Annual Report 2009

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ON COURSE, POSITIONED FOR GROWTH

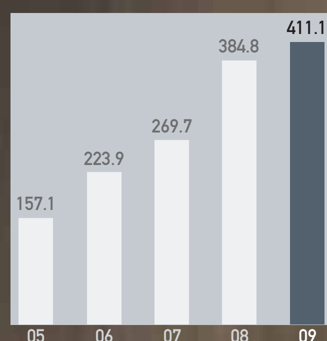
In 2009, Stella-Jones reported the highest revenues in its history and solid profitability. The Company, one of North America's leading manufacturers of treated wood railway ties and utility poles, as well as a producer of industrial and consumer lumber, operates fourteen treating facilities located in five Canadian provinces and six U.S. states. Stella-Jones has deep roots in the marketplace as a supplier to many of the continent's largest railroad operators, electrical transmission utilities and telecommunications companies. As such, the Company has consistently maintained a solid financial performance and is positioned for significant long-term growth.

Stella-Jones continued its strategy of expansion and consolidation of the industry in 2009 by signing a non-binding letter of intent with Tangent Rail Corporation ("Tangent") to acquire its railway tie plants and ancillary facilities in the states of Alabama, Indiana, Louisiana, Minnesota, Pennsylvania, Tennessee and Utah. As this Report goes to press, the transaction to acquire the shares of Tangent is expected to close, and the Company is poised to begin integrating Tangent's operations and assets and realizing the synergies of an expanded network.

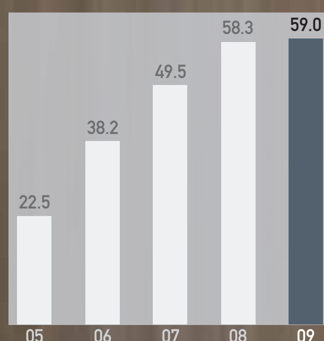
5-YEAR REVIEW

For the years ended December 31 (thousands of dollars, except per share data and ratios)	2009 $	2008 $	2007 $	2006 $	2005 $
Operating results					
Sales	411,119	384,822	269,714	223,853	157,129
EBITDA[1]	59,023	58,329	49,500	38,166	22,457
Net earnings	30,069	28,547	25,700	20,846	11,505
Cash flow from operating activities [1,2]	40,936	41,055	33,438	26,839	15,975
Financial position					
Working capital	170,082	156,898	103,241	79,966	55,485
Total assets	370,795	407,546	244,856	213,675	137,891
Long-term debt [3]	87,080	105,759	47,444	31,893	26,466
Shareholders' equity	179,978	161,112	127,757	105,822	64,808
Per share data					
Net earnings per common share	2.38	2.29	2.09	1.81	1.10
Diluted net earnings per common share	2.37	2.25	2.03	1.76	1.08
Cash flow from operating activities [1,2]	3.24	3.29	2.71	2.33	1.53
Book value	14.19	12.82	10.35	8.60	5.96
Dividend per share	0.36	0.34	0.24	0.14	0.10
Average number of shares outstanding (000's)	12,638	12,483	12,324	11,541	10,451
Shares outstanding at year end (000's)	12,684	12,565	12,341	12,298	10,881
Average number of diluted shares outstanding (000's)	12,704	12,695	12,690	11,868	10,681
Financial ratios					
Return on average equity	17.6%	19.8%	22.0%	24.4%	20.2%
Long-term debt to equity [3]	0.48:1	0.66:1	0.37:1	0.30:1	0.41:1
Working capital	3.01	2.31	2.56	2.11	2.23

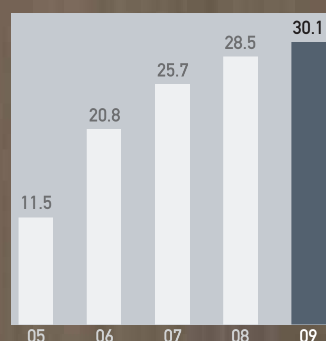
SALES
(in millions of $)



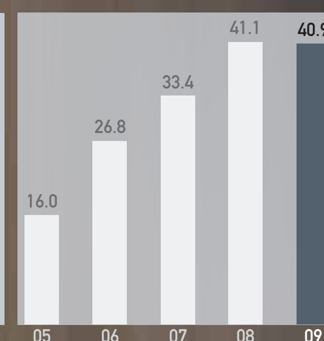
EBITDA
(in millions of $)



NET EARNINGS
(in millions of $)



CASH FLOW FROM OPERATING ACTIVITIES [1,2]
(in millions of $)



1 Earnings before interest, taxes, depreciation and amortization ("EBITDA") and cash flow from operating activities 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.
2 Before changes in non-cash working capital components.
3 Including current portion.

CORE STRENGTHS OF STELLA-JONES

- Essential products
- A continental network
- Tailored production
- Substantial purchasing power
- Extensive sourcing rights

SUPPORTING BASIC INFRASTRUCTURE

The railroad industry, electrical transmission utilities and telecommunications companies of North America provide much of the physical infrastructure upon which the continental economy relies. These industries in turn rely on railway ties and utility poles to support their vast transportation, energy and communications networks. Stella-Jones is one of the largest North American producers of treated wood railway ties and treated wood utility poles, and the only such producer working on a national scale in Canada.

ENSURING SUPPLY

The Company's manufacturing facilities include fourteen wood treating plants located in the provinces of Nova Scotia, Quebec, Ontario, Alberta and British Columbia, and the states of Pennsylvania, Virginia, West Virginia, Kentucky, Wisconsin and Washington. Stella-Jones also operates pole peeling plants in Idaho and British Columbia, and holds a 50% interest in a third pole peeling plant in British Columbia. In the event of production demands in excess of a plant's capacity, client orders can rapidly be accommodated at a sister facility. Moreover, if railroad or electrical lines are damaged by natural disasters, the Company's large inventories and multi-factory network allow it to produce the required volumes of replacement ties and poles to meet emergency needs.

PROVIDING OPTIMAL SERVICE

Adding to the security of supply that Stella-Jones provides, the Company's production is customer-driven. Stella-Jones manufactures to the specifications of end users, and offers all species of wood and the complete spectrum of preservatives. With network efficiency a key driver, the decision on where to produce an order is always determined by the most advantageous use of Stella-Jones' North America-wide inventory and resources.

BENEFITING FROM ECONOMIES OF SCALE

With size comes purchasing power, and with purchasing power comes the ability to improve margins. Stella-Jones has progressively leveraged economies of scale as it has expanded. The Company has also increased the efficiency of its operations by instituting plant specialization.

HARVESTING A RENEWABLE RESOURCE

Having built long-term relationships with hundreds of forestry suppliers in strategic regions of North America, Stella-Jones enjoys a competitive advantage by virtue of its strong wood supply position. Moreover, a substantial portion of the wood the Company uses to manufacture poles comes from trees harvested through its own cutting rights in Quebec, Alberta and British Columbia. The Company's relationships with suppliers and its cutting rights not only provide the Company with a guaranteed supply of raw material, but allows it to offer all species in a market increasingly sensitive to diversity of product.

2009 HIGHLIGHTS

- Strong profitability
- Steady core markets
- Network synergies
- Growth by acquisition

SOLID FINANCIAL PERFORMANCE

In 2009, during a year of wide ranging economic challenge, Stella-Jones demonstrated its recession-resilient character with impressive force. The Company increased both sales and net earnings, generated a strong cash flow, substantially reduced debt and strengthened its balance sheet.

SUSTAINED SALES VOLUMES

As one of the largest suppliers in North America of two fundamental components of transportation and transmission infrastructure, Stella-Jones increased its market share and partially offset a decline in sales volume caused by the overall decrease in demand for pressure treated wood railway ties and wood utility poles. The Company's ancillary products – pressure treated industrial and consumer lumber – also enjoyed generally sustained sales during the year.

CAPACITY OPTIMIZATION

Reviewing the cost efficiency of operations remained a prime commitment. As part of the integration of the 2008 acquisition of The Burke-Parsons-Bowlby Corporation, the Company's facility in Stanton, Kentucky was closed and the majority of its production transferred to its Spencer, West Virginia plant. This move furthered the Company's program of capacity optimization across its North American plant network, and advanced its objective of benefiting from all possible synergies afforded by the acquisition.

FURTHER CONTINENTAL EXPANSION

In 2009, Stella-Jones once again pursued its objective of increasing shareholder value through both top and bottom line growth. In line with the Company's long-term goal of consolidating the wood treating industry in North America for railway ties and utility poles, Stella-Jones signed a non-binding letter of intent to acquire the shares of Tangent Rail Corporation, a provider of wood crosstie supply chain services to the railroad industry. This acquisition is scheduled to close on April 1, 2010. Tangent's facilities are located in Alabama, Indiana, Louisiana, Minnesota, Pennsylvania, Tennessee and Utah. Its lifecycle services for the railroad industry include tie pickup and tie disposal. In 2009, Tangent's sales totalled approximately US$178 million. This acquisition will expand Stella-Jones' capabilities within the U.S. railway tie industry. Significantly, it will also provide Stella-Jones with creosote manufacturing operations.

- August 2009: Stella-Jones announced a semi-annual dividend of $0.18 per share
- March 2010: Stella-Jones announced a semi-annual dividend of $0.18 per share

Stella-Jones produced another strong and successful result in 2009, which more than adequately justifies the claims we have so often made about the soundness of our business model.

CHAIRMAN'S REPORT

Most companies, in whichever country in the world they are based and in whatever sector they operate, will have been happy to see the end of 2009 and to have survived intact. Stella-Jones Inc. is not only intact but produced another strong and successful result in 2009, which more than adequately justifies the claims we have so often made of the soundness of our business model, of our operating efficiencies and of the special niche markets in which we operate.

All of our business streams performed strongly

Clearly, neither we nor our customers have been totally immune from the world recession and some of our margins have inevitably been squeezed. Our net earnings reached $30.1 million on sales of $411.1 million, compared to $28.5 million on sales of $384.8 million in 2008, although the latter included only nine months results of our newly acquired company, The Burke-Parsons-Bowlby Corporation. It was particularly encouraging that all of our main business streams - railway ties, utility poles and treated lumber for the industrial and residential markets - performed strongly.

We have made a good start to 2010 but it will be another challenging year and we continue to drive costs out of our system to protect our margins.

A formidable addition to our group

We announced on December 15, 2009 that we had signed a non-binding letter of intent to acquire Tangent Rail Corporation in the United States. As I write this report, we are well on our way to closing this deal by April 1, 2010. This acquisition will, I am certain, prove to be a formidable addition to our group both in commercial and geographic terms. It will additionally give us an entrée into two important and closely linked businesses in which we have not been present before, namely, coal tar distillation for the production of creosote and recycling of used railway ties.

The total cost of this proposed acquisition is approximately $175 million which will be funded by debt of approximately $95 million and an equity increase of $80 million. Of the latter, $15 million will be provided by Stella Jones International S.A., the joint venture company owned by my family company, James Jones & Sons Ltd, and Stella International S.A., owned by the Chiarva family. In doing so, Stella Jones International's share of the equity in Stella-Jones will be reduced from approximately 60% to approximately 52%, thus increasing the public float but also, crucially, demonstrating the confidence of the major shareholders in the future of Stella-Jones.

CONFIDENCE OF THE MAJOR SHAREHOLDERS IN THE FUTURE OF STELLA-JONES

In my Chairman's Message last year, I made reference to the impending retirement from our Board of our longest serving director, Arthur Earle. This vacancy has been filled by Barrie Shineton, President and CEO of Norbord Inc. Since his appointment, Barrie has made an important contribution to our company, drawing on his long career in the forest products industry and, significantly, his experience in Canada, the USA and overseas.

I am proud of the tremendous contribution from all our employees in a challenging year and I thank them, our loyal customers and our shareholders for their continuing support.

Tom A. Bruce-Jones, CBE
Chairman

PRESIDENT'S MESSAGE

While the year 2009 was a challenging one for Stella-Jones, it was by no means disappointing. The Company remained profitable in a fragile economy. At the same time, we continued to pursue continental expansion and positioned the Company for significant growth once the economy recovers.

In a year characterized by a lingering recessionary environment that affected many of our customers, we tightly controlled costs and aligned expenses with revenues to protect our margins wherever possible. We concentrated on improving our market share to partially offset declines in demand.

The railway ties and utility poles produced in the plants of Stella-Jones constitute essential components of fundamental infrastructure. This advantage does not render our products recession-proof, but does distinguish them as relatively recession-resilient. As a result, compared to most other manufacturing companies in North America in 2009, Stella-Jones performed quite well.

SOLID FINANCIAL PERFORMANCE

2009 marked our ninth consecutive year of sales and net earnings growth. Sales totalled $411.1 million, representing an increase of 6.8%, while net earnings of $30.1 million rose 5.3% above year-earlier levels. Stella-Jones generated a strong cash flow and its balance sheet strengthened as debt was substantially reduced.

RAILWAY TIE CATEGORY

The principal factor holding back overall sales growth in the railway tie category in 2009 was a decline in demand from railroad operators. This product is customarily the most likely to experience volatility during difficult economic conditions. As a consequence of reduced North American freight volumes during the year, both Class 1 and short-line railways refrained from certain investments in new track and track upgrades.

As demand from the railroads decreased, pricing pressures steadily increased. Excess inventories also played a role in price reductions. Some of our competitors had ramped up production for what they believed would be a high demand year. These factors combined to considerably soften the market during the latter part of 2009, and particularly during the last quarter. Many of the railroads stopped taking deliveries of ties as they sought to reduce their own inventories.

UTILITY POLE CATEGORY

Sales volume in the utility pole category held firm from the previous year, with performance varying from region to region. While competitive pressures brought down pricing, Stella-Jones nevertheless generated greater revenues as our sales were more heavily weighted to transmission poles which command a higher selling price per cubic foot.

INDUSTRIAL AND RESIDENTIAL LUMBER

The industrial and residential lumber segments continued to play an important ancillary role in the overall financial performance of Stella-Jones. Together, these product categories accounted for nearly 20% of our revenues.

Potential acquisition of tangent rail corporation

In December of 2009, Stella-Jones signed a non-binding letter of intent to acquire Tangent Rail Corporation. Tangent is one of the leading providers of wood crosstie supply chain services to the railroad industry with sales of approximately US$178 million in 2009. As we go to press, we are nearing the close of this transaction, which will constitute our largest ever acquisition.

This strategic move will represent a geographically consistent expression of the ongoing expansion of Stella-Jones – the most logical "next step" in our continental thrust. When completed, the transaction will notably enhance our offering to the U.S. railroad industry, while contiguously widening our scope. Tangent serves the railroad industry with treated wood products, mainly railway ties, through five treating facilities located in Alabama, Indiana, Louisiana and Pennsylvania.

Significantly for Stella-Jones, Tangent is licensed to manufacture the wood preservative, creosote, at its two coal tar distilleries in Indiana and Tennessee. The acquisition will thus secure our supply base for this indispensable constituent of the railway tie treating process. Moreover, Tangent performs value added pre-plating and recycling for its railway clients. The latter services, carried out at three facilities in Alabama, Minnesota and North Carolina, consist of tie retrieval and tie disposal. These capacities and services will gainfully complement the core competence of Stella-Jones.

In short, the acquisition of Tangent – which has built a reputation for excellence on the basis of a corporate culture that mirrors our own – will take our Company to a still higher level of capacity and reach. We believe it will make us an even stronger option for Class 1 railroads, and contribute very positively to long-term value creation for our shareholders.

Outlook

The year 2010 will likely resemble 2009 in many respects. We do not expect a rapid recovery, but neither do we anticipate lower general demand for our products.

Subsequent to year-end, price and sales levels began to stabilize in the railway tie category, and we saw increased activity in some regions.

Given the abiding uncertainty in the North American economy, we will stay focused on network optimization and cost control throughout the organization. In this way, as we await a full recovery for which we are well positioned, Stella-Jones will continue to protect shareholder value.

I want to take this opportunity to thank all our employees for their dedication during a challenging year in our industry, as well as our customers, shareholders and Board of Directors for their continuous support.

Brian McManus
President and Chief Executive Officer

The Stella-Jones Network

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

TREATING FACILITIES

1. New Westminster, B.C.
2. Prince George, B.C.*
3. Carseland, Alberta*
4. Guelph, Ontario
5. Gatineau, Quebec*
6. Delson, Quebec
7. Sorel-Tracy, Quebec
8. Truro, Nova Scotia
9. Arlington, Washington*
10. Bangor, Wisconsin
11. Fulton, Kentucky
12. Spencer, West Virginia
13. Goshen, Virginia
14. DuBois, Pennsylvania

* Facility with pole peeling capacity

POLE PEELING FACILITIES

A. Maple Ridge, B.C.
B. Revelstoke, B.C.
C. Juliaetta, Idaho

NORTHWEST TERRITORIES
NUNAVUT
SASKATCHEWAN
MANITOBA
ONTARIO
QUEBEC
NEWFOUNDLAND AND LABRADOR
P.E.I
NEW BRUNSWICK
NOVA SCOTIA
5*
6
7
8
WISCONSIN
10
4
PENNSYLVANIA
14
WEST VIRGINIA
12
VIRGINIA
13
11
KENTUCKY
Sales by Geographic Region
U.S.A. 54.3%
CANADA 45.7%

PRODUCTS: RAILWAY TIES

THE BUSINESS MODEL OF STELLA-JONES IS STRAIGHTFORWARD, ADVANTAGEOUS AND ENDURING: THE COMPANY IS IN THE BUSINESS OF TREATING WOOD AND TRANSFORMING IT INTO RAILWAY TIES, UTILITY POLES, AND INDUSTRIAL AND CONSUMER LUMBER.

- Basic component of continental transport
- Largest product category of Stella-Jones

Since the first railroads were built in North America some 180 years ago, the ribbons of iron crisscrossing the continent have steadily proliferated. The demand for rail services shows no sign of letting up, as the energy savings and environmental benefit of rail transport are compelling. Where the machinery of the economy is concerned, the railroads represent a fundamental and virtually indispensable component. In tandem with the expansion of the railroad industry, the market for railway crossties has progressively grown. It is a simple reality in the industry that railroads must regularly replace aging ties on existing track and lay new ones on track extensions. The story of the size and reliability of the North American market for railway ties is told in its statistics.

Nearly 180,000 miles of railway track weave through the countryside and cities of the U.S. and Canada. Holding the tracks together and forming the railbed are well over a billion wooden ties. Every year for the last twenty years, an average of more than fifteen million ties have been purchased by the railroad industry.

Environmentally, wood remains the material of choice for the industry. Wood is a renewable resource and consumes much less energy to produce than steel, plastic or concrete. Additionally, at the end of their useful life, wood crossties make a clean and efficient source of biomass energy.

Historically, Stella-Jones has long been the largest supplier of ties to Canadian railroads, and is now also among the leading suppliers in the U.S.

$185.1 M	RAILWAY TIE SALES IN 2009
45.0%	OF TOTAL SALES IN 2009

The markets of Stella-Jones are fundamental to the economic life of North America; the Company's products underlie and support the continent's physical infrastructure.

- Integral component of energy transmission and communications networks
- Second principal product category of Stella-Jones

Well over 150 million wood utility poles are currently in use across Canada and the U.S. They support the transmission lines of our communications networks. They bear the lines that distribute our electrical energy. Common and ubiquitous, they form a familiar part of both the rural and urban landscape.

Owing to its strategically located plants, operational flexibility, and broad coverage of the North American market, Stella-Jones is well positioned to capture opportunities in this category.

The production prowess of Stella-Jones is unsurpassed in the industry. Only very few in the industry can match the Company's range of product in utility poles. Thanks to its cutting rights and long established relationships with forestry suppliers, Stella-Jones can supply poles made from timber of the highest quality, in all required species, and sized anywhere between 25-feet and 140-feet. With its continental network of plants, Stella-Jones has been able to meet sudden massive orders for poles after natural disaster events. These factors have earned the Company recognition as a reliable single source supplier in many of the markets it serves.

Wood has proven itself the preferred material for utility poles for over a century. Poles manufactured from timber are considerably less expensive to produce than steel or fiberglass, and they offer much greater flexibility in terms of climbing or re-drilling once they've been installed.

$149.7 M	Utility Pole sales in 2009
36.4%	of total sales in 2009

PRODUCTS:

INDUSTRIAL LUMBER

THE STELLA-JONES BUSINESS MODEL ADHERES TO A CORE COMPETENCE THAT HAS BEEN DEVELOPED AND REFINED OVER MANY DECADES, AND WHICH KEEPS THE COMPANY EXCLUSIVELY FOCUSED ON WHAT IT DOES BEST: THE MANUFACTURE OF PRESSURE TREATED WOOD PRODUCTS.

- Providing wood for construction and marine applications
- Expertise in treating allows for capture of significant market share

Many industrial projects require wood as a construction material. In such cases, the demand includes selected species and specialized pressure treatment of the timber to withstand environmental conditions – different outdoor conditions call for different preservatives. Accordingly, due to the Company's species range and gamut of preservatives, many users of industrial lumber have come to depend upon Stella-Jones. In addition, they value the reliability of supply and delivery that the Company's network of plants makes possible. Among the products manufactured in the industrial lumber category are foundation and marine pilings, bridge timbers, highway guardrail posts and custom log homes.

In 2009, Stella-Jones' industrial lumber sales were marginally higher than the previous year, with activity improving appreciably in the fourth quarter.

$44.8 M	INDUSTRIAL LUMBER SALES IN 2009
10.9%	OF TOTAL SALES IN 2009

CONSUMER LUMBER

- Serving the Canadian home renovation retail market
- A growing complementary category of Stella-Jones

The home renovation marketplace, with its demand for the highest quality standards in pressure treated wood, is a natural ancillary business for Stella-Jones. Allied with a major lumber wholesaler in Canada, the Company brings its production expertise to bear on treating wood for fences, patios, decks and various outdoor applications. Over the years, this product category, which is sold only in Canada, has become a steady and significant contributor to the revenues of Stella-Jones. In 2009, a year in which a home renovation tax credit was available in Canada, the performance of the category held firm against recessionary pressures in residential real estate.

$31.5 M	CONSUMER LUMBER SALES IN 2009
7.7%	OF TOTAL SALES IN 2009

MANAGEMENT'S DISCUSSION & ANALYSIS

The following Management's Discussion and Analysis ("MD&A") dated March 12, 2010 provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2009 compared with the fiscal year ended December 31, 2008. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2009 and 2008 and the notes thereto. The audited consolidated financial statements and MD&A have been reviewed by the Company's Audit Committee and, upon its recommendation, have been approved by the Board of Directors.

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

The Company's audited consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and results are reported in Canadian dollars. All amounts in this MD&A are in Canadian dollars unless otherwise indicated.

Additional information, including the Company's annual information form, quarterly and annual reports, and supplementary information is available on SEDAR at www.sedar.com. Press releases and other information are also available in the Investor/Media Centre section of the Company's Web site at www.stella-jones.com.

OUR BUSINESS

Stella-Jones is a leading North American producer and marketer of industrial pressure treated wood products and also provides treated consumer lumber products and customized services to lumber retailers and wholesalers for outdoor applications.

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

As of March 12, 2010, the Company owns and operates fourteen wood treating plants, two distribution centres, two pole peeling facilities and has a 50% interest in a third pole peeling operation. These nineteen facilities are located in six Canadian provinces and seven American states. The Company's workforce currently numbers approximately 690 employees.

Stella-Jones enjoys a number of key attributes which should further enhance the Company's strategic positioning and competitive advantage in the wood treatment industry. Among these are the ability to service clients from multiple plants, a solid financial position that allows the Company to stockpile and air-season green wood for major long-term contracts, and a long-standing stable source of wood supply. Stella-Jones also operates dedicated production facilities which result in higher productivity and better efficiency, helping to preserve a competitive manufacturing cost structure.

OUR MISSION

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

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

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

NON-GAAP MEASURES

Operating earnings before amortization of capital and intangible assets (also referred to as earnings before interest, taxes, depreciation and amortization ["EBITDA"]), operating earnings, and cash flow from operations 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 it to be useful information to assist knowledgeable investors in evaluating the cash generating capabilities of the Company.

MAJOR ACHIEVEMENTS OF 2009

Financial results for the year ended December 31, 2009, marked the ninth consecutive year of uninterrupted growth in revenues and net earnings. Revenues grew by 6.8%, primarily as a result of the acquisition of The Burke-Parsons-Bowlby Corporation ("BPB") completed in 2008 and favourable currency fluctuations. Organically, sales decreased approximately 7.0%, mainly reflecting reduced demand in the railway tie product category. Gross profit decreased in monetary terms and as a percentage of sales, reflecting softer pricing in most markets as the year progressed. Net earnings grew 5.3% to reach $30.1 million.

Stella-Jones' solid performance once again generated strong cash flows in 2009, with cash flow from operations, before changes in non-cash working capital components, reaching $40.9 million, compared with $41.1 million in 2008. The Company improved an already sound balance sheet, with a total long-term debt to equity ratio of 0.48:1 and a ratio of total debt to operating earnings before amortization of capital and intangible assets of 2.43:1.

On December 15, 2009, the Company announced it had signed a non-binding letter of intent to acquire Tangent Rail Corporation ("Tangent"), a provider of wood crosstie supply chain services to the railroad industry. Tangent serves the railroad industry with treated wood products, mainly railway ties, through five facilities located in Alabama, Indiana (2), Louisiana and Pennsylvania. It also produces creosote, a wood preservative, at two distilleries in Indiana and Tennessee. Subsequent to year-end, on February 4, 2010, the proposed transaction received U.S. antitrust clearance. The transaction is expected to close no later than April 1, 2010 subject to customary closing conditions, including entry into a definitive purchase agreement and satisfactory due diligence.

KEY PERFORMANCE INDICATORS

For the years ended December 31	2009	2008	2007
(thousands of dollars, except per share data and ratios)	$	$	$
Sales	411,119	384,822	269,714
Gross profit	76,669	78,398	66,788
Net earnings	30,069	28,547	25,700
Net earnings per common share	2.38	2.29	2.09
Diluted net earnings per common share	2.37	2.25	2.03
Total assets	370,795	407,546	244,856
Total long-term debt*	87,080	105,759	47,444
Total long-term debt* to equity ratio	0.48:1	0.66:1	0.37:1
Total debt** to operating earnings before amortization of capital and intangible assets	2.43	3.21	1.75
Dividend per share	0.36	0.34	0.24

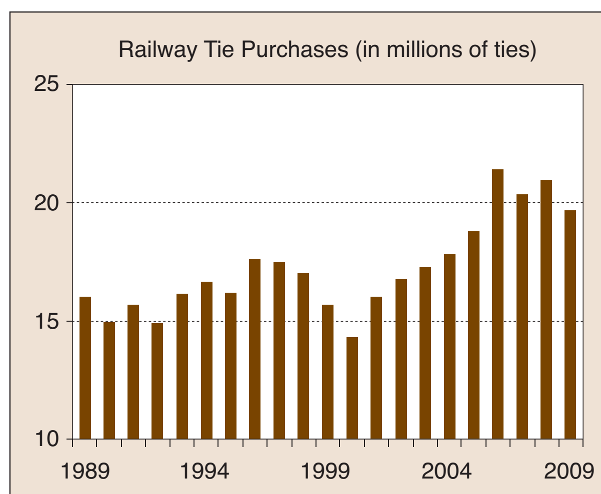
* Including current portion
** Including short-term bank indebtedness

FOREIGN EXCHANGE

The table below shows exchange rates applicable to the periods ended December 31, 2009 and 2008. Average rates are used to translate sales and expenses for the periods mentioned, while closing rates translate assets and liabilities of self-sustaining foreign operations and monetary assets and liabilities of the Canadian operations.

Cdn$/US$	2009		2008	
	Average	Closing	Average	Closing
First Quarter	1.2389	1.2613	0.9909	1.0265
Second Quarter	1.1820	1.1630	1.0110	1.0197
Third Quarter	1.1118	1.0707	1.0425	1.0642
Fourth Quarter	1.0694	1.0510	1.1686	1.2180
Fiscal Year	1.1505	1.0510	1.0515	1.2180

INDUSTRY OVERVIEW



Source: Railway Tie Association

Railway ties

As reported by the Railway Tie Association, railway tie purchases declined approximately 6.0% to 19.6 million ties in 2009. Although below previous year levels, railway tie purchases still remained high in comparison with the average for the last twenty years.

In the last decade, volatile fuel prices and persistent highway congestion have increasingly caused shippers to favour rail, a more fuel efficient transportation mode, over trucks. The resulting surge in rail transportation volume, combined with an aging infrastructure, yielded increased demand for products and services related to the modernization and extension of the North American rail network, including railway ties.

According to the Association of American Railroads, economic weakness reduced the number of carloads hauled on North American railroads by approximately 16.0% in 2009, while the volume of intermodal trailers and containers was down 14.0% from 2008 levels.

OPERATING RESULTS

SALES

Sales for the year ended December 31, 2009 reached $411.1 million, an increase of $26.3 million, or 6.8%, over last year's sales of $384.8 million. All of the Company's product categories posted gains with the exception of consumer lumber, where sales were marginally lower. A full-year's contribution, in 2009, from the BPB operations, compared with nine months in the preceding year, added sales of approximately $37.3 million. Organically, sales decreased approximately 7.0%, reflecting weaker demand and softer pricing for the Company's core products, mainly in the second half of 2009. When compared with the previous year, fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, increased the value of U.S. dollar denominated sales by about $17.7 million.

SALES BY PRODUCT CATEGORY

RAILWAY TIES

Railway tie sales for 2009 amounted to $185.1 million, an increase of 2.2% over sales of $181.2 million in 2008. These results reflect the contribution for a full year from the BPB operations, offset by weaker industry demand in North America and softer pricing in the last nine months of the year. While demand from normal maintenance activity held, the weaker economy resulted in fewer special projects in the short-line and contractor markets. In addition, Class 1 railway operators deferred advanced deliveries, normally occurring in the fourth quarter, to later periods to reduce their tie inventory levels. Railway tie sales accounted for 45.0% of the Company's total sales in 2009.

UTILITY POLES

Utility pole sales amounted to $149.7 million in 2009, an increase of 8.6% over sales of $137.8 million in 2008. The increase is due to higher sales of transmission poles and stable demand for distribution poles. It also reflects greater penetration of the U.S. market and a higher average conversion rate on U.S. dollar denominated utility pole sales. These factors were somewhat offset by softer pricing in the second half of 2009. Utility pole sales accounted for 36.4% of the Company's total sales in 2009.

INDUSTRIAL LUMBER

Industrial lumber sales rose 35.5% in 2009, reaching $44.8 million, compared with $33.1 million in 2008. This increase is attributable to solid demand for marine applications in Eastern Canada and to the full-year contribution from the BPB operations, which added both new products aimed at the rail transportation industry, such as panelized railway crossings, as well as additional bridge timber sales. This product category also includes BPB's custom log home business. Industrial lumber represented 10.9% of overall sales in 2009.

CONSUMER LUMBER

Sales in the consumer lumber category totalled $31.5 million in 2009, down 3.7% from $32.7 million in 2008. The decrease reflects reduced renovation spending in Canada due to unfavourable weather during the peak summer period, somewhat offset by demand stemming from the home renovation tax credit program in Canada. The Company does not sell consumer lumber into the U.S. market. Consumer lumber accounted for 7.7% of Stella-Jones' total sales in 2009.

SALES BY DESTINATION

In 2009, sales in Canada grew 4.4% over 2008 levels, reaching $188.0 million, or 45.7% of the Company's total sales. Sales in the United States amounted to $223.1 million, or 54.3% of sales, representing an increase of 9.0% over 2008. Sales of products exported to the United States from the Canadian based facilities totalled $13.1 million in 2009, compared with $25.5 million in 2008, as the Company continues to optimize its asset base through plant specialization. The increase in sales in the U.S. market, in addition to the foreign exchange effect, came mainly as a result of the full-year contribution of the BPB operations, acquired in April 2008.

Management believes that the U.S. market presents additional growth opportunities, as evidenced by the proposed acquisition of Tangent. This would further solidify the Company's number two position in the North American railway tie market.

Gross profit

Gross profit reached $76.7 million or 18.6% of sales in 2009, down slightly from $78.4 million or 20.4% of sales in 2008. The reduction in gross profit, both in monetary terms and as a percentage of sales, essentially stems from softer pricing in most product categories resulting from lower demand. These factors were partially offset by greater efficiencies from the BPB integration.

Cost of sales in 2009 also included $511,600 (US$468,600) for plant closure and workforce reduction costs in connection with the closure of the Stanton, Kentucky facility on September 4, 2009 and the downsizing of the Spencer, West Virginia facility effective August 13, 2009.

Expenses

Selling and administrative expenses for 2009 were $20.4 million, essentially stable in comparison with 2008 expenses of $20.3 million. As a percentage of sales, selling and administrative expenses decreased to 5.0% of sales in 2009, from 5.3% in the prior year.

The Company realized a foreign exchange gain of $1.4 million for the year ended December 31, 2009, versus a foreign exchange gain of $0.3 million last year.

The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to its sales and purchases in U.S. dollars by its Canadian based operations. Stella-Jones U.S. Holding Corporation, the Company's wholly-owned U.S. subsidiary, is a self-sustaining foreign operation and unrealized foreign exchange gains and losses on translating its financial statements are deferred in shareholders' equity. The Company monitors its transactions in U.S. dollars generated by Canadian based operations. Its basic hedging activity for economic purposes consists of entering into forward foreign 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 foreign 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, 2009, the Company had on hand forward foreign exchange contracts for the future sale of US$12.8 million at an average contract rate of Cdn$1.2240/US$1.00. The non-cash loss on these forward foreign exchange contracts resulting from the change in their mark-to-market values as at December 31, 2009, compared to September 30, 2009, totalled $0.3 million, whereas the non-cash gain from the change compared to December 31, 2008, was $2.2 million.

Amortization of capital and intangible assets totalled $8.8 million in 2009, an increase of $0.4 million over 2008. This marginal increase reflects the amortization of BPB's capital and intangible assets for the full year in 2009, as opposed to nine months in 2008, partially offset by a change in accounting estimates that increased the useful life of certain capital assets in order to better reflect their use in time (see "Changes in Accounting Policies" below). This revision resulted in an adjustment that reduced the total amortization expense by $579,625 in the fourth quarter of 2009.

Financial expenses for 2009 amounted to $8.5 million, a decrease of $0.3 million over financial expenses incurred in 2008. The decline in financial expenses is due to lower interest rates, on average, in 2009 and to the gradual year-over-year deleveraging of the balance sheet, as a solid cash flow generation enabled the Company to repay long- and short-term borrowings.

Earnings before income taxes and income tax expense

Stella-Jones generated earnings before income taxes of $41.8 million, or 10.2% of sales, in 2009. This represents an increase of $0.6 million, or 1.4%, over earnings before income taxes of $41.2 million, or 10.7% of sales, in the prior year.

Stella-Jones' income tax expense totalled $11.7 million in 2009, representing an effective tax rate of 28.1%. In 2008, the income tax expense stood at $12.7 million, equivalent to an effective tax rate of 30.8%. The lower effective tax rate is a consequence of the higher proportion of revenue generated in the United States that is subject to the domestic manufacturing tax deduction for qualifying manufacturing income, and deductions for Canadian income tax related to dividends received from a related party. Other non-income based corporate taxes represent a relatively small component of the Company's total tax burden.

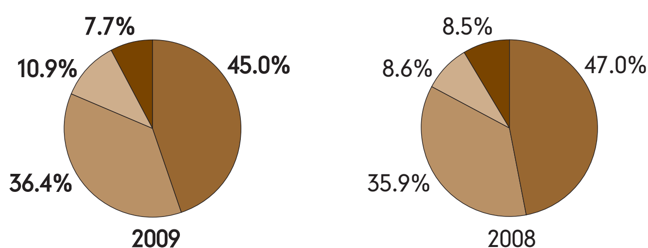
Net earnings

Net earnings for the year totalled $30.1 million, or $2.37 per share, fully diluted, compared with $28.5 million, or $2.25 per share, fully diluted, in 2008. This represents a year-over-year increase in net earnings of $1.5 million, or 5.3%.

Sales by product

(% of revenues)

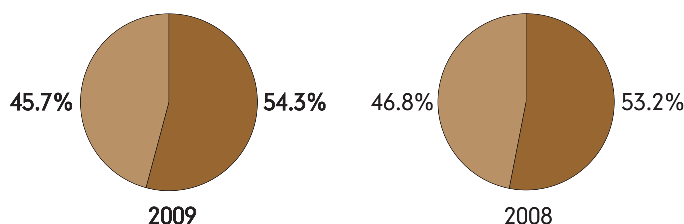
- Railway Ties 45.0% (2008 – 47.0%)
- Utility Poles 36.4% (2008 – 35.9%)
- Industrial Lumber 10.9% (2008 – 8.6%)
- Consumer Lumber 7.7% (2008 – 8.5%)



Sales by geographic region

(% of revenues)

- United States 54.3% (2008 – 53.2%)
- Canada 45.7% (2008 – 46.8%)



BUSINESS ACQUISITION

On December 15, 2009, the Company announced that it had signed a non-binding letter of intent to acquire Tangent Rail Corporation ("Tangent"), a provider of wood crosstie supply chain services to the railroad industry.

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

For the year ended December 31, 2009, Tangent is expected to generate sales of approximately US$178.0 million and earnings before interest, taxes, depreciation and amortization ("EBITDA") of approximately US$28.0 million. The value of the transaction, which would solidify the Company's position as the second largest North American provider of railway ties, is estimated at US$165.0 million, subject to post closing adjustments. The Company plans to finance the acquisition through a combination of equity and debt, subject to prevailing market conditions.

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

On February 24, 2010, the Company announced that it had entered into an underwriting agreement with a syndicate of underwriters led by RBC Capital Markets, pursuant to which such underwriters have agreed to purchase from treasury, on an underwritten private placement basis, 2,402,000 Subscription Receipts of the Company (the "Subscription Receipts") at a price of $25.00 per Subscription Receipt, for aggregate gross proceeds to the Company of $60,050,000 (the "Underwriters' Private Placement").

In addition to the Underwriters' Private Placement, the Company has received firm commitments from Stella Jones International S.A. ("SJ International") and the Solidarity Fund QFL (the "Fund") whereby such shareholders have agreed to purchase Subscription Receipts under the same terms as the Underwriters' Private Placement for gross proceeds of $15,000,000 and $5,000,000, respectively (the "Shareholders' Private Placement").

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

Net proceeds from the Private Placements will be used by the Company to partially fund the proposed acquisition of Tangent.

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

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

QUARTERLY RESULTS

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

After posting sales increases in the first two quarters of 2009, compared with the corresponding periods in 2008, challenging economic conditions led to lower industry demand and softer pricing in most markets in the latter half of 2009. In addition, the value of the Canadian dollar, Stella-Jones' reporting currency, firmed up against the U.S. dollar as 2009 progressed, thereby gradually reducing the conversion rate applicable to the Company's revenue stream generated in U.S. dollars. Reflecting increased efficiencies and cost controls measures, operating earnings increased in all periods with the exception of the fourth quarter, where lower volume had a negative impact on fixed cost absorption.

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

2009

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(thousands of dollars, except per share data)	$	$	$	$	$
Sales	111,954	129,104	104,671	65,390	411,119
Operating earnings before amortization of capital and intangible assets [1]	15,924	20,976	15,272	6,851	59,023
Operating earnings [1]	13,313	18,475	13,376	5,104	50,268
Net earnings	7,687	11,021	8,320	3,041	30,069
Net earnings per common share					
Basic	0.61	0.87	0.66	0.24	2.38
Diluted	0.61	0.87	0.65	0.24	2.37

2008

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(thousands of dollars, except per share data)	$	$	$	$	$
Sales	66,182	123,081	111,828	83,731	384,822
Operating earnings before amortization of capital and intangible assets [1]	11,199	19,402	14,249	13,479	58,329
Operating earnings [1]	9,616	17,599	12,127	10,622	49,964
Net earnings	5,323	10,047	6,850	6,327	28,547
Net earnings per common share					
Basic	0.43	0.81	0.55	0.50	2.29
Diluted	0.42	0.80	0.54	0.50	2.25

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

Note: due to rounding, the sum of results for the quarters may differ slightly from the total shown for the full year.

Fourth quarter results

Sales for the fourth quarter of 2009 reached $65.4 million, down from $83.7 million reported for the same period in 2008. This $18.3 million, or 21.9%, decrease is mainly attributable to weak industry demand and soft pricing in most product categories. The stronger year-over-year value of the Canadian dollar, Stella-Jones' reporting currency, decreased the value of U.S. dollar denominated sales by approximately $2.8 million. A fire that broke out at the New Westminster, British Columbia facility on November 6, 2009 had no impact on sales. Although local operations were suspended for 12 days, no customer shipments were lost due to the incident, as the Company's inventory was sufficient and wood treating operations were carried out at the Company's other regional facilities.

Fourth quarter sales of railway ties amounted to $22.1 million, down from $34.9 million a year earlier. This decrease reflects weaker industry demand resulting from lower advanced deliveries to Class 1 railway operators for their regular 2010 maintenance programs, as purchases have been deferred to keep tie inventory levels down. Utility pole sales reached $31.1 million, compared with sales of $35.4 million in the fourth quarter of 2008. This decrease of 12.2% is attributable to lower demand for distribution poles and competitive pricing. Industrial lumber sales amounted to $10.1 million, stable in comparison with $10.2 million a year earlier, as stronger sales in Eastern Canada were offset by lower sales in Western Canada and the United States. Finally, consumer lumber sales reached $2.1 million, versus $3.2 million last year.

Gross profit in the fourth quarter of 2009 totalled $10.6 million, or 16.2% of sales, compared with $18.4 million, or 21.9% of sales, in the corresponding period in 2008. The decrease in gross profit, both in dollars and as a percentage of sales, principally reflects a less favourable product mix, softer pricing in most markets and lower volume that negatively affected the absorption of fixed costs.

Net earnings for the period totalled $3.0 million, or $0.24 per share, fully diluted, compared with $6.3 million, or $0.50 per share, fully diluted, in the fourth quarter of 2008.

BALANCE SHEET

The Company's working capital at December 31, 2009 was $170.1 million, an increase of $13.2 million over a working capital balance of $156.9 million at December 31, 2008. Current assets amounted to $254.6 million at the end of 2009 compared with $277.1 million twelve months earlier.

The value of accounts receivable was $30.2 million as at December 31, 2009 compared with $41.5 million at the same date in 2008. This decrease essentially reflects lower business activity at year end and a lower conversion rate applicable to U.S. dollar denominated receivables.

Inventories stood at $212.6 million, down from $223.2 million a year earlier. This decrease is due to the impact of local currency depreciation on U.S. based inventory and reduced wood prices compared with the same period a year ago.

Because of the long periods required to air season wood, which can occasionally exceed nine months before a sale is concluded, inventories are a significant component of working capital. However, solid relationships, and long-term contracts with certain customers enable the Company to better ascertain inventory requirements. The Company believes that its cash flow from operations and available operating lines of credit are adequate to meet its working capital requirements for the foreseeable future.

Capital assets stood at $96.9 million as at December 31, 2009, compared with $108.8 million as at December 31, 2008. This $11.9 million decrease was primarily related to local currency depreciation on U.S. based capital assets and, to a lesser extent, to the amortization of capital assets exceeding purchases of capital assets in 2009.

Intangible assets totalled $13.1 million as at December 31, 2009, compared with $17.1 million one year earlier. Intangible assets include customer relationships, the discounted value of the BPB related non-compete agreements as well as goodwill. The year-over-year decline of $4.0 million reflects the amortization of customer relationships and non-compete agreements as well as local currency depreciation on U.S. based intangible assets.

Bank indebtedness at the end of 2009 totalled $56.1 million, down from $81.6 million at the end of 2008. This decrease mirrors a strong cash flow generation. The credit facilities supporting bank indebtedness include a $50.0 million demand operating loan with a Canadian bank (unchanged from last year), as well as a US$45.0 million operating line of credit with the U.S. bankers of Stella-Jones' U.S. subsidiaries (unchanged from last year). At the beginning of 2009, the Company's Canadian bankers amended the interest rate structure with no change to the available amount of the operating facility and approved an increase to the credit availability for the purchase of foreign exchange contracts. Total availability under the Company's Canadian and U.S. operating lines of credit was $13.2 million and US$14.1 million, respectively, as at December 31, 2009.

The Company believes that these operating lines of credit, combined with its funds from operations in the next quarters, will be adequate to meet its cash requirements for the foreseeable future. However, future acquisitions, such as the proposed Tangent transaction, would require new sources of financing.

As at December 31, 2009, the Company's long-term debt, including the current portion, amounted to $87.1 million, down from $105.8 million as at December 31, 2008. This decrease is due to principal repayments of $9.0 million and favourable currency movements near the end of 2009 that decreased the conversion rate of U.S. dollar denominated long-term debt into Canadian currency.

Shareholders' equity was $180.0 million as at December 31, 2009, an increase of $18.9 million from December 31, 2008. The Company's strong earnings generation accounted for most of this gain, offset by a greater dividend payout than the previous year. Book value stood at $14.19 per common share as at December 31, 2009, up from $12.82 per share twelve months earlier.

LIQUIDITY AND CAPITAL RESOURCES

The following table sets forth summarized cash flow components for the periods indicated:

Summary of cash flows	**Fiscal Year Ended**	
(thousands of dollars)	December 31, 2009	December 31, 2008
	$	$
Operating activities	40,481	(3,296)
Financing activities	(36,220)	52,335
Investing activities	(4,261)	(49,039)
Cash and cash equivalents	—	—

The Company's activities, acquisitions and capital expenditures are primarily financed by cash flows from operating activities, the use of cash and operating lines of credit, and the issuance of common shares. The Company's operating lines of credit are demand operational facilities that are renewable annually and are subject to review by the Company's bankers at intervals no greater than one year. The Company anticipates no difficulties in its ability to renew these demand operating facilities.

Cash flow from operating activities before changes in non-cash working capital components was $40.9 million for the year ended December 31, 2009, compared with $41.1 million for the prior year. This marginal decrease reflects a reduction in non-cash expenses resulting from a gain on derivative financial instruments that more than offset the increase in net earnings.

Changes in non-cash working capital components used liquidity of $0.5 million compared with a liquidity reduction of $44.4 million a year ago. This relative stability, in 2009, essentially mirrors lower accounts receivable offset by lower accounts payable and accrued liabilities. Last year's liquidity requirement mainly resulted from increased inventories following the BPB acquisition. As a result, operating activities provided liquidity of $40.5 million for the year ended December 31, 2009, versus requiring liquidity of $3.3 million a year earlier.

The Company's use of funds for net financing activities for the year ended December 31, 2009 was $36.2 million. This amount mainly reflects reductions in short-term bank indebtedness ($21.8 million), repayment of long-term debt ($9.0 million), and the payment of annual dividends ($4.5 million). For the year ended December 31, 2008, cash flows from financing activities had generated liquidity of $52.3 million, mainly because of short- and long-term indebtedness required to finance the BPB transaction in April 2008.

Investing activities required $4.3 million in cash during 2009, primarily for the purchase of capital assets. Capital asset expenditures were mainly for the addition of various equipment upgrades and expansion. For the year ended December 31, 2008, cash flows from investing activities reduced liquidity by $49.0 million, owing to the BPB acquisition.

The following table details the maturities of the financial obligations as at December 31, 2009:

(thousands of dollars)	Carrying Amount ($)	Contractual Cash flow ($)	Less than 1 year ($)	1 – 3 years ($)	4 – 5 years ($)	After 5 years ($)
Bank indebtedness	56,119	57,109	57,109	—	—	—
Accounts payable and accrued liabilities	19,152	19,152	19,152	—	—	—
Long-term debt obligations [1]	85,786	111,328	9,112	17,918	23,694	60,604
Capital lease obligations [1]	1,584	1,584	203	192	317	872
Interest rate swaps	1,431					
Outflow	—	6,274	1,859	1,766	1,371	1,278
Inflow	—	(2,712)	(1,007)	(734)	(620)	(351)
Other contractual obligations	—	19,686	3,236	4,293	2,203	9,954
Non-compete agreements	4,602	5,585	1,314	2,628	1,643	—
Total	168,674	218,006	90,978	26,063	28,608	72,357

[1] Amounts include capital and interest

SHARE AND STOCK OPTION INFORMATION

As at December 31, 2009, the capital stock issued and outstanding consisted of 12,684,325 common shares (12,564,925 as at December 31, 2008). As at March 12, 2010, the capital stock issued and outstanding consisted of 12,688,325 common shares.

As at December 31, 2009, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 197,785 (December 31, 2008 – 147,785) of which 126,185 (December 31, 2008 – 93,285) were exercisable. As at March 12, 2010, the number of outstanding options was 193,785, of which 122,185 were exercisable.

DIVIDENDS

On March 11, 2010, the Board of Directors declared a semi-annual dividend of $0.18 per common share. On August 12, 2009, the Board of Directors declared a semi-annual dividend of $0.18 per common share.

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

COMMITMENTS AND CONTINGENCIES

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

The Company has issued guarantees amounting to $14,583,548 (2008 – $14,788,448) under letters of credit and various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on and, as such, no provisions have been recorded in the financial statements.

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

CURRENT ECONOMIC CONDITIONS

In light of an uncertain economy and tighter credit conditions in the financial markets, the Company continues to carefully monitor its strategy and risk management. Although financial results remain positive, the economic climate is prompting Management to take a more cautious approach in executing its business strategy.

Operations

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

Economic and financial market conditions have put on hold certain projects with significant capital requirements for which some of the Company's products could be required, including alternative energy projects, such as wind farms. In recent years, the Company has supplied railway ties to link up ethanol plants with the continental rail network and utility poles to connect wind farms with the electricity transmission grid. In addition, special projects in the railway tie market, which often generate increased activity in the short-line and contractor markets, have been put on hold until economic and financing conditions recover. As at March 12, 2010, Stella-Jones has only been mildly affected by such deferrals.

Liquidity

As at December 31, 2009, the Company is in full compliance with its debt covenants and contractual obligations. In addition, it has total availability under its Canadian and U.S. operating lines of credit of $13.2 million and US$14.1 million, respectively, as at December 31, 2009.

Management considers that substantially all receivables are fully collectible as major customers, mainly Class 1 railroad operators and large-scale utility service providers, have good credit standing and limited history of default. Nevertheless, Management is providing additional focus on accounts receivable collection and credit extensions. As at December 31, 2009 58.8% of accounts receivable were past due less than 30 days (58.0% as at December 31, 2008) and only 2.3% were past due more than 90 days (5.7% as at December 31, 2008).

RISKS AND UNCERTAINTIES

Environmental laws and regulations

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. Contamination on and from the Company's sites may subject it to liability to third parties or governmental authorities for injuries to persons, property or the environment and could adversely affect the Company's ability to sell or rent its properties or to borrow money using such properties as collateral.

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

Availability and cost of raw materials

Management considers that the Company may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. Nevertheless, the Company's overall competitiveness in this industry is strengthened by its access to a high quality timber supply provided by its long-term cutting licenses and its long-standing relationships with private woodland owners and other suppliers. In addition, there are a limited number of suppliers for certain of the preservatives that the Company employs in its production process, which lessens the availability of alternate sources of supply in the event of unforeseen shortages or disruptions of production. The Company is mitigating this risk by researching and identifying alternate suppliers outside of its traditional sources of supply.

Currency risk

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

Interest rate fluctuations

As at December 31, 2009, the Company had limited exposure to interest rate risk on long-term debt as only 14.0% (2008 – 7.0%) of the Company's long-term debt is at variable rates. The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

Credit risk

The geographic distribution of customers and procedures regarding commercial risk management limit the concentration of credit risks. Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. The Company reduces this risk by dealing primarily with utility and telecommunication companies and other major corporations.

OFF-BALANCE SHEET ARRANGEMENTS AND FINANCIAL INSTRUMENTS

For details pertaining to off-balance sheet arrangements and financial instruments, refer to Note 19 to the Company's audited consolidated financial statements for the year ended December 31, 2009.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's significant accounting policies are described in Note 2 to the December 31, 2009 consolidated financial statements.

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

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

CHANGES IN ACCOUNTING POLICIES

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. During the fourth quarter, Management reviewed and increased the useful life of certain capital assets in order to better reflect their use in time. These changes were applied prospectively from October 1, 2009. The impact on the amortization expense for the twelve-month period ended December 31, 2009 was as follows:

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

The Canadian Institute of Chartered Accountants ("CICA") issued the following accounting standards which were adopted by the Company effective January 1, 2009:

Handbook Section 3064, "Goodwill and Intangible Assets" replaces Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs". Section 1000, "Financial Statement Concepts" was amended according to Section 3064. This new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented companies. The Company has assessed that the impact of this new accounting standard is not significant. Additionally, the required disclosures have been included in Note 9 to the December 31, 2009 consolidated financial statements.

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

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

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

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

Handbook Section 1582, "Business Combinations" replaces Section 1581 of the same title. This new Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to the International Financial Reporting Standard ("IFRS") IFRS 3 (Revised) standard, "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Company will apply this new standard effective January 1, 2010 as early adoption is permitted.

Handbook Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", which together replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are equivalent to the corresponding provisions of the International Accounting Standard 27 (Revised), "Consolidated and Separate Financial Statements". The Company will apply these new standards effective January 1, 2010 as early adoption is permitted. The adoption of these new standards will not have a significant impact on the Company's consolidated financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the AcSB confirmed that Canadian publicly listed companies will be required to use IFRS in the preparation of financial statements for fiscal years beginning on or after January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences in recognition, measurement and disclosures.

Management has established an IFRS implementation team to develop an IFRS changeover plan. In 2008, a preliminary diagnostic analysis (phase I) was prepared by external consultants who identified the key areas where changes in accounting policy may have some impact on the Company's consolidated financial statements.

The Company is presently in the phase II stage of its changeover plan, which includes a definition of roles and responsibilities, a review of the differences between current Canadian GAAP (as applied by the Company) and IFRS, and the analysis of possible options regarding adoption. Once phase II is completed, Management will be able to determine the consequences of the change by the end of the second quarter of 2010. Planning continued in the fourth quarter of 2009 to precisely establish and document the changes to be made to accounting principles and computer systems, training requirements, internal control mechanisms for financial reporting and the repercussions on the Company's business activities.

In the period leading up to the changeover, the Company continues to monitor standards to be issued by the International Accounting Standards Board ("IASB"), because the IASB work plan expects the completion of several projects in calendar years 2010 and 2011.

Set out below are the key areas where changes in accounting policies may impact the Company's consolidated financial statements. It is intended to highlight those areas the Company believes to be most significant. However, the analysis of changes is still in process and not all decisions have been made when alternative accounting policies are available.

Property, plant and equipment

IAS 16 – Property, plant and equipment permits assets to be measured based on either a cost model or a revaluation model. Under a revaluation model, an item of property, plant and equipment is carried at a revalued amount, being the fair value at the date of the revaluation.

The property, plant and equipment ("capital assets") review and analysis has been completed. The useful life of certain capital assets has been revised. The impact of this review and analysis will be assessed in the first quarter of 2010. The Company plans to continue to use the cost model under IFRS.

Leases

The company undertook a detailed review of material lease arrangements in order to determine the appropriate lease classification under IFRS.

After reviewing lease contracts subject to IAS 17, the Company concluded that capital and operational leases are properly classified.

Cutting rights

Cutting rights contracts are presently being analyzed to determine if they should be considered under IAS 17, Leases or under IAS 38, Intangible Assets. Current discussions indicate that cutting rights should be recorded under intangible assets. This analysis will be completed by the end of the second quarter of 2010.

As at December 31, 2009, cutting rights were accounted for as part of capital assets. Under IFRS, the company might have to reclassify these assets from capital assets to intangible assets on the balance sheet.

Joint ventures

Under Canadian GAAP, the 50% interest that the Company has in Kanaka Creek Pole Company Limited ("Kanaka") is accounted for under the proportionate consolidation method. Essentially, 50% of the balance sheet and profit and loss statement of Kanaka are added to the Company's consolidated financial statements. Under Exposure Draft 9, which addresses joint venture accounting, the proportionate consolidation method will no longer be allowed and proposes instead the equity method. The equity method presents joint ventures in the financial statements as an investment valued at the original contribution cost in the joint venture.

The documentation for joint venture accounting is in place and no additional disclosures will be required.

Financial instruments

Effective January 1, 2008, the Company adopted CICA handbook Section 3862 – Financial Instruments - Disclosure and handbook Section 3863 - Financial Instruments - Presentation. These new sections were introduced to better harmonize Canadian GAAP to IFRS by incorporating many of the concepts found in IAS 32 - Financial Instruments Presentation and IAS 39 - Financial Instruments Recognition and Measurement. Under IAS 39, the Company must prepare an analysis to demonstrate that the cash flows from the hedged item and the hedging instrument are matched in an effective manner. This analysis has been prepared by an external consultant.

Employee future benefits

In August 2009, Stella-Jones mandated Morneau Sobeco, Human Resource Consultants, to perform an analysis of adopting IAS 19 – Pensions and Other Employee Benefits. Morneau Sobeco submitted their conclusions on October 9, 2009. Based on their report, the Company has made a decision concerning the various approaches for addressing gains and losses under IAS 19 and the Company has decided to reflect the same in the statement of other comprehensive income. As a result, a total unamortized gain of approximately $270,000 as of January 1, 2010 will be reflected on the balance sheet upon transition.

Share-based payments

The Company has a stock option plan, employee share purchase plans and restricted stock units that will be subject to IFRS 2 – Share-Based Payments. Under this standard, the expense related to these arrangements must be recognized based on a financial model such as Black-Scholes. The stock option plan is currently calculated based on the Black-Scholes model and no financial impact is expected for the conversion. For the employee share purchase plans and the restricted stock units, the analysis will be completed before the end of the second quarter of 2010, but no major impact is expected.

Asset retirement obligations

Under the British Columbia Forest Act and the Alberta Forests Act, the Company is obligated to assume the costs related to reforestation on certain harvest licences and to incur remediation costs for certain sites.

The Company modified the Asset retirement obligation calculations in 2008 and current disclosure adequately meets IAS 37 – Provisions, Contingent Liabilities and Contingent Assets.

Business combinations and goodwill

Effective July 1, 2009, IFRS 3 becomes the reference document to guide corporations through business combinations. The Company is aware of these new rules, which are similar to Canadian GAAP with the significant exception that acquisition costs can no longer be deferred. Those costs shall be expensed in the period they are incurred. Under IFRS, these costs are not permitted to form a component of goodwill as is permitted under Canadian GAAP.

Under IFRS 1, the Company has the option to retroactively apply IFRS 3 to all business combinations or may chose to apply the standard prospectively only to those acquisitions that occur after the date of transition. The Company has not yet taken a decision regarding this choice.

Impairment

IAS 36 – Impairment of Assets uses a one-step approach for testing and measuring asset impairment. Asset carrying values are being compared to the higher of the value in use and fair value less disposal costs. Value in use is defined as being equal to the present value of future cash flows expected to be derived from the asset. The use of discounted cash flows under IFRS to test and measure asset impairment differs from Canadian GAAP where undiscounted future cash flows are used to compare against the asset's carrying value to determine if impairment exists.

As of December 2009, a goodwill impairment test model has been prepared and no impairment adjustment is required. The IFRS documentation has also been completed.

First time adoption of IFRS

In addition, as a first time adopter of IFRS, the Company is required to apply IFRS 1 "First time adoption of International Financial Reporting Standards". IFRS 1 provides a number of selected optional exemptions that the Company is presently evaluating. The more significant elections include: recognizing through opening retained earnings, cumulative translation adjustments on self-sustaining operations and using fair value at the transition date as the deemed cost for capital assets. The Company is presently assessing the impact of these exemptions and a decision will be made before the end of the second quarter of 2010.

Impact on information systems

The Company is assessing the information requirements of IFRS reporting. During the fourth quarter of 2009, the diagnostic analysis regarding current information systems was completed. Changes are being made to ensure that dual reporting of both Canadian GAAP and IFRS will be possible in 2010 and new reports will be created to meet IFRS disclosure requirements.

Impact on internal controls over financial reporting and disclosure

The Canadian Securities Administrators' National Instrument 52-109 sets out rules that public companies are required to follow concerning internal controls over financial reporting and disclosure controls and procedures. In compliance with these rules, Management intends to identify, review and potentially modify, as considered necessary, certain key controls that may be impacted by changes due to IFRS conversion. Affected key controls will be evaluated and tested using a risk based approach to ensure they are properly designed and are operating effectively in order to ensure that no material errors will be generated from the changeover to IFRS.

Impact on business activities

The effects of IFRS conversion on the Company's debt covenants are being reviewed. It is not expected that the conversion to IFRS will significantly impact these requirements.

DISCLOSURE CONTROLS

The Company maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, accurate, reliable and timely. The disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed in its various reports are recorded, processed, summarized and reported accurately.

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company have evaluated, or caused the evaluation of under their direct supervision, the effectiveness of the Company's disclosure controls and procedures (as defined in National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) as at December 31, 2009, and have concluded that such disclosure controls and procedures were designed and operating effectively.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Management has evaluated the design and effectiveness of its internal controls and procedures over financial reporting (as defined in National Instrument 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) for the year ended December 31, 2009. The evaluation was based on the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This evaluation was performed by the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer concluded that the internal controls and procedures over financial reporting were appropriately designed and operating effectively.

The Company did not make any material changes to the design of internal controls over financial reporting during the twelve months ended December 31, 2009 that have had a material effect on the Company's internal controls over financial reporting.

In spite of its evaluation, Management does recognize that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives. In the unforeseen event that lapses in the disclosure of internal controls and procedures occur and/or mistakes happen of a material nature, the Company intends to take the steps necessary to minimize the consequences thereof.

RELATED PARTY TRANSACTIONS

In 2009, the Company paid a total of $300,000 (2008 - $300,000) to its parent company and ultimate shareholders with respect to marketing and technical services fees and incurred interest expense of $52,000 (2008 - $64,000) with respect to a loan from its parent company, as detailed in Note 21 to the December 31, 2009 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. (marketing and technical service fees). The majority shareholder and ultimate shareholders have extensive international experience in the forest products and wood treating industries and Management considers the amounts paid with respect to the various transactions to be reasonable and competitive.

OUTLOOK

Although global economic conditions have shown signs of improvement, the recovery is likely to be gradual in the Company's core markets. However, demand is not expected to be generally lower and the key role played by Stella-Jones' products in basic transportation and utility infrastructure should enable the Company to maintain market share and a steady business level.

The Company's products are integral to capital infrastructure projects that governments often initiate during times of economic slowdown and various stimulus measures and programs with such aims have been announced. These actions may drive demand, as they could potentially involve, in both maintenance and new installation endeavours, many of the Company's clients in the railway and electrical transmission and distribution industries.

In the railway tie category, Class 1 railway operators seeking to reduce their inventory levels deferred advanced deliveries of their regular 2010 maintenance programs. Such deferrals, which reduced fourth quarter sales, are scheduled for the first half of 2010. As a result, demand declines and pricing pressures are believed to have bottomed out. Meanwhile, demand is holding in the utility pole market although pricing pressures are being experienced.

The successful integration of the proposed Tangent acquisition will also be a major performance driver in 2010. This transaction would solidify the Company's position as the second largest North American provider of railway ties and yield appreciable synergies. Organically, Stella-Jones will strive to capture more of its existing clients' business in the railway tie and utility pole markets across North America, while diligently seeking new market opportunities, as it continues to realize the full potential of recent acquisitions. The Company will also remain focused on improving operating efficiencies throughout the organization.

The Company will continue to focus on cash generation and to maintain a prudent use of leverage, as a solid balance sheet will favourably position Stella-Jones to continue its acquisition strategy while meeting the challenges of current market conditions. The Company's long-term strategic vision, focused on continental expansion and consolidation, remains intact. Stella-Jones will continue to seek targets in its core railway tie and utility pole markets that meet its stringent investment requirements, provide synergistic opportunities, and, most of all, add value for shareholders.

March 12, 2010

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009 and 2008

Management's Statement of Responsibility for Financial Information

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

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

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

Brian McManus
President and Chief Executive Officer

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

Saint-Laurent, Quebec
March 12, 2010

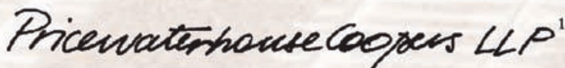
AUDITORS' REPORT

To the Shareholders of Stella-Jones Inc.

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

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

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



Montréal, Quebec
March 12, 2010

[1] Chartered accountant auditor permit No. 9986

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

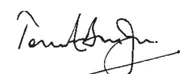
CONSOLIDATED BALANCE SHEETS

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

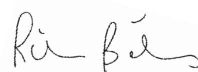
Commitments and contingencies (note 18).

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

Approved by the Board of Directors



Tom A. Bruce Jones, CBE
Director



Richard Bélanger, FCA
Director

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

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

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

CONSOLIDATED STATEMENTS OF EARNINGS

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

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

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

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

1 DESCRIPTION OF THE BUSINESS

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

2 SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

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

Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to estimates and assumptions include the estimated useful life of assets, impairment of long-lived assets, future income taxes, stock-based compensation, pension and post-retirement benefits, legal liabilities, bad debts, allowance for doubtful accounts, inventory valuations, reforestation and environmental provisions. It is possible that actual results could differ from those estimates and such differences could be material. Estimates are reviewed periodically, and as adjustments become necessary, they are reported in earnings in the period in which they become known.

Revenue recognition

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

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

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

Cash and cash equivalents

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

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

Capital assets

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

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

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

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

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

Intangible assets

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

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Business combinations and goodwill

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

Impairment of long-lived assets

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

Asset retirement obligations

Reforestation obligations

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

Site remediation obligations

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

Income taxes

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

Employee future benefits

Post-retirement benefit programs

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

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Defined benefit pension plan

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

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

Stock-based compensation and other stock-based payments

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

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

Foreign currency transactions

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

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

Financial instruments

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods is dependent on the classification of the financial instruments as held-for-trading, held-to-maturity, available-for-sale, loans and receivables, or other financial liabilities. The held-for-trading classification is applied when an entity is "trading" in an instrument. Alternatively, the standard permits that any financial instrument be irrevocably designated as held-for-trading. The held-to-maturity classification is applied only if the asset has specified characteristics and the entity has the ability and intent to hold the asset until maturity. The loans and receivables classification is applied for assets that are non-derivative financial assets resulting from the delivery of cash or other assets by a lender to a borrower in return for a promise to repay on a specified date or dates, or on demand. The available-for-sale classification is applied for all non-derivative financial assets that do not belong in the other categories. Alternatively, the standard permits that any financial asset not classified as held-for-trading may be designated as available-for-sale. Significant transaction costs related to long-term credit facilities are capitalized and amortized over the life of the instrument. Other transaction costs related to short-term credit facilities are expensed in the period they are incurred.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial instruments (continued)

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with changes in those fair values recognized in the consolidated statement of earnings. Financial assets classified as held-to-maturity, loans and receivables, or other financial liabilities are subsequently measured at amortized cost using the effective interest rate method of amortization. Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses, including changes in foreign exchange rates, being recognized in the consolidated statement of comprehensive income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market are measured at cost.

Derivative financial instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial or non-financial contracts. Changes in the fair values of derivative financial instruments are recognized in the consolidated statement of earnings with the exception of foreign exchange risk management contracts and derivatives designated as effective cash flow hedges, as further described below.

For any guarantee issued that meets the definition of a guarantee pursuant to Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline 14, "Disclosure of Guarantees", the inception fair value of the obligation relating to the guarantee is recognized and amortized over the term of the guarantee. It is the Company's policy to not remeasure the fair value of the financial guarantee unless it qualifies as a derivative.

The Company has implemented the following classifications:

Cash and cash equivalents are classified as assets held-for-trading and are measured at fair value.

Accounts receivable and notes receivable are classified as loans and receivables. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, the measured amount generally corresponds to the original cost unless otherwise specified.

Bank indebtedness, accounts payable and accrued liabilities, and long-term debt are classified as other financial liabilities. After their initial fair value measurement, they are measured at amortized cost using the effective interest rate method. For the Company, the measured amount generally corresponds to the original cost unless otherwise specified.

Hedging transactions

The Company enters into foreign exchange forward contracts to limit its exposure under contracted cash inflows and outflows of US dollars. The Company also enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These contracts are treated as cash flow hedges for accounting purposes and are not held-for-trading or speculative purposes.

Effective derivative financial instruments held for cash flow hedging purposes are recognized at fair value, and the changes in fair value related to the effective portion of the hedge are recognized in other comprehensive income (loss). The changes in fair value related to the ineffective portion of the hedge are immediately recorded in the consolidated statement of earnings. The changes in fair value of foreign exchange forward contracts and interest rate swaps recognized in other comprehensive income (loss) are reclassified in the consolidated statement of earnings under sales and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect earnings.

2 SIGNIFICANT ACCOUNTING POLICIES (continued)

Hedging transactions (continued)

When the derivative financial instrument no longer qualifies as an effective hedge, or when the hedging instrument is sold or terminated prior to maturity, hedge accounting, if applicable, is discontinued prospectively. Accumulated other comprehensive income (loss) related to a foreign exchange forward contract and interest swap hedges that cease to be effective are reclassified in the consolidated statement of earnings under foreign exchange gain or loss and interest on long-term debt respectively in the periods during which the cash flows constituting the hedged item affect earnings. Furthermore, if the hedged item is sold or terminated prior to maturity, hedge accounting is discontinued, and the related accumulated other comprehensive income (loss) is then reclassified in the consolidated statement of earnings at the original maturity date of the hedged item.

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

Earnings per share

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

3 CHANGES IN ACCOUNTING POLICIES

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

Handbook Section 3064, “Goodwill and Intangible Assets”, replaces Section 3062, “Goodwill and Other Intangible Assets”, and Section 3450, “Research and Development Costs”. Section 1000, “Financial Statement Concepts”, was amended according to Section 3064. This new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented companies. The Company has assessed that the impact of this new accounting standard is not significant. Additionally, the required disclosures have been included in note 9.

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

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

4 IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

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

Handbook Section 1582, "Business Combinations", replaces Section 1581 of the same title. The new Section establishes standards for the accounting for a business combination. It provides the Canadian equivalent to International Financial Reporting Standard ("IFRS") 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. The Company will apply this new standard effective January 1, 2010 as early adoption is permitted.

Handbook Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", which together replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard 27 (Revised), "Consolidated and Separate Financial Statements". The Company will apply these new standards effective January 1, 2010 as early adoption is permitted. Their adoption will not have a significant impact on the Company's consolidated financial statements.

5 BUSINESS ACQUISITIONS

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

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

The acquisition has been accounted for using the purchase method and, accordingly, the purchase price was allocated to the assets acquired and liabilities assumed based on management's estimate of their fair value as at the acquisition date. The results of operations of BPB have been included in the Company's consolidated financial statements from the acquisition date.

5 BUSINESS ACQUISITIONS (continued)

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

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

The BPB acquisition was financed through additional borrowings of approximately $40.9 million (US$40.0 million), including the issuance of a $25.5 million (US$25.0 million) unsecured and non-convertible debenture to the *Fonds de solidarité des travailleurs du Québec (F.T.Q.)*, a $10.2 million (US$10.0 million) revolving term loan from a Canadian bank and a drawdown on an existing operating margin of $5.1 million (US$5.0 million). Details of the financing are available in notes 11 and 12.

6 ACCOUNTS RECEIVABLE

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

7 INVENTORIES

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

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

8 CAPITAL ASSETS

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

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

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

8 CAPITAL ASSETS (continued)

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

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

9 INTANGIBLE ASSETS

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

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

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

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

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

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

10 OTHER ASSETS

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

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

11 BANK INDEBTEDNESS

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

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

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

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

11 BANK INDEBTEDNESS (continued)

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

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

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

12 LONG-TERM DEBT (note 20)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

13 ASSET RETIREMENT OBLIGATIONS

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

Reforestation

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

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

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

13 ASSET RETIREMENT OBLIGATIONS (continued)

Reforestation (continued)

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

Site remediation

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

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

Total asset retirement obligations

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

14 CAPITAL STOCK

a) Capital stock consists of the following:

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

14 CAPITAL STOCK (continued)

b) Earnings per share

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

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

* Number of shares is presented in thousands.

c) Stock option plan

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

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

14 CAPITAL STOCK (continued)

c) Stock option plan (continued)

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

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

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

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

d) Stock option agreement

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

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

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

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

14 CAPITAL STOCK (continued)

e) Stock-based compensation

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

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

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

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

f) Employee share purchase plans

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

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

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

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

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

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

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

14 CAPITAL STOCK (continued)

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

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

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

15 INCOME TAXES

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

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

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

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

15 INCOME TAXES (continued)

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

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

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

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

16 EMPLOYEE FUTURE BENEFITS

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

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

16 EMPLOYEE FUTURE BENEFITS (continued)

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

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

The significant assumptions used are as follows:

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

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

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

16 EMPLOYEE FUTURE BENEFITS (continued)

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

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

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

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

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

16 EMPLOYEE FUTURE BENEFITS (continued)

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

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

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

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

The significant weighted average assumptions used are as follows:

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

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

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

17 INTEREST IN JOINT VENTURE

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

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

18 COMMITMENTS AND CONTINGENCIES

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

b) The Company has issued guarantees, other than those disclosed elsewhere in these financial statements, amounting to $14,583,548 (2008 – $14,788,448) under letters of credit and various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on. As a result, no provisions have been recorded in the consolidated financial statements.

18 COMMITMENTS AND CONTINGENCIES (continued)

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

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

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

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

19 FINANCIAL INSTRUMENTS

Financial instruments, carrying values and fair values

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

Credit risk

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

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

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

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

19 FINANCIAL INSTRUMENTS (continued)

Credit risk (continued)

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

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

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

Liquidity risk

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

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

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

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

(a) Including capital and interest

19 FINANCIAL INSTRUMENTS (continued)

Market risk

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

Currency risk

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

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

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

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

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

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

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

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

19 FINANCIAL INSTRUMENTS (continued)

Currency risk (continued)

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

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

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

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

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

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

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

Interest rate risks

As at December 31, 2009, the Company has limited exposure to interest rate risk on long-term debt after giving effect to its interest rate swaps; 86% (2008 – 93%) of the Company's long-term debt is at fixed rates.

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

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

19 FINANCIAL INSTRUMENTS (continued)

INTEREST RATE RISKS (CONTINUED)

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

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

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

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

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

20 CAPITAL DISCLOSURES

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

20 CAPITAL DISCLOSURES (continued)

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

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

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

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

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

21 RELATED PARTY TRANSACTIONS

The Company had the following transactions with related parties:

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

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

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

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

22 SEGMENT INFORMATION

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

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

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

Sales by product as at December 31 are as follows:

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

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

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

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

23 SUBSEQUENT EVENT

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

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

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

23 SUBSEQUENT EVENT (continued)

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

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

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

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

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

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

24 COMPARATIVE FIGURES

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

DIRECTORS & OFFICERS

BOARD OF DIRECTORS

Richard Bélanger, FCA (1)
President,
Toryvel Group Inc.
(Holding company)
Québec, Québec
Director since March 1997

Tom A. Bruce Jones, CBE (3)
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 paper, tissue,
wood products, energy
(hydro/wind) and wine and
spirits products)
Montréal, Québec
Director since May 2001

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

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

Nycol Pageau-Goyette (1) (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

John Barrie Shineton (1)
President and CEO
Norbord Inc.
(producer of oriented strand board)
Toronto, Ontario
Director since May 2009

Mary Webster (3)
Corporate Director
Wayzata, MN, USA
Director since May 2009

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(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 4, 2010 Annual Meeting of Shareholders.

OFFICERS

Tom A. Bruce Jones, CBE
Chairman of the Board

Gianni Chiarva
Vice-Chairman of the Board

Brian McManus
President and
Chief Executive Officer

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

Marla Eichenbaum
Vice-President,
General Counsel and Secretary

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

Martin Poirier
Vice-President and
General Manager,
Central Region

Rémi Godin, CGA
Vice-President and
Corporate Comptroller

DIRECTORS & OFFICERS (CONTINUED)

SUBSIDIARIES

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

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

Douglas J. Fox
Senior Vice-President, Engineering
and Operations,
Stella-Jones Corporation

Glen Ritchie
Vice-President, Fibre,
Stella-Jones Canada Inc.

W.G. Downey, Jr.
Vice-President,
U.S. Operations

Eric Vachon, CA
Vice-President, Finance,
U.S. Operations

CORPORATE INFORMATION

ANNUAL MEETING OF SHAREHOLDERS

May 4, 2010
10:00 a.m.
Fairmont The Queen Elizabeth
Salon Marquette
900 Rene-Levesque Blvd. West
Montreal, Qc

STOCK INFORMATION

Shares listed:
Toronto Stock Exchange
Ticker symbol: SJ
Initial public offering: 1994
Majority shareholder:
Stella Jones International S.A. (59.8%)
52-week high/low
(Jan. 1 – Dec. 31, 2009): $26.49/$12.50
Share price at March 12, 2010: $26.20
Common shares outstanding as at
December 31, 2009: 12.68 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 11, 2010, the Board of Directors declared a semi-annual dividend of $0.18 per common share.

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.

AUDITORS

PricewaterhouseCoopers LLP

LEGAL COUNSEL

Fasken Martineau DuMoulin LLP
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