lines has created significant additional demand for railway ties manufactured by Stella-Jones.

As new energy sources develop, Stella-Jones plays a key role

It has become conventional wisdom that our economy must reduce its dependence on oil. As a result, the use of wind as a renewable energy source is growing. Large wind farms have been built and many more are being planned. Typically, they operate far from urban areas. The transmission of generated electricity from wind farms requires utility poles – a principal product of Stella-Jones. At the same time, particularly in the United States, ethanol (a plant-based alcohol fuel) has become a significant fuel extender and alternative fuel blend. Ethanol plants are mushrooming, and the corn and grain they process is largely moved by rail – again, sparking additional railway investment and requirement for an established prime product of Stella-Jones.

As potential acquisitions arise, Stella-Jones identifies opportunity

North American companies that provide treated wood products identical to those of Stella-Jones are often under-capitalized, their owners content with existing levels of activity. Accordingly, their investments to seize opportunities and meet additional demand have been constrained. Such companies are of great interest to Stella-Jones, and vice-versa. Our track record of acquisition, and most particularly the value in capacity and performance that we add to the companies we acquire, has become widely known in the industry. This is why suitable targets for future acquisitions are no longer waiting for us to come to them – they often approach us.

Market Advantages of Stella-Jones

Product range from multiple plants	Economies of scale	Cutting rights
Globally competitive costs	Entrepreneurial synergies	Enduring value of wood

Critical mass: ensuring client satisfaction

Market reach in our wood treating categories is measured by diversity of product and capacity to deliver. Distinct from many of our competitors, we offer all species types and the full gamut of preservatives, with supply ensured by our cutting rights and relationships with hundreds of forestry suppliers. Customer-driven rather than production-driven, Stella-Jones manufactures to order – and uses its size to become the lowest cost producer. With ten treating facilities, should production be interrupted at one of our plants, we can turn to another. Equally as important, our multi-plant network gives us the ability to gear up at once to supply large numbers of poles if a utility is hit by a natural disaster.

Purchasing power: impacting directly on costs

We are leveraging our purchasing power as we grow. The ability to buy whole mill runs of utility poles or ties significantly reduces supply costs. At the same time, instituting plant specialization increases efficiency and further streamlines operations.

Renewable product in the ground: guaranteeing raw material

Over a third of Stella-Jones' poles come from trees harvested through our own cutting rights. We control the most extensive cutting rights of any pole manufacturer in Canada. This gives us a guaranteed base source of raw material supply.

Technology and efficiency: perpetuating market leadership

Two critical factors provide confidence that our product categories sold in North America will continue to be manufactured in North America. First, the sheer weight of utility poles, railway ties and other lumber products renders their transportation cost an inhibition to importation from abroad. Second, labour does not constitute the major element of the manufacturing cost. Thus, in the long run, technological prowess and managerial efficiency will determine the leaders in the North American wood treating business.

The Stella-Jones continental network: eliminating the silo mentality

Once a sale is made by Stella-Jones, the decision concerning where to produce the order is not determined by where the sale was made. The plant that makes the sale receives no special consideration. Regional factors do not influence such decisions – only a strict bias toward network efficiency. Thus the determination on where to produce an order responds to the optimal employment of the Company's continental inventory and resources.

Non-wood alternatives: The choice is still wood

Steel, fiberglass, and cement utility poles all have a place in the built infrastructure of our economy. However, the vast majority of poles going into service today are still made of wood. The advantages of wood are legion. To begin with, wood poles are thirty to fifty percent less expensive. Furthermore, the ability to climb them and re-drill them while in service are characteristics that differentiate wood poles from competing materials. Durability also counts for a great deal; a wood pole can provide forty years and more of service. The experience with railway ties is similar – upwards of eighty percent in North America are wood. The users of both utility poles and railway ties are, of course, the best and final arbiters – and they have endorsed wood's proven track record and matchless value.

Stella-Jones' Operating Locations

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 categories.

1. New Westminster (BC), Plant and Sales Office
2. Maple Ridge (BC), Pole PeelingYard
3. Prince George (BC), Plant and Sales Office
4. Salmon Arm (BC), Fibre & Woodlands Dept.
5. Revelstoke (BC), Pole Peeling Yard
6. Arlington (WA), Plant and Sales Office
7. Juliaetta (ID), Pole Peeling Yard
8. Carseland (AB), Plant
9. Bangor (WI), Plant and Sales Office
10. Guelph (ON), Plant and Sales Office
11. Belleville (ON), Distribution Yard
12. Gatineau (QC), Plant and Sales Office
13. Delson (QC), Plant and Sales Office
14. St-Laurent (QC), Head Office
15. Sorel-Tracy (QC), Plant
16. Truro (NS), Plant and Sales Office
17. Clarenville (NF), Distribution Centre and Sales Office

NUNAVUT
SASKATCHEWAN
NEWFOUNDLAND
AND LABRADOR
ONTARIO
MANITOBA
QUÉBEC
17
P.E.I.
NEW
BRUNSWICK
16
15
8
NOVA SCOTIA
12
14
13
11
10
WISCONSIN
9
CANADA
68.3%
U.S.A.
31.7%

Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") dated March 14, 2007 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2006 compared with the fiscal year ended December 31, 2005. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2006 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 and marketer of industrial pressure treated wood products and also provides treated consumer lumber products and customized services to lumber retailers and wholesalers for outdoor applications.

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

As of March 14, 2007, following the acquisition of J.H. Baxter & Co. ("Baxter") on February 28, 2007 (see "Subsequent event" below), the Company owns and operates ten wood treating plants, two distribution centres, two pole peeling facilities and has a 50% interest in a third pole peeling operation. These fifteen facilities are located in the Canadian provinces of British Columbia, Alberta, Ontario, Québec, Nova Scotia and Newfoundland as well as in the states of Wisconsin, Idaho and Washington, USA. The Company's workforce currently numbers approximately 475 employees.

OUR MISSION

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

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

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

2006 OVERVIEW

Stella-Jones' financial results for the year ended December 31, 2006 continued on an upward trend, driven by growth in revenues of 42.5%, compounded by a widening gross margin which led to an overall 81.2% improvement in net earnings compared to the prior year. While acquisitions accounted for close to 80.0% of sales growth in 2006, sales also grew organically by approximately 9.0% on a comparable basis. The Company's two main product categories, domestic utility poles and railway ties, both posted solid sales growth, driven by acquisitions and robust demand.

On July 1st, 2006, the Company, through a wholly-owned subsidiary, acquired substantially all of the assets and operations of Bell Pole Company, a Canadian manufacturer of wood utility poles based in western Canada. Bell Pole Company was also involved in the remanufacturing and treating of dimensional lumber in Alberta. 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. See "Business acquisition" below.

Stella-Jones' solid earnings performance translated into strong cash flow generation in 2006, with cash flow from operations (before changes in non-cash working capital components) reaching $26.4 million compared to $16.0 million in 2005. This growth was achieved while preserving the Company's healthy balance sheet, with a long-term debt to equity ratio of 0.30:1 and an average debt to operating earnings before amortization of capital assets ratio of 1.6:1. Going forward, Management remains optimistic about the prospects for market conditions and believes that the Company is well positioned to once again enjoy positive momentum in its financial results in 2007. Stella-Jones is also focused on continuing to grow organically by concentrating on its key markets and capturing more of its existing clients' business tied to railway ties and utility pole markets in the United States.

SELECTED ANNUAL INFORMATION

For the years ended December 31 (thousands of dollars, except per share data)	2006 $	2005 $	2004 $
Sales	223,853	157,129	128,972
Net earnings	20,846	11,505	7,291
Net earnings per common share	1.81	1.10	0.72
Diluted net earnings per common share	1.76	1.08	0.70
Total assets	213,675	137,891	98,200
Total long-term debt*	31,893	26,466	16,184
Dividend per share	0.14	0.10	0.08

*Including current portion

OPERATING RESULTS

Sales

Sales for the year ended December 31, 2006 grew to $223.9 million, an increase of $66.7 million, or 42.5%, over last year's sales of $157.1 million. While the July 2006 Bell Pole Company acquisition and the additional contribution from last year's Webster Wood Preserving Company ("Webster") acquisition accounted for almost 80% of this gain, legacy sales in all of the Company's product categories posted gains, with the two main categories — domestic utility poles and railway ties— once again accounting for the bulk of the improved performance.

Sales by product group

Utility poles

Domestic utility pole sales reached $95.6 million in 2006, an increase of $24.5 million or 34.4% over the 2005 sales of $71.1 million. While organic sales growth in utility poles was strong, the Bell Pole Company acquisition (discussed further below) accounted for most of the increase. Utility pole sales for the newly-acquired operations were $17.9 million, which reflects activities solely during the last six months of the year. Organic sales also grew, as a result of strong demand for transmission poles and growth in demand for distribution poles in certain markets. Domestic utility pole sales accounted for 42.7% of the Company's total sales in fiscal 2006.

Railway ties

Railway tie sales for the year totalled $91.1 million, a 54.9% increase over 2005 sales of $58.8 million. These results reflect the strong performance of the rail transport sector, which continues to report record traffic levels, as well as the full-year contribution from the Webster operations in Bangor, Wisconsin, which were acquired on August 31, 2005. Railway tie sales accounted for 40.7% of the Company's total sales in fiscal 2006.

Demand for railway ties has been strong over the last few years, driven by maintenance requirements, installation of double-tracking and new siding construction. Stella-Jones enjoys a number of key attributes which have been and should continue to help the Company grow its sales and position in the railway tie market. Among these are the 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. Stella-Jones also operates dedicated production facilities which allow higher productivity and better efficiency, helping the Company maintain a competitive manufacturing cost position. These attributes are allowing the Company to post solid growth not only with the Class 1 (major) railroads, but also with short-line customers and to operators of dedicated lines in the mining sector.

In response to this continued strength in railway tie demand, the Company is expanding its Bangor, Wisconsin facility with an additional treating cylinder scheduled to go into production in May of 2007. This cylinder will increase the capacity of the plant by over 50 percent.

Industrial lumber

Industrial lumber sales rose by 16.5% to $20.1 million in 2006 from the $17.3 million reported in 2005. A strong piling market in western Canada and steady demand from the marine market on the East Coast resulted in this positive performance.

Consumer lumber

Sales in the consumer lumber treating category totalled $17.0 million in 2006, up from $9.9 million in 2005, a 71.9% increase, with the recently acquired Bell Pole Company operations at Carseland, Alberta accounting for most of the gain. It should be noted that while the Company's other treating facilities provide treating services for customer-owned lumber, the Carseland plant purchases the consumer lumber that it processes. This results in a higher sales figure that is not directly comparable to those of the Company's other plants on a per volume basis. A healthy North American repair and remodelling market also contributed meaningfully to consumer lumber sales growth in 2006.

Sales by destination

Of the 2006 total sales levels, 68.3% were made in Canada and 31.7% in the United States, while overseas sales fell to nil, in line with Management's strategy of focusing on higher margin North American markets.

The strong increase in sales to the U.S. market came as a result of the contribution of the Bangor, Wisconsin facility, acquired in August 2005, but also to a lesser extent to the contribution of the Bell Pole Company assets acquired in the middle of 2006 as the Carseland, Alberta facility sells roughly 31.0% of its production on the U.S. market. In fact, sales of products exported to the United States from the Canadian based facilities totalled $32.6 million in 2006, an increase of $11.3 million or 53.1% over the $21.3 million recorded in 2005.

Management believes that the U.S. market presents opportunities for additional growth, particularly for the Company's West Coast operations where access to douglas fir as well as cedar through the Bell Pole Company acquisition — a preferred species for a number of utilities — is a competitive advantage when bidding on transmission projects. The recent acquisition of the utility pole business of Baxter will further strengthen the Company's position. See "Subsequent event" below.

Gross profit

Gross profit reached $50.4 million or 22.5% of sales in 2006, up from $32.0 million or 20.4% of sales in 2005. The improvement in gross profit was both a function of recent acquisitions and of 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 2006 were $12.5 million, an increase of $2.8 million or 28.7% compared to prior year levels. This increase is the result of an increase in stock-based compensation expense, higher selling expenses related to acquisitions, increases under the Company's profit sharing plan as well as increased costs related to reviewing and documenting the design effectiveness of the Company's internal controls. This more than offset reduced expenses related to the final year of the Technical Recommendations Documents ("TRD's"), a Canada wide environmental compliance program. Notably, selling and administrative expenses have grown more slowly than sales levels and represented just 5.6% of sales in 2006, down from 6.2% in the prior year.

The Company realized a foreign exchange gain of $213,619 for the year, higher than last year's foreign exchange gain of $150,768. The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to its sales and purchases in U.S. dollars by its Canadian based operations. Stella-Jones Corporation, the Company's wholly-owned U.S. subsidiary, is a self-sustaining foreign operation and unrealized foreign exchange gains and losses are deferred in shareholders' equity. The Company monitors its transactions in U.S. dollars generated by Canadian based operations. Its basic hedging activity consists of entering into forward exchange contracts for the sale of U.S. dollars and purchasing certain goods and services in U.S. dollars. The Company will also consider forward exchange contracts for the purchase of U.S. dollars for significant purchases of goods and services that are not covered by natural hedges. On December 31, 2006, the Company had on hand foreign exchange contracts for the future sale of U.S. dollars totalling $2,000,000, at rates averaging C$1.6113/US$1.00 and maturity dates up to December 2007. The unrealized net foreign exchange gain on these contracts totalled approximately $881,660 as at December 31, 2006.

Amortization of capital assets totalled $3.4 million for the year, an increase of approximately $86,000 over the same period in 2005. The amortization of forestry related capital assets, primarily cutting rights (timber tenures) and access roads, is included in cost of sales as a part of wood costs.

Financial expenses for 2006 totalled $3.6 million, an increase of approximately $1.7 million over the financial expenses of $1.9 million incurred in 2005. The rise in financial expenses is due to increases in the short and long-term borrowings resulting from the Webster acquisition in August 2005 and the Bell Pole Company acquisition in July 2006, as well as increases in the Company's working capital requirements.

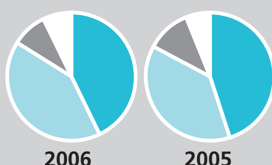
Income tax expense totalled $10.3 million in 2006 versus $5.7 million in 2005, an increase of $4.6 million, reflecting the Company's vastly improved earnings before tax. The effective tax rate for 2006 was 33.2%, unchanged from the 33.2% in the prior year. Other non-income based corporate taxes represent a relatively small component of the Company's total tax burden.

Net earnings

Net earnings for the year totalled $20.8 million, or $1.81 per share, compared to $11.5 million, or $1.10 per share, in 2005. This represents a year-over-year net earnings increase of $9.3 million, or 81.2%.

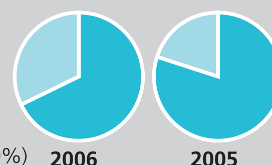
Sales by product
(% of revenues)

- Utility Poles 43% (2005 – 45%)
- Railway Ties 41% (2005 – 38%)
- Industrial Lumber 9% (2005 – 11%)
- Consumer Lumber 7% (2005 – 6%)



Sales by geographic region
(% of revenues)

- Canada 68% (2005 – 80%)
- United States 32% (2005 – 20%)



BUSINESS ACQUISITION

On July 1st, 2006, the Company, through a wholly-owned subsidiary, acquired substantially all of the assets and operations of Bell Pole Company, a Canadian manufacturer of wood utility poles based in western Canada. Bell Pole Company was also involved in the remanufacturing and treating of dimensional lumber in Alberta. Assets acquired include a treating plant located in Carseland, Alberta, peeling facilities in the province of British Columbia, as well as all inventories and accounts receivable. Assets acquired also include substantial cutting rights in British Columbia and Alberta.

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(a) of the Company's audited consolidated financial statements for the year ended December 31, 2006. The results of operations of the acquired assets have been included in the consolidated financial statements from the acquisition date.

Financing for the transaction was provided by the private placement of 1,060,000 subscription receipts issued on May 2, 2006 for a total consideration of $18.0 million. Following the closing of the acquisition, the subscription receipts were exchanged into common shares of the Company, on a one-for-one basis. The remainder of the purchase price was financed by a $10.0 million debenture to the *Fonds de solidarité des travailleurs du Québec (F.T.Q.),* as well as additional debt funding under existing and new bank facilities.

SUBSEQUENT EVENT

On February 28, 2007, the Company announced that its wholly-owned U.S. subsidiary, Stella-Jones Corporation, had completed the acquisition of the wood utility pole business of J.H. Baxter & Co. ("Baxter"). Assets acquired include the Baxter production plant located in Arlington, Washington, its pole peeling facility in Juliaetta, Idaho as well as all inventories and accounts receivable relating to its wood pole business. The Arlington facility will become Stella-Jones' 10th treating plant. The purchase price totaled US$22.3 million, of which approximately US$12.0 million was for inventory and receivables. Financing for the transaction was provided by a subordinated vendor note of US$8.0 million as well as additional debt funding under existing and new bank facilities. The new bank facilities comprise an increase of US$5.0 million in the operating line of credit of Stella-Jones Corporation, as well as a new 5-year term loan of US$4.0 million, both arranged with its existing U.S. banker.

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 2006, compared to the corresponding periods in 2005. However, sales and earnings growth in the fourth quarter were particularly strong due to the performance of the assets acquired by the Company in July 2006.

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

QUARTERLY RESULTS

2006

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

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 capital assets [1]	3,091	7,087	6,350	5,929	22,457
Operating earnings [1]	2,335	6,286	5,503	5,056	19,180
Net earnings	1,325	3,930	3,316	2,934	11,505
Net earnings per common share	0.13	0.38	0.32	0.27	1.10
Diluted net earnings per common share	0.13	0.37	0.31	0.27	1.08

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

FOURTH QUARTER RESULTS

Sales for the fourth quarter of 2006 increased to $49.5 million, up 32.5% from the $37.4 million reported for the same period in 2005, with the contribution of the Bell Pole Company assets, acquired at the beginning of the third quarter of 2006 accounting for most of the increase. Consequently, utility poles accounted for close to three quarters of the year-over-year increase in sales. Fourth quarter railway tie sales were down only marginally compared to the strong year ago levels, as the Company continued to make progress in growing its customer base in the Unites States. Industrial lumber sales benefited from healthy demand for piling in the West as well as strong marine markets in the East, while consumer lumber sales more than tripled as a result of the Bell Pole Company acquisition, reflecting both increased volume and the inclusion of the purchased lumber component in the Carseland facility's consumer lumber sales.

Gross margins as a percentage of sales were 23.0% in the fourth quarter of 2006, up from 20.9% in the same period last year, primarily as a result of 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.

The net earnings for the fourth quarter of 2006 were $5.1 million, or $0.42 per share, compared to net earnings of $2.9 million, or $0.27 per share in the fourth quarter of 2005.

LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital at December 31, 2006 was $80.0 million, an increase of $24.5 million over last year's working capital balance of $55.5 million at the same date. The increase in current assets of $51.7 million is primarily related to the $34.0 million of current assets acquired with the Bell Pole Company acquisition, as well as increased receivable and inventory levels required for current and future sales volume increases.

Capital assets stood at $59.9 million as at December 31, 2006, compared to $37.0 million as at December 31, 2005. This $22.9 million increase was primarily related to the acquisition of Bell Pole Company in the third quarter and, to a lesser extent, to capital expenditures that were marginally in excess of amortization levels.

Bank indebtedness at year end totalled $42.3 million, an increase of $21.0 million over the bank indebtedness of $21.3 million at the end of the prior year. This increase essentially reflects the Company's additional working capital requirements. Bank indebtedness includes a $50.0 million demand operating loan with Canadian banks (up from $30.0 million last year), as well as a US$12.0 million operating line of credit with the U.S. bankers of Stella-Jones Corporation (up from US$10.0 million last year). Total availability under the Company's Canadian and U.S. operating lines of credit was $26.6 million and US$1.8 million, respectively, as at December 31, 2006.

For the year ended December 31, 2006, the Company's long-term debt and other liabilities posted a $5.7 million net increase, which was primarily related to the credit facilities arranged to partially finance the Bell Pole Company acquisition. A significant portion of the acquisition financing was provided by a new $10.0 million debenture to the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)*. This unsecured and non-convertible debenture bears interest at 7.72% per annum and is repayable beginning July 1, 2011 in five consecutive annual instalments of $1.0 million and a last payment of $5.0 million on July 1, 2016.

Shareholders' equity was $105.8 million as at December 2006, a $41.0 million increase from December 31, 2005 levels. The Company's strong earnings generation accounted for most of this gain, with an $18.0 million private placement of subscription receipts to finance the Bell Pole Company acquisition also increasing capital stock during the year.

Cash flow from operating activities was $26.4 million for the year ended December 31, 2006, compared to $16.0 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, 2006 was $10.2 million, versus $2.1 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 share issues under the employee share purchase plans, less repayments of long-term debt and the payment of annual dividends, generated another $39.9 million of cash. The primary uses of cash were for the Bell Pole Company acquisition ($46.0 million – See "Business acquisition" above) and for the purchase of capital assets ($4.3 million). Of the $4.3 million disbursed for capital acquisitions in 2006, $1.5 million was spent on environmental investments required to complete the Technical Recommendations Documents ("TRD") baseline assessments undertaken by Environment Canada in the year 2000. In 2006, Stella-Jones successfully completed the audit phase of this five-year program, which has seen the Company invest close to $10.0 million to ensure the environmental

integrity of its Canadian operations. As a result, all of the Company's Canadian treatment plants were certified compliant. The conclusion of this multi-year program will allow the Company to concentrate a larger proportion of its capital expenditure budget on value creating, high return projects going forward. The remainder of the capital acquisitions were for equipment upgrades and expansion, including $1.1 million invested at the Company's Bangor, Wisconsin facility and $0.3 million at the newly acquired facility in Carseland, Alberta.

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

CONTRACTUAL OBLIGATIONS

(thousands of dollars)	Payments due by period				
	Total $	Less than 1 year $	1-3 years $	4-5 years $	After 5 years $
Long-term debt obligations	31,848	3,779	7,226	7,499	13,344
Capital lease obligations	45	18	27	—	—
Operating leases	7,195	1,670	2,322	908	2,295
Commitments for capital expenditures	—	—	—	—	—
Total contractual obligations	39,088	5,467	9,575	8,407	15,639

SHARE AND STOCK OPTION INFORMATION

As at March 14, 2007, the capital stock issued and outstanding consisted of 12,300,158 common shares (10,880,840 as at December 31, 2005 and 12,298,015 as at December 31, 2006).

As at March 14, 2007, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 181,355 (December 31, 2006 – 183,355) of which 81,355 (December 31, 2006 – 83,355) were exercisable.

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

DIVIDENDS

On March 15, 2006, the Board of Directors declared a semi-annual dividend of $0.06 per common share. On August 8, 2006, the Board of Directors declared a semi-annual dividend of $0.08 per common share. In light of the Company's strong financial performance and solid expectations for the coming quarters, on March 14, 2007, the Board of Directors declared a semi-annual dividend of $0.10 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 its long-standing relationships with private woodland owners and other suppliers. In addition, there are a limited number of suppliers for certain of the preservatives that the Company employs in its production process, which lessens the availability of alternate sources of supply in the event of unforeseen shortages or disruptions of production. The Company is mitigating this risk by researching and identifying alternate suppliers outside of its traditional sources of supply.

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

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

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

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

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

OFF-BALANCE SHEET ARRANGEMENTS AND FINANCIAL INSTRUMENTS

For details pertaining to off-balance sheet arrangements and financial instruments, refer to Note 18 to the Company's consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's significant accounting policies are described in Note 2 to the December 31, 2006 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

Effective January 1, 2006, the Company adopted the new CICA Handbook Section 3831, "Non-Monetary Transactions". The Company has determined that there is no effect to the current or prior year relating to the implementation of this standard.

Handbook Section 3855, "Financial Instruments – Recognition and Measurement", applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The section describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial assets, except for those classified as held-to-maturity or loans and receivables, and derivative financial instruments must be measured at their fair value. All financial liabilities must be measured at their fair value if they are classified as held for trading purposes. If not, they are measured at their carrying value.

Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity", apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Comprehensive income is the change in equity of an enterprise during a period arising from transactions and other events and circumstances from non-owner sources. It includes items that would normally not be included in net income such as changes in the foreign currency translation adjustment relating to self-sustaining foreign operations and unrealized gains or losses on available for sale financial instruments. This section describes how to report and disclose comprehensive income and its components. Section 3251, "Equity", replaces Section 3250, "Surplus", and describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530, "Comprehensive Income". Upon adoption of this section, the consolidated financial statements will include a statement of comprehensive income.

The Company will be required to present this new statement in the publication of its March 31st, 2007, interim consolidated financial statements.

Handbook Section 3865, "Hedges", applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. This section describes when hedge accounting is appropriate. Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period. The Company has documented its use of derivative financial instruments and has concluded that they qualify for hedge accounting.

Handbook Section 1535, "Capital Disclosures", establishes standards for disclosing information about an entity's objectives, policies and processes for managing capital. This standard is effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis. The Company will adopt this new standard effective January 1, 2008.

Handbook Sections 3862, "Financial Instruments – Disclosures" and 3863, "Financial Instruments – Presentation", enhance existing disclosures in previously issued Section 3861 "Financial Instruments – Disclosures and Presentation". Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis. The Company will adopt these new standards effective January 1, 2008.

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, 2006, 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.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

The Company has experienced rapid expansion through an acquisition in the last year, while maintaining a relatively small accounting and administrative department throughout most of this period. An implication arising from this is the lack of in-house GAAP expertise surrounding increasingly complex accounting, tax and reporting issues.

Management have and will continue to mitigate this potential internal control risk by increasing overall levels and expertise of its own accounting group, in addition to engaging outside consultants to assist when complex accounting and technical issues arise. For example, the Company has retained an independent income tax consultant to support the Company in the computation of the income tax provision and has hired additional professional staff in the finance and administration area.

RELATED PARTY TRANSACTIONS

In 2006, the Company paid a total of $300,000 (2005 - $300,000) to its parent company and ultimate shareholders with respect to marketing and technical services fees and incurred interest expense of $86,774 (2005 - $105,190) with respect to loans to the same parties, as detailed in Note 19 to the December 31, 2006 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.

As part of an $18.0 million private placement of Subscription Receipts, the Company entered into agreements with Stella Jones International S.A. ("SJ International") and the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)* (collectively, the "Shareholders") whereby the Shareholders agreed to purchase 795,000 Subscription Receipts (677,353 and 117,647 respectively) at a price of $17.00 per Subscription Receipt for aggregate gross proceeds to the Company of $13,515,000 ($11,515,001 and $1,999,999, respectively). The Subscription Receipts were converted into common shares on a one for one basis effective July 1, 2006.

In addition, on July 1, 2006, as part of the financing for the Bell Pole Company acquisition described above, the Company borrowed $10.0 million from the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)* by way of a 10-year, unsecured debenture bearing interest at a fixed rate of 7.72%. The debenture is repayable in five consecutive annual instalments of $1,000,000, starting on July 1, 2011 and a final payment of $5,000,000 on July 1, 2016.

On October 18, 2006, the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)* exercised all of their outstanding warrants allowing them to subscribe to 190,000 common shares of the Company at an exercise price of $4.10 per share. The Company has no other warrants outstanding.

OUTLOOK

Stella-Jones' core markets are continuing to enjoy strong fundamentals and Management is once again optimistic about organic and external growth potential in 2007. The Company will continue to grow organically by focusing on its key markets and by capturing more of its existing clients' business by leveraging the opportunities offered by economies of scale – notably in the customer service area. Management will also remain focused on expanding its customer base in Canada and the U.S. as it realizes the full potential of recent acquisitions.

The market for utility poles remains strong with pent-up demand pointing to future sales increases. The February 28, 2007 acquisition of the wood utility pole business of J.H. Baxter & Co., combined with a full-year contribution from the Carseland, Alberta facility acquired as part of the Bell Pole Company acquisition in 2006, should also result in upward momentum. Strong geographical diversification, combined with a complete product offering also gives Stella-Jones the ability to respond promptly to market opportunities.

The railway tie market, Stella-Jones' other large product category, is expected to stay strong for the foreseeable future driven by Class-1 railroad capital expenditures and short-line railroad expansion projects. In order to better meet this expected demand and to increase efficiency, the Company is expanding capacity at its Bangor, Wisconsin facility – with the addition of a new treating cylinder – to service its growing customer base in the U.S.

Finally, Management also believes that room for growth exists in industrial and consumer lumber, as the Company increasingly establishes itself as a preferred supplier.

Strategic acquisitions will continue to be an integral part of the Company's growth plan as well, and Management will continue to seek targets in the railway tie and utility pole markets that provide synergistic opportunities, meet its stringent investment requirements and, most of all, add value to Stella-Jones' shareholders.

March 14, 2007

Consolidated Financial Statements

December 31, 2006 and 2005

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

Saint-Laurent, Quebec
March 14, 2007

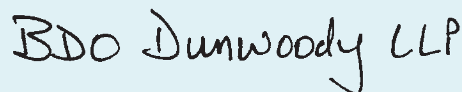
Auditors' Report

To the Shareholders of Stella-Jones Inc.

We have audited the consolidated balance sheets of Stella-Jones Inc. as at December 31, 2006 and 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

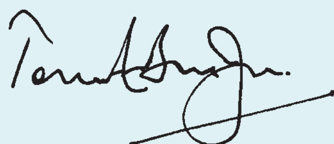
Montréal, Quebec
March 14, 2007

Consolidated Balance Sheets

As at December 31	2006	2005
Assets		
Current		
Accounts receivable (Note 5)	$ 32,113,553	$ 21,059,721
Inventories (Note 6)	117,441,115	77,316,420
Prepaid expenses	2,325,219	1,611,755
Future income taxes (Note 13)	356,000	550,000
	152,235,887	100,537,896
Capital assets (Note 7)	59,925,656	37,003,106
Other assets (Note 8)	1,088,343	—
Future income taxes (Note 13)	425,000	350,000
	$ 213,674,886	$ 137,891,002
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness (Note 9)	$ 42,286,469	$ 21,311,735
Accounts payable and accrued liabilities	22,299,399	17,452,438
Income taxes (Note 13)	2,964,247	2,227,785
Current portion of long-term debt (Note 9)	3,797,096	4,061,370
Current portion of asset retirement obligations (Note 10)	922,929	—
	72,270,140	45,053,328
Long-term debt and other long-term liabilities (Note 9)	28,096,118	22,404,874
Future income taxes (Note 13)	5,960,036	4,646,000
Asset retirement obligations (Note 10)	414,635	—
Employee future benefits (Note 14)	1,112,177	978,649
	107,853,106	73,082,851
Shareholders' equity		
Capital stock (Note 11)	45,473,435	26,174,801
Contributed surplus (Note 12)	2,416,650	53,499
Cumulative translation adjustment (Note 15)	(72,679)	(201,646)
Retained earnings	58,004,374	38,781,497
	105,821,780	64,808,151
	$ 213,674,886	$ 137,891,002

Commitments and contingencies (Note 17)
Subsequent event (Note 21)
The accompanying 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	2006	2005
Balance – beginning of year	$ 38,781,497	$ 28,330,148
Net earnings for the year	20,845,956	11,504,861
	59,627,453	39,835,009
Dividends on common shares	(1,623,079)	(1,053,512)
Balance – end of year	$ 58,004,374	$ 38,781,497

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

Consolidated Statements of Earnings

For the years ended December 31	2006	2005
Sales	$ 223,853,026	$ 157,128,551
Expenses (income)		
Cost of sales	173,489,937	125,100,344
Selling and administrative	12,488,487	9,704,612
Foreign exchange gain	(213,619)	(150,768)
Amortization of capital assets	3,363,474	3,277,093
(Gain) loss on disposal of capital assets	(77,932)	17,383
	189,050,347	137,948,664
Operating earnings	34,802,679	19,179,887
Financial expenses (Note 9(k))	3,613,325	1,946,026
Earnings before income taxes	31,189,354	17,233,861
Provision for income taxes (Note 13)		
Current	10,506,398	5,944,000
Future (recovery)	(163,000)	(215,000)
	10,343,398	5,729,000
Net earnings for the year	$ 20,845,956	$ 11,504,861
Net earnings per common share (Note 11)	$ 1.81	$ 1.10
Diluted net earnings per common share (Note 11)	$ 1.76	$ 1.08

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

Consolidated Statements of Cash Flows

For the years ended December 31	2006	2005
Cash provided by (used in)		
Operating activities		
Net earnings for the year	$ 20,845,956	$ 11,504,861
Adjustments for		
Amortization of capital assets	3,363,474	3,277,093
(Gain) loss on disposal of capital assets	(77,932)	17,383
Employee future benefits	133,528	106,269
Stock-based compensation	2,338,808	1,283,955
Future income taxes	(163,000)	(215,000)
	26,440,834	15,974,561
Changes in non-cash working capital components		
Accounts receivable	(3,760,105)	(5,217,107)
Inventories	(13,485,127)	(11,280,636)
Prepaid expenses	(300,901)	(746,628)
Accounts payable and accrued liabilities	570,060	2,921,435
Income taxes payable	765,468	452,868
	10,230,229	2,104,493
Financing activities		
Increase in bank indebtedness	16,421,513	9,890,975
Increase in long-term debt	13,393,582	20,379,008
Repayment of long-term debt	(6,687,317)	(12,826,522)
Decrease in asset retirement obligations	(835,934)	—
Proceeds from issuance of common shares	19,275,977	5,254,453
Dividends on common shares	(1,623,079)	(1,053,512)
	39,944,742	21,644,402
Investing activities		
Increase in other assets	(446,289)	—
Business acquisitions	(46,023,314)	(17,953,798)
Purchase of capital assets	(4,272,982)	(6,107,522)
Proceeds from disposal of capital assets	379,998	231,000
	(50,362,587)	(23,830,320)
Effect of translation adjustment	187,616	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	$ 3,415,273	$ 1,770,887
Income taxes paid	$ 10,533,807	$ 5,168,398

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

Notes to Consolidated Financial Statements
December 31, 2006 and 2005

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 treated consumer lumber products and customized services to lumber retailers and wholesalers 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 wholly-owned subsidiaries, Guelph Utility Pole Company Ltd., I.P.B. – W.P.I. International Inc., Stella-Jones Corporation ("SJ Corp") since August 31, 2005, and since July 1, 2006 (Note 4) the consolidated accounts of Bell Pole Canada Inc. ("Bell Pole"), using the purchase method. The consolidated accounts of Bell Pole include the accounts of a 50% interest in Kanaka Creek Pole Company Limited ("Kanaka"), a joint venture which is accounted for under the proportionate consolidation method of accounting.

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, accounts payable and accrued liabilities, and income taxes payable 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.

Logs are harvested from timber licenses operated by the Company as part of a process to procure raw material for processing and treatment of utility poles. Logs not meeting pole-quality standards are regularly harvested and sold to third parties. Proceeds from the sale of non-pole quality logs are included in the cost of poles sold since the production of non-pole quality logs are a by-product of the Company's pole raw material procurement operations.

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.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis using rates based on the estimated useful lives of the assets 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

Roads, timberlands and cutting rights are recorded at cost less accumulated amortization. Amortization is provided on the basis of timber cut.

Impairment of Long-lived Assets

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

Asset Retirement Obligations

Reforestation obligations:

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

Site remediation obligations:

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

Income Taxes

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

Employee Future Benefits

Post retirement benefit programs:

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

Defined benefit pension plan:

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

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

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.

Stock-based compensation redeemable in shares or in cash at the option of the holder is accounted for as a liability at the intrinsic value prorated based upon the vesting period and the liability is revalued at each balance sheet date.

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 SJ Corp, a self-sustaining foreign operation, are translated using the rate in effect 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 US dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These contracts are treated as 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. RECENT ACCOUNTING CHANGES

New Accounting Standards Adopted

Effective January 1, 2006, the Company adopted the new CICA Handbook Section 3831, "Non-Monetary Transactions". The Company has determined that there is no effect to the current or prior year relating to the implementation of this standard.

The CICA has Issued the Following New Handbook Sections:

Handbook Section 3855, "Financial Instruments – Recognition and Measurement", applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The section describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial assets, except for those classified as held-to-maturity or loans and receivables, and derivative financial instruments must be measured at their fair value. All financial liabilities must be measured at their fair value if they are classified as held for trading purposes, if not, they are measured at their carrying value.

3. RECENT ACCOUNTING CHANGES (CONTINUED)

Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity", apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. Comprehensive income is the change in equity of an enterprise during a period arising from transactions and other events and circumstances from non-owner sources. It includes items that would normally not be included in net income such as changes in the foreign currency translation adjustment relating to self-sustaining foreign operations and unrealized gains or losses on available for sale financial instruments. This section describes how to report and disclose comprehensive income and its components. Section 3251, "Equity", replaces Section 3250, "Surplus", and describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530, "Comprehensive Income". Upon adoption of this section, the consolidated financial statements will include a statement of comprehensive income.

Handbook Section 3865, "Hedges", applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. This section describes when hedge accounting is appropriate. Hedge accounting ensures that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period. The Company has documented its use of derivative financial instruments and has concluded that they qualify for hedge accounting.

Handbook Section 1535, "Capital Disclosures", establishes standards for disclosing information about an entity's objectives, policies and processes for managing capital. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 on a prospective basis. The Company will adopt this new standard effective January 1, 2008.

Handbook Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation", enhance existing disclosures in previously issued Section 3861, "Financial Instruments – Disclosures and Presentation". Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. These new standards are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 on a prospective basis. The Company will adopt these new standards effective January 1, 2008.

4. BUSINESS ACQUISITION

a) Effective July 1, 2006, the Company, through a wholly-owned subsidiary, acquired substantially all of the assets and operations of Bell Pole Company, a Canadian manufacturer of wood utility poles based in western Canada. Bell Pole Company was also involved in the remanufacturing and treating of dimensional lumber in Alberta. Assets acquired include a treating plant located in Carseland, Alberta, peeling facilities located in the province of British Columbia, as well as all inventories and accounts receivable. Assets acquired also include cutting rights in British Columbia and Alberta. The Company also assumed certain liabilities including accounts payable and accrued liabilities and asset retirement obligations.

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 Bell Pole have been included in the consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired at fair values:

Assets acquired	
Accounts receivable	$ 7,264,996
Inventories	26,370,676
Prepaid expenses	394,643
Capital assets	22,665,988
Other assets	642,054
	57,338,357
Liabilities assumed	
Bank indebtedness	4,553,221
Accounts payable and accrued liabilities	3,763,180
Asset retirement obligations and other liabilities	2,607,498
	10,923,899
	$ 46,414,458
Consideration	
Bank debt paid at closing on behalf of Seller	$ 8,126,152
Cash, including transaction costs of $2,368,556	37,897,162
Reserve amount for transaction costs, included in accounts payable	391,144
	$ 46,414,458

4. BUSINESS ACQUISITION (CONTINUED)

Financing for the transaction was provided by the private placement of 1,060,000 subscription receipts issued on May 2, 2006 for a total consideration of $18.0 million. Following the closing of the acquisition, the subscription receipts were exchanged into common shares of the Company, on a one-for-one basis. The remainder of the purchase price was financed by a $10.0 million debenture to the *Fonds de solidarité des travailleurs du Québec (F.T.Q.),* as well as additional debt funding under existing and new bank facilities.

b) On August 31, 2005, SJ Corp 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	
Accounts receivable	$ 2,765,551
Capital assets	3,997,577
Prepaid expenses	8,452
Inventories	13,557,195
	20,328,775
Liabilities assumed	
Accounts payable and accrued 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 SJ Corp's US 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 US operations provided by a new operating line of credit of $11.6 million (US$10.0 million) with SJ Corp's US banker.

5. ACCOUNTS RECEIVABLE

	2006	2005
Trade	$ 30,057,252	$ 20,671,727
Other	2,056,301	387,994
	$ 32,113,553	$ 21,059,721

6. INVENTORIES

	2006	2005
Raw materials	$ 91,946,806	$ 57,743,165
Finished goods	25,494,309	19,573,255
	$ 117,441,115	$ 77,316,420

7. CAPITAL ASSETS

	Cost	Accumulated Amortization	Net
			2006
Land	$ 5,506,487	$ —	$ 5,506,487
Roads, timberland and cutting rights	8,493,633	299,038	8,194,595
Buildings	12,239,169	2,692,566	9,546,603
Production equipment	40,580,462	16,202,261	24,378,201
Rolling stock	2,143,896	1,796,172	347,724
Anti-pollution equipment	15,650,586	4,404,042	11,246,544
Office equipment	1,584,645	879,143	705,502
	$ 86,198,878	$ 26,273,222	$ 59,925,656

	Cost	Accumulated Amortization	Net
			2005
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

The net book value of assets held under capital lease as at December 31, 2006 is $73,931 (December 31, 2005 – $274,463).

8. OTHER ASSETS

	2006	2005
Land held for resale	$ 263,500	$ —
Notes receivable	389,128	—
Accrued benefit asset (Note 14(b))	435,715	—
	$ 1,088,343	$ —

9. LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES

	2006	2005
Long-term debt		
Term loans (Note 9(a))	$ 12,606,231	$ 14,960,013
Unsecured and non-convertible debenture (Note 9(b))	10,000,000	—
Unsecured and non-convertible debenture (Note 9(c))	4,666,667	5,000,000
Promissory note (Note 9(d))	874,050	872,250
Promissory note (Note 9(e))	1,311,759	1,443,590
Mortgage loans (Note 9(f))	2,389,525	2,589,260
Obligations under capital leases (Note 9(j))	44,982	103,779
Term note unsecured (Note 9(g))	—	232,352
Long-term debt	31,893,214	25,201,244
Less current portion	3,797,096	4,061,370
Total long-term debt	28,096,118	21,139,874
Other long-term liabilities		
Stock-based compensation liability	—	1,265,000
	$ 28,096,118	$ 22,404,874

9. LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES (CONTINUED)

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, SJ Corp. In addition, Kanaka, in which Bell Pole has a 50% joint venture interest, also has available facility with a Canadian bank.

- The primary Canadian facility comprises a demand operating loan of $50,000,000 (2005 - $30,000,000) which includes a bid and performance bond guarantee facility of up to a maximum of $5,000,000, term loan facilities of $2,300,000 and $2,700,000 to assist in refinancing short and long-term debt, a term loan of $1,900,000 to assist in financing the August 31, 2005 business acquisition (see Note 4(b)), a $5,703,800 capital lease facility, a demand revolving line of credit in the amount of $6,586,000 for the purchase of forward exchange contracts with an aggregate nominal value of $25,100,000, and an interest rate swap facility for up to the full amount outstanding under the term loans of $6,900,000.

  The Canadian demand operating loan of $50,000,000 bears interest at the bank's prime rate, bank's US base rate or LIBOR plus 1.5% at the option of the Company. As collateral, the bank holds movable 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 movable hypothec over the universality of the Company's Canadian assets, creating a first charge over all the Company's Canadian capital 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.

  Amounts owing under the $2,300,000 term loan are repayable in 19 equal consecutive principal repayments of $82,143 on each three-month anniversary of the date upon which the initial advance was made (December 28, 2005), and a balloon repayment of $739,286 constituting the 20th and final payment of the residual capital balance on December 28, 2010. The loan bears interest at a fixed rate of 5.81% over the term of the loan.

  Amounts owing under the $2,700,000 term loan are repayable in 19 equal consecutive principal repayments of $96,429 on each three-month anniversary of the date upon which the initial advance was made (February 1, 2006), and a balloon repayment of $867,857 constituting the 20th and final payment of the residual capital balance on February 1, 2011. The loan bears interest at a fixed rate of 5.85% over the term of the loan.

  Amounts owing under the $1,900,000 term loan are repayable in 19 equal consecutive principal repayments of $100,000 on each three-month anniversary of the date upon which the initial advance was made (December 19, 2005) and shall, in any event, be repaid in full by September 30, 2010. The loan bears interest at a fixed rate of 5.9% over the term of the loan.

- 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 (b)), 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 term loan of $1,900,000 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 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 third credit facility arranged with a US bank comprises a US$12,000,000 (2005 – US$10,000,000) operating line of credit and a US$1,100,000 term loan to fund capital assets. The operating line of credit bears interest at the US prime rate or LIBOR plus 1.75% at the option of SJ Corp (previously US prime rate plus 0.25% or LIBOR plus 2.25%). 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 under a swap agreement at 7.23% over its term.

  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 SJ Corp. 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 an event of default SJ Corp if requested by the US bank.

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

The Kanaka facility is comprised of a $7,000,000 demand operating loan. One half of the indebtedness, up to a maximum of $5,000,000, has been guaranteed by Bell Pole and the Company. The Company has also provided an Environmental Indemnity Agreement to the bank with respect to the Maple Ridge property, the site of Kanaka's operations, with liability limited to one half of the monies which become due and owing to the bank under such indemnity.

9. LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES (CONTINUED)

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

c) Unsecured and non-convertible debenture bearing interest at 7.0%, repayable after December 31, 2006 in five consecutive annual instalments of $333,333 and a last payment of $3,000,000 on December 21, 2012.

d) SJ Corp borrowed US$750,000 from the Company's majority shareholder, Stella Jones International S.A., by way of a subordinated promissory note. The note is for a term of six years, bears interest at LIBOR plus 4.5% and is repayable in full on the 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 subsidiary's loans to all of its secured lenders.

e) Pursuant to the business acquisition on August 31, 2005 (see Note 4(b)), SJ Corp assumed an unsecured note payable to a former general partner of Webster. The imputed interest rate of the note is 8.0% and is payable in quarterly instalments of US$52,891 including interest through October 2013.

f) The mortgage loans bear interest at a weighted average rate of 6.0% as at December 31, 2006 (December 31, 2005 – 5.6%) and certain specific capital assets with a net book value of $4,556,632 (December 31, 2005 – $5,062,874) have been pledged as collateral. The loans are repayable in monthly instalments of $77,809 including interest and mature at various dates to November 2011.

g) Term note unsecured bearing interest at 4.75%, payable in monthly instalments at $8,333 and maturing in March 2008. This loan was reimbursed in the course of 2006 and refinanced the Canadian operating loan.

h) The aggregate fair value of the Company's long-term debt was estimated at $32,600,000 as at December 31, 2006 (December 31, 2005 – $28,400,000) based on discounted future cash flows using interest rates available to the Company for issues with similar terms and average maturities.

i) 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:

Year	
2007	$ 3,778,741
2008	3,927,923
2009	3,297,656
2010	4,948,330
2011	2,550,676

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

	2007	$ 20,508
	2008	27,737
Total future minimum lease payments		48,245
Less: Interest (weighted average rate of 6.1%)		3,263
Balance of obligation		44,982
Less: Current portion		18,355
		$ 26,627

k) Financial expenses are detailed as follows:

	2006	2005
Interest on long-term debt	$ 1,802,882	$ 1,005,647
Other interest	1,810,443	940,379
	$ 3,613,325	$ 1,946,026

10. ASSET RETIREMENT OBLIGATIONS

The Company assumed the asset retirement obligations of Bell Pole at the date of the acquisition. Asset retirement obligations relating to reforestation and site remediation have been estimated using a credit-adjusted risk-free rate of 6.1% to approximate the present value of future expenditures.

Reforestation:

Reforestation obligations represent discounted cash flow estimates of future silviculture costs relating to areas logged for which the Company has the responsibility of reforestation.

	2006
Reforestation obligations, as at July 1	$ 1,110,294
Changes to reforestation estimates and accretion expense	429,894
Expenditures	(302,624)
Reforestation obligations, as at December 31	1,237,564
Current portion	822,929
	$ 414,635

Future non-discounted reforestation expenditures approximate $245,000 to $875,000 in each of the next three years. There are uncertainties in estimating future reforestation costs due to potential changes in regulation as well as the impact of weather-related changes on areas reforested. Accordingly, the actual cost of reforestation may differ from current estimates.

The Company has contracts whereby third party licencees that harvest certain areas assume the responsibility for reforestation. Should the third party licencees fail to perform, the Company is responsible for these additional future reforestation costs, which are currently estimated to be $624,981. Payments, if any, required as a result of this contingency will be expensed in the period in which they are determined and are not included in the provision for reforestation noted above.

Site remediation:

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

	2006
Site remediation obligations as at July 1	$ 1,063,204
Changes to site remediation estimates	(275,586)
Expenditures	(687,618)
Site remediation obligations, as at December 31	100,000
Current portion	100,000
	$ —

The Company will complete the environmental remediation of former treating sites in the course of 2007.

Total asset retirement obligations:

	2006
Reforestation obligations	$ 1,237,564
Site remediation obligations	100,000
	1,337,564
Current portion	922,929
	$ 414,635

11. 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 – Common

	2006		2005	
	Shares		Shares	
Balance – beginning of year	10,880,840	$ 26,174,801	10,234,639	$ 20,920,348
Private placement (Note 4(a))	1,060,000	18,020,000	555,556	5,000,000
Stock option plan	161,370	391,627	83,450	195,620
Warrants exercised (Note 11(e))	190,000	779,000	—	—
Share purchase plan	5,805	108,007	7,195	58,833
Balance end of year	12,298,015	45,473,435	10,880,840	26,174,801

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:

	2006	2005
Net earnings applicable to common shares	$ 20,845,956	$ 11,504,861
Weighted average number of common shares outstanding	11,541,087	10,451,098
Effect of dilutive stock options and warrants	327,220	229,862
Weighted average number of diluted common shares outstanding	11,868,307	10,680,960
Net earnings per common share	$ 1.81	$ 1.10
Diluted net earnings per common share	$ 1.76	$ 1.08

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 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.

11. CAPITAL STOCK (CONTINUED)

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

	2006			2005		
	Number of options		Weighted average exercise price	Number of options		Weighted average exercise price
Outstanding – beginning of year	272,225	$	4.94	285,675	$	2.21
Exercised	161,370		2.29	83,450		2.34
Granted	72,500		19.79	70,000		13.00
Outstanding – end of year	183,355		13.15	272,225		4.94
Options exercisable – end of year	83,355	$	8.60	210,225	$	2.88

The following options were outstanding under the Stock Option Plan as at December 31, 2006:

	Options outstanding			Options exercisable			
Year granted	Number of options		Weighted average exercise price	Number of options		Weighted average exercise price	Expiration date
2001	42,855	$	2.15	42,855	$	2.15	2011
2005	68,000		13.00	26,000		13.00	2015
2006	72,500		19.79	14,500		19.79	2016
	183,355			83,355			

d) Stock Option Agreement (see Note 12)

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 right to exercise these options terminates on May 6, 2013 or, in the case of a Triggering Event, within thirty days of the event.

e) Warrants

Warrants outstanding allowed for the subscription to 190,000 common shares at an exercise price of $4.10 per share before July 31, 2008. These warrants were exercised on October 18, 2006.

f) Stock-based Compensation (see Note 12)

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

In 2006, 72,500 options (2005 – 70,000) were granted, their fair value was $672,610 (2005 – $482,440) and the expense amortized to earnings was $123,808 (2005 – $18,955). The fair value was estimated with the following weighted average assumptions:

11. CAPITAL STOCK (CONTINUED)

	2006	2005
Risk-free interest rate	4.4%	4.0%
Dividend yield	1.0%	1.0%
Expected lives (years)	7.1	8.6
Volatility	44.7%	56.5%
Weighted average of fair value of options granted during the year	$ 9.28	$ 2.67

In 2006, the total stock-based compensation relating to the Stock Option Agreement (see Note 11(d)) was $2,215,000 (2005 – $1,265,000).

g) Employee Share Purchase Plans

The aggregate number of common shares reserved for issuance under the Company's two Employee Share Purchase Plans is 180,000.

Under the first plan, Company employees who are Canadian residents are eligible to purchase common shares from the Company at a price of 90% of the market value. Employees who hold common shares in the Employee Share Purchase Plan for 18 months following the date of acquisition of such shares ("Acquisition Date") receive additional common shares of the Corporation equivalent to 10% of the amount of their contributions made on the Acquisition Date. In 2006, 5,405 shares (2005 – 7,195) were issued to Canadian resident employees at an average price of $18.61 per share (2005 – $8.18).

Under the second plan, Company employees who are US residents are eligible to purchase common shares from the Company at a price equal to the market value. Employees who hold common shares in the Employee Share Purchase Plan for 18 months following the date of acquisition of such shares ("Acquisition Date") receive additional common shares of the Corporation equivalent to 10% of the amount of their contributions made on the Acquisition Date. In 2006, 400 shares (2005 – nil) were issued to US resident employees at an average price of $22.71 per share (2005 – nil).

As at December 31, 2006, the total number of shares issued under these plans is 127,590 (December 31, 2005 – 121,785).

12. CONTRIBUTED SURPLUS

The following table summarizes the contributed surplus activity for the year ended December 31:

	2006	2005
Balance – beginning of year	$ 53,499	$ 34,544
Elimination of liability associated with stock-based compensation expense[1]	2,262,000	—
Stock-based compensation (Note 11(f))	123,808	18,955
Exercise of stock options	(22,657)	—
Balance – end of year	$ 2,416,650	$ 53,499

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

13. INCOME TAXES

The earnings before income taxes was computed for the year ending December 31 as follows:

	2006	2005
Canada	$ 25,498,419	$ 16,285,877
U.S.A.	5,690,935	947,984
	$ 31,189,354	$ 17,233,861

13. INCOME TAXES (CONTINUED)

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

	2006	2005
Current:		
Canada	$ 8,592,213	$ 5,564,000
U.S.A.	1,914,185	380,000
Total current expense	10,506,398	5,944,000
Future (recovery):		
Canada	(339,000)	(215,000)
U.S.A	176,000	—
Total future (recovery)	(163,000)	(215,000)
Total	$ 10,343,398	$ 5,729,000

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

	2006	2005
Statutory tax rates	34.22%	34.50%
Income tax expense at statutory rates	$ 10,672,522	$ 5,945,538
Income tax expense (recovery) resulting from:		
Future tax adjustments due to rate enactments	(361,909)	128,438
Manufacturing and processing credit	(179,500)	(124,015)
Effect of US tax rates	270,888	45,417
Other permanent differences	(58,603)	(266,378)
	$ 10,343,398	$ 5,729,000
Effective tax rates	33.16%	33.24%

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

	2006	2005
Future income tax assets due to:		
Accrued liabilities	$ 356,000	$ 550,000
Employee future benefits	425,000	350,000
	$ 781,000	$ 900,000
Future income tax liabilities due to:		
Capital assets	$ (5,865,036)	$ (4,646,000)
Other assets	(95,000)	—
	$ (5,960,036)	$ (4,646,000)

14. EMPLOYEE FUTURE BENEFITS

a) The Company offers to certain retired employees a post retirement program consisting of group health and dental care, life insurance and complementary retirement benefits. These plans are not funded.

The Company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of this plan was as of January 1, 2006 and the next required valuation will be as of January 1, 2009. The following information pertains to the Company's plans as established by independent actuaries.

Information about the Company's defined benefit plan is as follows:

14. EMPLOYEE FUTURE BENEFITS (CONTINUED)

	2006	2005
Accrued benefit obligation:		
Balance – beginning of year	$ 1,261,690	$ 913,978
Current service cost	86,142	62,688
Interest cost on obligation	66,962	58,126
Benefit payments	(27,899)	(15,772)
Actuarial loss	361,995	242,670
Balance – end of year	1,748,890	1,261,690
Plan assets:		
Fair value, beginning of year	—	—
Contributions	27,899	15,772
Benefits paid	(27,899)	(15,772)
Fair value, end of year	—	—
Net obligation – end of year	1,748,890	1,261,690
Unamortized net actuarial loss	621,002	266,103
Unamortized past service costs	15,711	16,938
Accumulated benefit obligation	$ 1,112,177	$ 978,649

The significant assumptions used are as follows:

	2006	2005
	%	%
Accrued benefit obligation and benefit cost as of December 31, 2006		
Discount rate	5.00	6.00
Rate of compensation increase	4.00	4.00

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2006. 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	$ 377,768	$ 292,051
Impact on benefit cost	37,891	29,590

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

	2006	2005
Current year service cost	$ 86,142	$ 62,688
Interest cost	66,962	58,126
Actuarial loss	361,995	242,670
Elements of employee future benefits cost before adjustments to recognize the long-term nature of employee future cost	515,099	363,484
Adjustments to recognize the long-term nature of employee future benefits cost:		
Difference between net actuarial gain and actuarial gain for year	(354,900)	(242,670)
Amortization of past service costs	1,227	1,227
Defined benefit cost recognized	$ 161,426	$ 122,041

14. EMPLOYEE FUTURE BENEFITS (CONTINUED)

Cash payments for employee future benefits for the year ended December 31, 2006, amounted to $27,899 (2005 – $15,772).

b) Bell Pole, acquired on July 1, 2006, contributes to a multi-employer plan for certain hourly employees and to three defined benefit pension plans for salaried and certain non-union hourly wage employees. Pension benefits are based on length of service and final average earnings.

The company measures its accrued benefit obligations and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was as of December 31, 2004 and the next required valuation will be as of December 31, 2007.

Information about Bell Pole's defined benefit plans other than the multi-employer defined benefit plan, in aggregate, is as follows:

	2006
Accrued benefit obligation:	
Beginning balance as at July 1, 2006	$ 10,560,800
Current service cost	205,000
Interest cost on obligation	279,650
Benefit payments	(1,171,350)
Actuarial loss	847,400
Balance, end of year	10,721,500
Plan assets:	
Fair value, beginning balance as at July 1, 2006	10,895,050
Actual return on plan assets	1,353,500
Contributions	113,450
Benefits paid	(1,171,350)
Fair value, end of year	11,190,650
Funded status-plan surplus	469,150
Unamortized net actuarial loss	33,435
Accrued benefit asset, included in other assets	$ 435,715

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

	2006
Accrued benefit obligation	$ (3,478,800)
Fair value of plan assets	3,189,300
Funded status-plan deficit	$ (289,500)

Percentage of plan assets consist of the following for the period ending December 31, 2006:

	2006 %
Equity securities	57
Debt securities	39
Short-term and cash	4
	100

14. EMPLOYEE FUTURE BENEFITS (CONTINUED)

The significant assumptions used are as follows (weighted-average):

	2006 %
Accrued benefit obligation as of December 31:	
Discount rate	5.00
Rate of compensation increase	4.00
Benefit costs for the year ended December 31:	
Discount rate	5.50
Expected long-term rate of return on plan assets	7.50
Rate of compensation increase	4.00

The elements of Bell Pole's defined benefit plan costs recognized in the year are as follows:

	2006
Current service cost, net of employee contributions	$ 198,100
Interest cost	279,650
Actual return on plan assets	(1,353,500)
Actuarial losses	847,400
Element of employee future benefit costs before adjustments to recognize the long-term nature of employee future benefit costs	(28,350)
Adjustment to recognize the long-term nature of employee future benefit costs:	
Difference between expected return and actual return on plan asset for year	960,350
Difference between actuarial gain recognized for year and actual actuarial gain for year	(841,652)
Defined benefit costs recognized	$ 90,348

The company expects to contribute $494,000 to its pension plan in 2007.

15. CUMULATIVE TRANSLATION ADJUSTMENT

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

16. INTEREST IN JOINT VENTURE

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

16. INTEREST IN JOINT VENTURE (CONTINUED)

		2006
Assets		
Current assets		
Accounts receivable	$	221,392
Other receivable		963,506
Inventories		1,306,446
Prepaid expenses		19,455
		2,510,799
Capital assets		531,569
Other assets		89,415
Total assets	$	3,131,783
Liabilities		
Current liabilities		
Bank indebtedness	$	2,778,556
Accounts payable and accrued liabilities		353,227
Total liabilities	$	3,131,783
Earnings		
Sales	$	2,338,331
Cost of sales		2,338,331
Income before taxes	$	—
Cash flows		
Cash flows used in operating activities	$	(546,013)
Cash flows provided by financing activities		685,902
Cash flows used in investing activities		(139,889)
	$	—

17. COMMITMENTS AND CONTINGENCIES

a) The Company is from time to time involved in various claims and legal proceedings arising in the ordinary course of business. It is the opinion of Management that a final determination of these proceedings cannot be made at this time but should not materially affect the Company's financial position or results of operations.

b) The Company has issued guarantees amounting to $127,396 (December 31, 2005 – $638,740) 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.

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

2007	$	1,669,573
2008		1,294,078
2009		1,027,816
2010		626,101
2011		281,517
Thereafter		2,294,716

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

18. FINANCIAL INSTRUMENTS

Currency Risks

The Company is exposed to currency risks due to its export of goods manufactured in Canada and of its trade accounts receivable and payable denominated in US dollars. These risks are partially covered by purchases. The Company also uses foreign exchange forward contracts to hedge contracted net cash inflows and outflows of US 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 US 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 US dollars required to pay these suppliers.

The following table summarizes the Company's foreign currency commitments as at December 31:

2006

Foreign currency contracts	Notional Amount $	Average Exchange Rate	Maturing Up to	Notional Equivalent $ CDN	Fair Value $ CDN
Sell $ US to $ CDN	2,000,000	1.6113	Dec. 2007	2,330,800	881,660

2005

Foreign currency contracts	Notional Amount $	Average Exchange Rate	Maturing Up to	Notional Equivalent $ CDN	Fair Value $ CDN
Sell $ US to $ CDN	4,000,000	1.6084	Dec. 2007	4,652,000	1,493,268

Interest Rate Risks

As at December 31, 2006, the Company had limited exposure to interest rate risk on long-term debt as only 3% (December 31, 2005 – 3%) of the Company's long-term debt is at variable rates.

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

The following table summarizes the Company's interest rate swap agreements as at December 31:

2006

	Notional Amount $	Fixed Rate	Maturing Date	Notional Equivalent $ CDN
Interest rate swap - CDN	2,300,000	5.81	Dec. 2010	2,300,000
Interest rate swap - CDN	2,700,000	5.85	Feb. 2011	2,700,000
Interest rate swap - US	1,100,000	7.23	Sept. 2010	1,281,940

2005

	Notional Amount $	Fixed Rate	Maturing Date	Notional Equivalent $ CDN
Interest rate swap - CDN	2,300,000	5.81	Dec. 2010	2,300,000
Interest rate swap - US	1,100,000	7.23	Sept. 2010	1,279,300

The fair value of the interest rate swap agreements based on cash settlement requirements as of December 31, 2006 is a loss position of $32,727 which is not recorded in the financial statements.

18. FINANCIAL INSTRUMENTS (CONTINUED)

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 telecommunication companies and other major corporations.

19. RELATED PARTY TRANSACTIONS

The Company had the following transactions with related parties:

	2006	2005
Parent company		
Marketing and technical service fees paid	$ 200,000	$ 200,000
Interest on promissory note	86,774	30,786
Ultimate shareholders		
Marketing and technical service fees paid	100,000	100,000
Interest on loans	—	74,404

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:

	2006	2005
Accounts payable to parent company	$ 86,675	$ 80,786
Accounts payable to ultimate shareholders	25,000	25,000

20. 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, Alberta, 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:

	2006	2005
Geographic sales information:		
Canada	$ 152,988,724	$ 125,607,119
U.S.A.	70,864,302	31,112,891
Other, primarily Mexico	—	408,541
	$ 223,853,026	$ 157,128,551

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

	2006	2005
Canada	$ 54,970,181	$ 32,902,359
U.S.A.	4,955,475	4,100,747
Total	$ 59,925,656	$ 37,003,106

In 2006, the Company had one customer representing 21% of its sales (2005 – 19% of sales).

21. SUBSEQUENT EVENT

On February 28, 2007, the Company announced that its wholly-owned US subsidiary, SJ Corp, had completed the acquisition of the wood utility pole business of J.H. Baxter & Co. ("Baxter"). Assets acquired include the Baxter production plant located in Arlington, Washington, its pole peeling facility in Juliaetta, Idaho as well as all inventories and accounts receivable relating to its wood pole business. The purchase price totalled US$22.3 million, of which approximately US$12.0 million was for inventory and receivables. Financing for the transaction was provided by a subordinated vendor note of US$8.0 million as well as additional debt funding under existing and new bank facilities. The new bank facilities are comprised of an increase of US$5.0 million in the operating line of credit of SJ Corp as well as a new 5-year term loan of US$4.0 million, both arranged with its existing US banker.

22. COMPARATIVE FIGURES

The 2005 comparative amounts were restated on December 21, 2006 to give effect to the accounting for stock-based compensation.

In addition, 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, CMA [(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., B.Eng., F.E.I.C. [(1) (3)]
Corporate Director,
Beaconsfield, Québec
Director since October 1992

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

Nycol Pageau-Goyette [(2) (3) (4)]
President,
Pageau Goyette et associés limitée
(Management services firm)
Chairperson,
Sorinco Inc.
(Pharmaceutical and cosmetic product
recycling plant)
President,
Montrésor Corporation
(Holding company)
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
(4) Lead Director

A full report of Stella-Jones' corporate governance practices is set out in the Proxy Circular for the May 3, 2007 Annual and Special 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
Vice-President and Corporate
Comptroller

Wayne Hingley
Vice-President and General Manager,
Western Region

SUBSIDIARIES

Rick Thompson
Vice-President and General Manager,
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

Ian Jones
Vice-President and General Manager,
Bell Pole Canada Inc.

Glen Ritchie
Vice-President, Fibre
Bell Pole Canada Inc.

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.

AUDITORS

BDO Dunwoody LLP

LEGAL COUNSEL

Fasken Martineau DuMoulin LLP

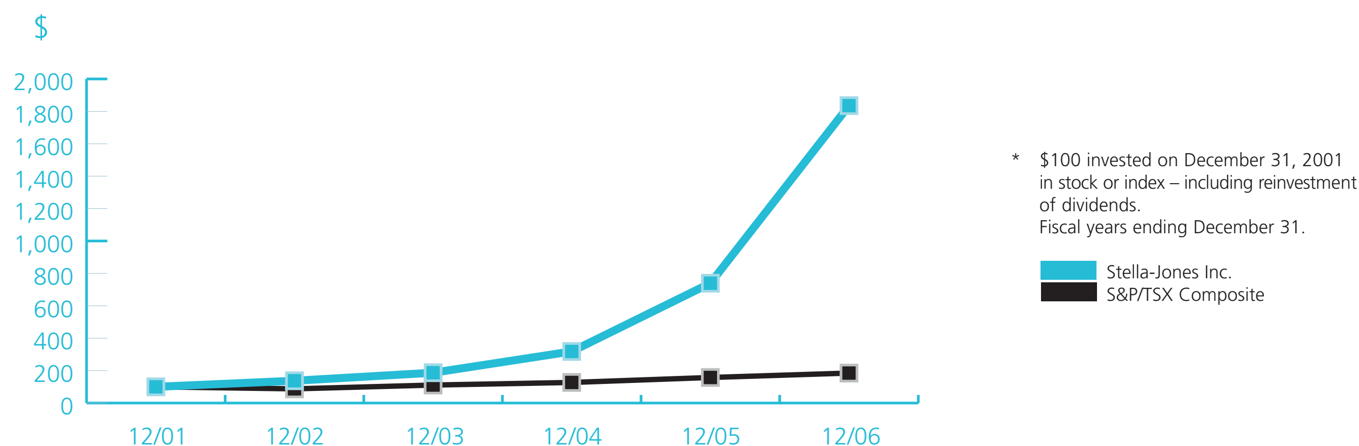
Corporate Information

ANNUAL AND SPECIAL MEETING OF SHAREHOLDERS
May 3, 2007
10:00 a.m.
Ritz-Carlton Montréal
Salon Bleu
1228 Sherbrooke 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. (61.7%)
52-week high/low
(Jan. 1 – Dec. 31, 2006): $34.90/$13.50
Share price at March 14, 2007: $34.01
Common shares outstanding as at December 31, 2006: 12.30 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 14, 2007, in light of the Company's strong financial performance in fiscal 2006 and confidence in the prospects for 2007, the Board of Directors resolved to increase the next semi-annual dividend to $0.10 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, 2001 in stock or index – including reinvestment of dividends.
Fiscal years ending December 31.

CUMULATIVE TOTAL RETURN

	2002	2003	2004	2005	2006
Close	$2.75	$3.65	$6.10	$14.00	$34.50
Price / earnings	6.7	9.1	8.5	12.7	19.1
Price / book value	0.70	0.86	1.27	2.35	4.01

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