MANAGEMENT'S DISCUSSION & ANALYSIS

Three-month period ended June 30, 2010 compared with three-month period ended June 30, 2009

The following Management's Discussion and Analysis ("MD&A") and the Company's interim unaudited consolidated financial statements were approved by the Audit Committee and the Board of Directors on August 11, 2010. The MD&A provides a review of the significant developments and results of operations of the Company during the three-month period ended June 30, 2010 compared with the three-month period ended June 30, 2009. The MD&A should be read in conjunction with the Company's interim unaudited consolidated financial statements for the periods ended June 30, 2010 and 2009 and the notes thereto as well as the Company's annual consolidated financial statements and MD&A. The interim 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.

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 disclaims any obligation to update or revise these forward-looking statements, except as required by applicable law.

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 Inc. (TSX: SJ) 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 manufactures the wood preservative creosote and other coal tar based products and provides the railroad industry with used tie pickup and disposal services. Switching, locomotive and railcar maintenance services are also offered, as is tie-derived boiler fuel. The Company also provides treated consumer lumber products and customized services to lumber retailers and wholesalers for outdoor applications. Other treated wood products include marine and foundation pilings, construction timbers, highway guardrail posts and treated wood for bridges.

Following the acquisition of Tangent Rail Corporation ("Tangent") on April 1, 2010, the Company operates nineteen wood treating plants, two coal tar distilleries, three facilities providing railway tie pickup and disposal services, two distribution centres, two pole peeling facilities and has a 50% interest in a third pole peeling operation. These twenty-nine facilities are located in six Canadian provinces and fourteen American states. The Company's workforce currently numbers approximately 1,000 employees.

Stella-Jones enjoys a number of key attributes which should further enhance the Company's strategic positioning and competitive advantage in the wood treating 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, a long-standing stable source of wood supply, and a registration to produce and sell the wood preservative, creosote. 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

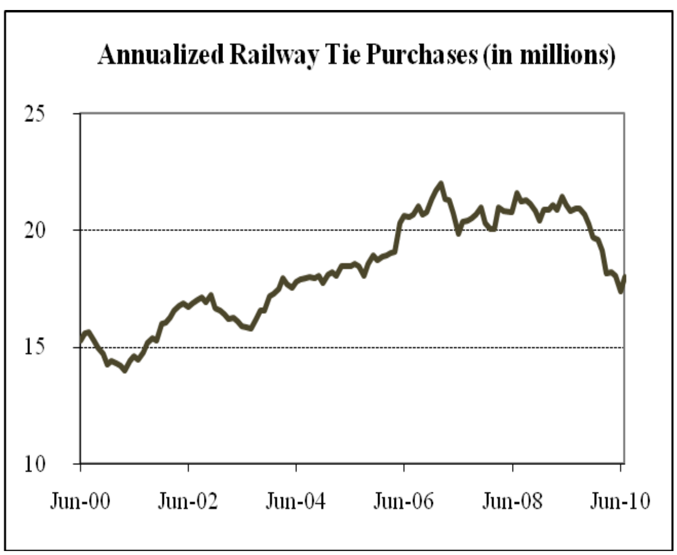
Operating earnings before amortization of capital and intangible assets (also referred to as earnings before interest, taxes, depreciation and amortization ["EBITDA"]), operating earnings, and cash flow from operations are financial measures not prescribed by Canadian generally accepted accounting principles ("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.

FOREIGN EXCHANGE

The table below shows exchange rates applicable to the periods ended June 30, 2010 and 2009. 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$/US$	**2010**		**2009**	
	Average	**Closing**	**Average**	**Closing**
Second Quarter	1.0250	1.0646	1.1820	1.1630

INDUSTRY OVERVIEW



Source: Railway Tie Association

Railway ties

As reported by the Railway Tie Association ("RTA"), the annualized tie purchase rate remained stable at the end of the second quarter of 2010, when compared to the first quarter, at approximately 18 million ties. The RTA also reported a significant decline in tie inventories since the beginning of the year, as production levels were adjusted to better match demand.

Meanwhile, the Association of American Railroads reported year-over-year increases of 10.8% and 13.6%, respectively, in the number of carloads and of intermodal trailers and containers hauled on North American railroads in the first six months of 2010. These increases support a gradually recovering economy.

OPERATING RESULTS

Sales

Sales for the quarter ended June 30, 2010 reached $167.3 million, an increase of $38.2 million, or 29.6%, over last year's second quarter sales of $129.1 million. The acquisition of Tangent, effective April 1, 2010, contributed sales of approximately $42.1 million. Once again, fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar had a significant effect in comparing quarterly sales this year versus last year. The conversion effect decreased the value of U.S. denominated sales by about $9.4 million when compared with the same period a year earlier. Organically, sales increased approximately 4.0%, reflecting higher railway tie sales in both the United States and Canada.

Sales for the six-month period ended June 30, 2010 amounted to $266.7 million, up $25.6 million from $241.1 million for the corresponding period a year earlier. The increase reflects the Tangent acquisition, while the stronger year-over-year Canadian dollar reduced the value of U.S. dollar denominated sales by approximately $18.2 million in the first half of 2010. Organically, sales increased approximately 1.0%.

Sales by product category

Railway ties

Railway tie sales for the second quarter of 2010 were $88.4 million, an increase of $30.8 million, or 53.6% over sales of $57.6 million in the second quarter of 2009. This increase reflects the acquisition of Tangent, which contributed railway tie sales of approximately $29.3 million, as well as increased industry demand. Excluding Tangent, year-over-year railway tie sales increased $1.5 million in spite of a $7.2 million adverse effect due to a lower average conversion rate on U.S. dollar denominated tie sales versus last year. Railway tie sales accounted for 52.9% of the Company's total sales in the second quarter of 2010.

In the six-month period ended June 30, 2010, railway tie sales reached $136.6 million, up from $118.9 million a year earlier. A lower conversion rate on U.S. dollar denominated tie sales reduced sales by approximately $13.5 million in the first six months of 2010 compared with the same period a year earlier.

Utility poles

Utility pole sales amounted to $38.7 million in the second quarter of 2010, a decrease of 12.4% compared with sales of $44.2 million in the second quarter of 2009. This decrease mainly reflects lower sales of transmission poles in the U.S. market, partially offset by slightly higher sales of distribution poles in Canada. The negative conversion effect on U.S. dollar denominated sales reduced utility pole sales by approximately $1.9 million. Utility pole sales accounted for 23.1% of the Company's total sales in the second quarter of 2010.

For the six-month period ended June 30, 2010, sales of utility poles amounted to $75.2 million, versus $81.7 million for the corresponding period in 2009. Approximately $3.6 million of this decrease is explained by a negative conversion effect on U.S. dollar denominated pole sales.

Industrial products

Sales of industrial products rose to $26.6 million in the second quarter of 2010, up from $11.9 million in the second quarter of 2009. The $14.7 million increase reflects the contribution from Tangent's operations related to coal tar distillation and lifecycle solutions, including used tie pickup and disposal services, as well as solid demand for marine applications in Eastern and Western Canada. These factors more than offset negative currency variations on U.S. dollar denominated sales. Industrial products represented 15.9% of overall sales in the second quarter of 2010. For the first six months of 2010, sales of industrial products reached $36.7 million, up from $22.3 million in the first six months of 2009.

Consumer lumber

Sales in the consumer lumber category totalled $13.5 million in the second quarter of 2010, down 12.5% from $15.5 million in the second quarter of 2009. The decrease reflects lower renovation spending in Canada due, in part, to the expiry of the home renovation tax credit program at the beginning of 2010. The Company does not sell consumer lumber into the U.S. market. Consumer lumber accounted for 8.1% of Stella-Jones' total sales in the second quarter of 2010. In the six-month period ended June 30, 2010, consumer lumber sales were $18.1 million, stable in comparison with $18.2 million for the corresponding period in 2009.

Sales by destination

In the second quarter of 2010, sales in Canada grew 8.6% to $64.5 million, or 38.6% of the Company's total sales. Sales in the United States amounted to $102.7 million, or 61.4% of sales, representing an increase of $33.0 million, or 47.3%, over the second quarter of 2009, essentially attributable to the Tangent acquisition, partially offset by a lower conversion rate on U.S. dollar denominated sales.

For the first six months of 2010, sales in Canada totalled $112.1 million, representing 42.1% of sales, up from $100.4 million in 2009, while sales in the United States amounted to $154.5 million, or 57.9% of sales, versus $140.6 million in the corresponding period of 2009.

Gross profit

Gross profit reached $28.9 million or 17.3% of sales in the second quarter of 2010, up from $23.9 million or 18.5% of sales in the corresponding period of 2009. The increase in gross profit dollars essentially reflects the contribution of the Tangent operations partially offset by a lower average rate applied to convert gross profit from U.S. dollar denominated sales. Meanwhile, the reduction in gross profit as a percentage of sales mainly stems from a highly competitive environment in the rail contractor and transit markets, softer pricing in the utility pole category, and slightly lower margins from the Tangent operations. For the first six months of 2010, gross profit stood at $47.1 million, or 17.6% of sales, compared with $46.4 million, or 19.3% of sales, for the same period a year earlier.

Expenses

Selling and administrative expenses for the three-month period ended June 30, 2010 were $11.2 million, up from $5.3 million in the three-month period ended June 30, 2009. In addition to expenses from the Tangent operations, selling and administrative expenses for the second quarter of 2010 include non-recurring expenses of approximately $3.0 million. These expenses consist of severance expenses, as well as a provision for an unfavourable legal judgement.

Selling and administrative expenses for the first six months of 2010 were $17.1 million, up from $11.1 million for the first six months of 2009. In addition to the aforementioned non-recurring expenses of $3.0 million recorded in the second quarter, selling and administrative expenses for the first six months of 2010 also include approximately $2.0 million in acquisition costs directly related to the purchase of Tangent.

During the three-month period ended June 30, 2010, the Company recorded asset impairment charges of $2.4 million for the Spencer, West Virginia facility and the Ripley, West Virginia U.S. corporate office (see “Asset Impairment Charges” below).

The Company realized a foreign exchange loss of $964,000 during the quarter ended June 30, 2010, versus a foreign exchange gain of $4,000 during the quarter ended June 30, 2009. For the first six months of 2010, the foreign exchange loss totalled $988,000, compared with a foreign exchange loss of $10,000 for the corresponding period in 2009.

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 June 30, 2010, the Company had on hand forward foreign exchange contracts for the future sale of US$6.4 million at an average contract rate of Cdn$1.2221/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 June 30, 2010, compared to March 31, 2010, amounted to $302,000, whereas the non-cash loss from the change compared to December 31, 2009, totalled $83,000. In the three- and six-month periods ended June 30, 2009, such gains on the change in mark-to-market values had amounted to $1.9 million and $0.9 million, respectively.

Amortization of capital and intangible assets totalled $2.9 million in the second quarter of 2010, an increase of $0.4 million over the corresponding period of 2009. This increase mainly reflects the amortization of Tangent’s capital and intangible assets. These elements were partially offset by a change in accounting estimates, applied prospectively from October 1, 2009, that increased the useful life of certain capital assets in order to better reflect their use in time (see “Critical Accounting Policies and Estimates” below).

For the first half of 2010, amortization of capital and intangible assets reached $4.6 million, compared with $5.1 million in the first half of 2009.

Financial expenses for the second quarter of 2010 amounted to $3.1 million, up from $2.3 million incurred in the second quarter of 2009. The increase in financial expenses is due to higher borrowings to partially finance the acquisition of Tangent, partially offset by lower Canadian dollar interest on the conversion of U.S. dollar denominated debt. For the first six months of 2010, financial expenses were $4.9 million, up from $4.5 million in the first six months of 2009.

Earnings before income taxes and income tax expense

Stella-Jones generated earnings before income taxes of $8.2 million, or 4.9% of sales, in the second quarter of 2010. This represents a decrease of $7.9 million over earnings before income taxes of $16.2 million, or 12.5% of sales, in the second quarter of 2009. Excluding non-recurring items and asset impairment charges, earnings before income taxes were $13.6 million, or 8.1% of sales, in the second quarter of 2010.

For the first six months of 2010, earnings before income taxes amounted to $16.9 million, or 6.3% of sales, compared with $27.3 million, or 11.3% of sales, in the first six months of 2009. Excluding non-recurring items and asset impairment charges, earnings before income taxes for the first half of 2010 were $24.3 million, or 9.1% of sales.

Stella-Jones' income tax expense totalled $2.6 million in the three-month period ended June 30, 2010, representing an effective tax rate of 31.8%. In the three-month period ended June 30, 2009, the income tax expense stood at $5.1 million, also equivalent to an effective tax rate of 31.8%.

For the six-month period ended June 30, 2010, Stella-Jones’ income tax expense was $5.5 million, representing an effective tax rate of 32.5%. This compares to an income tax expense of $8.6 million, representing an effective tax rate of 31.6%, in the first six months of 2009.

Net earnings
Net earnings for the three-month period ended June 30, 2010 totalled $5.6 million, or $0.35 per share, fully diluted, compared with $11.0 million, or $0.87 per share, fully diluted, in the same period a year earlier. The exchange of subscription receipts for common shares on April 1, 2010 to partially finance the Tangent acquisition increased the basic number of weighted average shares outstanding by approximately 25.9% in the second quarter of 2010 compared with the same period a year earlier.

Net earnings for the six-month period ended June 30, 2010, were $11.4 million, or $0.80 per share, fully diluted, compared with $18.7 million, or $1.48 per share, fully diluted, in the six-month period ended June 30, 2009.

ASSET IMPAIRMENT CHARGES

Pursuant to the Tangent acquisition, the Company has increased its production capacity and has consolidated the production of its railway tie requirements. As a result, the Spencer, West Virginia plant will be producing less annual volumes going forward. This management decision has triggered the requirement to test the Spencer plant long-lived assets for recoverability, which concluded in a $1,733,000 impairment expense recorded in earnings.

The Company has also decided to relocate its U.S. corporate office to Pittsburgh, Pennsylvania and sell its current corporate office located in Ripley, West Virginia. As a result, the land and building associated with the Ripley office have been re-classed as assets held for sale, presented on the balance sheet in other assets and written down, reducing their value by $679,000. The related expense was recorded in earnings.

BUSINESS ACQUISITION

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

Total cash outlay associated with the acquisition was approximately $172.2 million (US$169.5 million), subject to post closing adjustments, including cash on hand of $6.8 million (US$6.7 million) and excluding acquisition costs of approximately $2.0 million (US$2.0 million). This amount includes $89.9 million (US$88.5 million) paid to Tangent's shareholders, $81.3 million (US$80.1 million) used to reimburse Tangent's debts with financial institutions and $1.0 million (US$0.9 million) to pay accrued interest on these debts.

The acquisition has been accounted for using the acquisition method 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 following fair value allocation is preliminary and is based on Management's best estimates and information known at the time of preparing these interim unaudited consolidated financial statements. The purchase price allocation is expected to be completed by December 31, 2010 and consequently, changes could occur mainly with respect to intangible assets, goodwill and future income taxes. The results of operations of Tangent have been included in the Company's consolidated financial statements from the acquisition date.

The following is a preliminary 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.

	$
(tabular information presented in thousands of dollars)	
Assets acquired	
Non-cash working capital	49,238
Capital assets	22,323
Customer relationships	20,905
Customer backlog	670
Creosote registration	31,723
Non-deductible goodwill	70,982
Future income tax assets	615
	196,456
Liabilities assumed	
Accounts payable and accrued liabilities	4,529
Long-term debt	81,340
Asset retirement obligation	1,311
Future income tax liabilities	24,663
Total consideration	84,613
Consideration	
Cash	172,198
Payment of accrued interest	(956)
Payment of long-term debt	(81,340)
Consideration payable	1,544
Cash on hand	(6,833)
Purchase consideration for shares	84,613

The Company's preliminary valuation of intangible assets has identified customer relationships, a creosote registration and customer backlog. The assigned useful lives for customer relationships are between 6 to 10 years and 3 months for the customer backlog. The creosote registration is not subject to amortization as the Company considers it to have an indefinite useful life.

Goodwill value is determined as the excess of the total consideration over the estimated fair value of tangible and intangible assets acquired as well as liabilities assumed. Goodwill is not amortized, not deductible for tax purposes and represents the future economic value associated with the increased railroad network access, acquired work force and synergies with the Company's operations.

The following table presents a roll forward of the intangible assets and goodwill net book value balances from December 31, 2009 to June 30, 2010:

(tabular information presented in thousands of dollars)	Customer Relationships $	Non-compete Agreements $	Creosote Registration $	Total Intangible assets $	Goodwill $
Year ended December 31, 2009					
Cost	4,603	5,980	---	10,583	5,494
Accumulated depreciation	(1,259)	(1,744)	---	(3,003)	---
Net book value as at Dec. 31, 2009	3,344	4,236	---	7,580	5,494
Six-month period ended June 30, 2010					
Opening net book balance	3,344	4,236	---	7,580	5,494
Addition of Tangent customer relationships	20,905	---	---	20,905	---
Addition of Tangent customer backlog	670	---	---	670	---
Addition of Tangent creosote registration	---	---	31,723	31,723	---
Addition of Tangent goodwill	---	---	---	---	70,982
Amortization	(1,360)	(493)	---	(1,853)	---
Exchange difference	1,049	43	1,524	2,616	3,481
Net book value as at June 30, 2010	24,608	3,786	33,247	61,641	79,957

Financing for the transaction has been secured through an $80,050,000 private placement of subscription receipts which successfully closed on March 15, 2010, as well as through the issuance to the Solidarity Fund QFL of a $25,395,000 (US$25,000,000) unsecured and subordinated non-convertible debenture, the addition of a $40,632,000 (US$40,000,000) syndicated bank term facility which successfully closed on March 24, 2010, and the increase of existing operating debt facilities. Underwriting and legal fees related to the private placement of subscription receipts amounted to $3,147,000 generating net proceeds of $76,903,000. The subscription receipts were exchanged as at the close of business, April 1, 2010, for common shares in the share capital of the Company on the basis of one common share per subscription receipt. Holders of subscription receipts did not need to take any action in order to receive the common shares to which they were entitled. As the subscription receipts were sold on a private placement basis, these common shares were subject to regulatory restrictions on resale until July 16, 2010. On April 1, 2010, restricted cash in the amount of $142,920,000, consisting of the proceeds of the financing raised for the acquisition of Tangent and which were repayable or refundable in the event the Tangent acquisition did not close, were disbursed.

Tangent’s sales and net earnings in the three month period ended June 30, 2010 were $42,130,000 and $2,285,000, respectively. On a pro-forma basis, Management’s estimate of the sales and net earnings of the combined Company and Tangent’s operations would have been approximately $306,991,000 and $14,910,000, respectively, had the Tangent acquisition occurred as of January 1, 2010. To arrive at the pro-forma estimates, Management has considered the financing structure resulting from the acquisition as well as other acquisition adjustments.

QUARTERLY RESULTS

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

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

2010

For the quarters ended	**March 31**	**June 30**			
(thousands of dollars, except per share data)	**$**	**$**			
Sales	99,360	167,317			
Operating earnings before amortization of capital and intangible assets [1]	12,266	14,202			
Operating earnings [1]	10,500	11,325			
Net earnings	5,814	5,610			
Net earnings per common share					
Basic	0.46	0.35			
Diluted	0.46	0.35			

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.

BALANCE SHEET

The Company's working capital at June 30, 2010 was $197.6 million, an increase of $27.5 million over a working capital balance of $170.1 million at December 31, 2009. Current assets amounted to $304.2 million as at June 30, 2010 compared with $254.6 million as at December 31, 2009. Most of this $49.7 million increase is attributable to accounts receivable and inventories related to Tangent's operations.

The value of accounts receivable was $89.9 million as at June 30, 2010 compared with $30.2 million as at December 31, 2009. This increase mainly reflects the addition of Tangent's accounts receivables as well as normal seasonal demand pattern. Excluding Tangent, accounts receivables would have been $65.1 million as at June 30, 2010.

Inventories stood at $204.4 million on June 30, 2010, compared with $212.6 million on December 31, 2009. This decrease is due to higher seasonal business activity which more than offset the effect of adding Tangent's inventory. Excluding the latter, inventories would have been $176.5 million.

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 $116.5 million as at June 30, 2010, compared with $96.9 million as at December 31, 2009. This $19.6 million increase is related to the addition of Tangent's capital assets. Excluding the acquisition, capital assets would have been $93.2 million.

Following the Tangent acquisition, the value of intangible assets totalled $141.6 million as at June 30, 2010, compared with $13.1 million as at December 31, 2009. Intangible assets include customer relationships, the discounted value of the non-compete agreements, Tangent's creosote registration and goodwill. Excluding Tangent, intangible assets would have been $12.4 million.

Bank indebtedness as at June 30, 2010 totalled $47.6 million, down from $56.1 million at the end of 2009. This decrease is the result of a solid cash flow generation. As at June 30, 2010, the credit facilities supporting bank indebtedness include a $50.0 million demand operating loan with a syndicate of Canadian banks ($50.0 million as at December 31, 2009), as well as a US$75.0 million demand operating loan with a syndicate of U.S. bankers (US$45.0 million as at December 31, 2009). Total availability under the Company's Canadian and U.S. operating lines of credit was $16.6 million and US$63.2 million, respectively, as at June 30, 2010.

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, if any, may require new sources of financing.

As at June 30, 2010, the Company's long-term debt, including the current portion, amounted to $154.2 million, up from $87.1 million as at December 31, 2009. This increase is due to the issuance to the Solidarity Fund QFL of a US$25.0 million (Cdn$25.4 million) unsecured and subordinated non-convertible debenture and the addition of a US$40.0 million (Cdn$40.6 million) term facility to partially finance the acquisition of Tangent.

Shareholders' equity was $271.5 million as at June 30, 2010, up from $180.0 million as at December 31, 2009. This increase of $91.5 million is mostly attributable to net proceeds of $66.9 million from the issuance of subscription receipts to partially finance the acquisition of Tangent. The subscription receipts were exchanged, without additional payment, into common shares of the Company on a one-for-one basis upon completion of the acquisition on April 1, 2010. Book value stood at $17.08 per common share as at June 30, 2010, up from $14.19 per share as at December 31, 2009.

LIQUIDITY AND CAPITAL RESOURCES

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

Summary of cash flows	**Three-month periods ended**		**Six-month periods ended**	
(thousands of dollars)	**June 30, 2010**	**June 30, 2009**	**June 30, 2010**	**June 30, 2009**
Operating activities	$31,414	$14,668	$40,262	$2,142
Financing activities	($88,738)	($14,653)	$46,430	($21)
Investing activities	$57,324	($15)	($86,692)	($2,121)
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 raised from operating lines of credit and long-term debt, 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 $11.1 million for the quarter ended June 30, 2010, compared with $12.6 million for the corresponding period in 2009. This decrease reflects the reduction in net earnings for the period partially offset by higher non-cash charges, such as amortization of intangible assets and asset impairment charges.

For the six-month period ended June 30, 2010, cash flow from operating activities before changes in non-cash working capital components totalled $19.6 million, down from $23.9 million in the corresponding period a year earlier.

Changes in non-cash working capital components provided liquidity of $20.4 million in the second quarter of 2010 compared with providing liquidity of $2.1 million in the second quarter of 2009. This improvement is mainly attributable to a reduction in inventories and to an increase in accounts payable and accrued liabilities that more than offset an increase in accounts receivable. As a result, operating activities generated liquidity of $31.4 million for the three-month period ended June 30, 2010, up from $14.7 million for the corresponding period a year earlier.

For the six-month period ended June 30, 2010, operating activities provided liquidity of $40.3 million, compared with providing liquidity of $2.1 million in the six-month period ended June 30, 2009.

Financing activities for the three-month period ended June 30, 2010 used funds of $88.7 million. This amount mainly reflects a repayment of long-term debt of $82.1 million, mostly in connection with the Tangent acquisition, a $3.4 million reduction in bank indebtedness as well as the payment of dividends on common shares totalling $2.9 million. For the three-month period ended June 30, 2009, cash flows from financing activities had required liquidity of $14.7 million.

For the first six months of 2010, financing activities provided liquidity of $46.4 million, due to the partial financing of the Tangent acquisition, as opposed to requiring $21,000 in the corresponding period in 2009.

Investing activities provided $57.3 million in cash during the second quarter of 2010, as the $84.6 million Tangent acquisition on April 1, 2010 resulted in a $142.9 million decrease in restricted cash. The balance of the restricted cash was used to repay Tangent's long-term debt. Capital asset expenditures, mainly for the addition of various equipment upgrades and expansion, amounted to $1.1 million. For the second quarter of 2009, cash flows from investing activities had reduced liquidity by $15,000.

In the first six months of 2010, cash flows used for investing activities were $86.7 million compared with $2.1 million in the first six months of 2009.

The following table details the maturities of the financial obligations as at June 30, 2010:

(in thousands of dollars)	Carrying Amount ($)	Contractual Cash flow ($)	Less than 1 year ($)	1 – 3 years ($)	4 – 5 years ($)	After 5 years ($)
Bank indebtedness[1]	47,630	49,425	49,425	-	-	-
Accounts payable and accrued liabilities	41,988	41,988	41,988	-	-	-
Long-term debt obligations[1]	152,957	197,890	20,222	45,207	75,210	57,251
Capital lease obligations[1]	1,236	1,522	175	346	166	835
Interest rate swaps	1,930					
Outflow	-	6,574	2,393	1,692	1,282	1,207
Inflow	-	(3,252)	(1,393)	(801)	(679)	(379)
Other contractual obligations	-	23,343	4,847	5,879	2,616	10,001
Non-compete agreements	4,207	4,990	1,331	2,662	997	-
Total	249,948	322,480	118,988	54,985	79,592	68,915

[1] Amounts include capital and interest

SHARE AND STOCK OPTION INFORMATION

As at June 30, 2010, the capital stock issued and outstanding consisted of 15,900,353 common shares (12,684,325 as at December 31, 2009). As at August 11, 2010, the capital stock issued and outstanding consisted of 15,900,353 common shares.

As at June 30, 2010, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 197,285 (December 31, 2009 – 197,785) of which 119,685 (December 31, 2009 – 126,185) were exercisable. As at August 11, 2010, the number of outstanding options was 197,285, of which 128,685 were exercisable.

DIVIDENDS

On August 11, 2010, the Board of Directors declared a semi-annual dividend of $0.20 per common share payable on October 8, 2010 to shareholders of record at the close of business on September 3, 2010.

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 commitments and contingencies susceptible to affect the Company in the future remain substantially unchanged from those included in the Company's annual MD&A contained in its 2009 Annual Report.

CURRENT ECONOMIC CONDITIONS

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.

Liquidity

As at June 30, 2010, 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 $16.6 million and US$63.2 million, respectively.

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.

Inventories decreased during the second quarter of 2010 due to higher seasonal business activity. To ensure efficient treatment operations, given that air-dried wood reduces treatment cycles, inventory turnover has historically been relatively low. Nevertheless, Management continuously monitors the levels of inventory and market demand for its products. Production is adjusted accordingly to optimize efficiency and capacity utilization.

RISKS AND UNCERTAINTIES

The risk and uncertainty factors affecting the Company in the future remain substantially unchanged from those included in the Company's annual MD&A contained in its 2009 Annual Report.

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.

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 of 2009, Management reviewed and increased the useful life of certain capital assets in order to better reflect their use in time. These changes were applied prospectively from October 1, 2009.

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

CHANGES IN ACCOUNTING POLICIES

The Canadian Institute of Chartered Accountants ("CICA") issued the following accounting standards which were 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 the International Financial Reporting Standard ("IFRS") standard, 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 has applied this new standard effective January 1, 2010 as early adoption is permitted. As a result of the application of this new accounting standard, the Company charged deferred acquisition expenses in the amount of $328,399 to earnings. Effective January 1, 2010, expenses of a similar nature will be recorded to results in the period they are incurred.

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 IAS 27 (Revised) standard, "Consolidated and Separate Financial Statements". The Company has applied these new standards effective January 1, 2010 as early adoption is permitted. The adoption of these new standards did not have any impact on the Company's consolidated financial statements.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

In February 2008, the Canadian Accounting Standards Board ("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. Phase II is well underway, the consequences of most of the changes have been determined and Management is presently in the process of finalizing the Company's opening balance sheet as of January 1, 2010 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 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 finance and operational leases are properly classified.

Cutting rights and Standing Timber
Cutting rights contracts have been analyzed to determine if they should be considered under IAS 17, Leases or under IAS 38, Intangible Assets. This analysis has been completed and Management concluded that cutting right should be recorded under intangible assets.

As at December 31, 2009, cutting rights were accounted for as part of capital assets. Under IFRS, the company will have to reclassify these assets from capital assets to intangible assets on the balance sheet. This reclassification will be for a net book value of $6.1 million. Standing timber, under IAS 38 will also have to be reclassified under Intangible assets. This reclassification will be for a net book value of $3.1 million.

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 the equity method is proposed instead. The equity method presents joint ventures in the financial statements as an investment valued at the original contribution cost in the joint venture. As of January 1, 2010, Stella-Jones will present its joint venture under the equity method.

The documentation for joint venture accounting is in place and no additional disclosures will be required, based on the current standards.

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 and reviewed by Management.

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 related to Stella-Jones pension plans of $307,000 as of January 1, 2010 will be reflected on the balance sheet upon transition.

Stella-Jones also mandated Towers Watson to perform the same analysis regarding the post-retirement benefits. As a result, there will be two adjustments to the opening balance sheet as of January 1, 2010: an unamortized loss of $1.1 million and a gain of $549,000 related to the attribution period which changes under IAS 19.

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 is almost completed and 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 licenses 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. There are proposed changes to 1AS 37 that may require the Company to perform other assessments.

Business combinations and goodwill

Effective July 1, 2009, IFRS 3 becomes the reference document to guide corporations through business combinations.

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 decided to apply the standard prospectively. In addition, the Company has elected to early adopt a new standard under Canadian GAAP from January 1, 2010 which would align the accounting for business combinations under Canadian GAAP to IFRS.

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 was 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 has made a decision regarding cumulative translation adjustment. As of January 1, 2010 the cumulative translation adjustment on self-sustaining operations will be deemed to be $0. The amount of $1.8 million will be reclassed from Accumulated other comprehensive income to Retained earnings.

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 have been 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 AND INTERNAL CONTROL OVER FINANCIAL REPORTING

In accordance with the Canadian Securities Administrators' National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings), the Company has filed certificates signed by the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer that, among other things, report on the design of disclosure controls and procedures ("DC&P") and on the design of internal control over financial reporting ("ICFR").

The Company did not make any material changes to the design of ICFR during the three months ended June 30, 2010 that have had a material effect on the Company's ICFR. As a result of Tangent's migration to Stella-Jones' financial reporting platform, Management has extended the Company's ICFR and DC&P structure to the operations of Tangent. Management has evaluated the impact of the acquisition of Tangent on the overall structure of ICFR and, due to the similar nature of Tangent's business to that of Stella-Jones, has concluded that it does not represent a material change in ICFR and DC&P.

OUTLOOK

Although global economic conditions have shown some signs of improvement, the recovery is likely to be gradual in the Company's core markets. Demand is expected to be stable 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. Based on current market conditions, Management expects business activity to further improve in the second half of 2010.

The successful integration of the Tangent acquisition will be a major performance driver in 2010 and beyond. This transaction solidifies the Company's position as the second largest North American provider of railway ties and should 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.

August 11, 2010