MANAGEMENT'S DISCUSSION & ANALYSIS

Three-month period ended March 31, 2011 compared with the three-month period ended March 31, 2010

The following Management's Discussion and Analysis ("MD&A") and the Company's condensed interim unaudited consolidated financial statements were approved by the Audit Committee and the Board of Directors on June 1, 2011. The MD&A provides a review of the significant developments and results of operations of the Company during the three-month period ended March 31, 2011 compared with the three-month period ended March 31, 2010. The MD&A should be read in conjunction with the Company's condensed interim unaudited consolidated financial statements for the periods ended March 31, 2011 and 2010 and the notes thereto as well as the Company's annual consolidated financial statements and MD&A for the year ended December 31, 2010. The interim unaudited consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") 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 .sedar.com**.** Press releases and other information are also available in the Investor/Media Centre section of the Company's Web site at .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 residential lumber products and customized services to lumber retailers and wholesalers for outdoor applications. Other treated wood products include marine and foundation pilings, construction timbers, highway guardrail posts and treated wood for bridges.

The Company operates eighteen wood treating plants, a coal tar distillery, 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-seven facilities are located in six Canadian provinces and fourteen American states. The Company's workforce currently numbers approximately 940 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.

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-IFRS FINANCIAL MEASURES

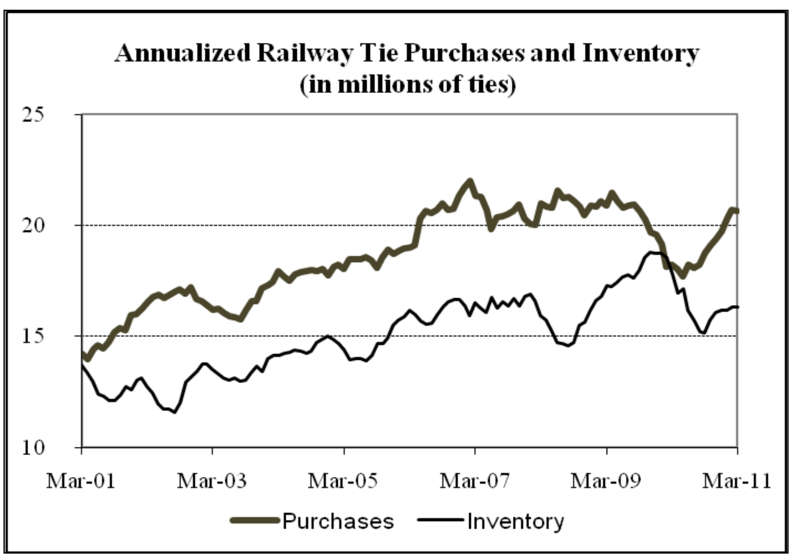
Operating income before depreciation of property, plant and equipment and amortization of intangible assets (also referred to as earnings before interest, taxes, depreciation and amortization ["EBITDA"]), operating income, and cash flow from operations are financial measures not prescribed by IFRS and are not likely to be comparable to similar measures presented by other issuers. Management considers these measures 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 March 31, 2011 and 2010. Average rates are used to translate sales and expenses for the periods mentioned, while closing rates translate assets and liabilities of foreign operations and monetary assets and liabilities of the Canadian operations.

Cdn$/US$	**2011**		**2010**	
	Average	**Closing**	**Average**	**Closing**
First Quarter	0.9892	0.9696	1.0576	1.0158

INDUSTRY OVERVIEW



Source: Railway Tie Association

Railway ties
As reported by the Railway Tie Association, railway tie purchases for the first three months of 2011 surpassed those of the year-earlier corresponding period by close to 1.0 million ties. As a result, industry purchases for the 12-month period ended March 31, 2011 reached 20.7 million ties. This greater activity reflects the ongoing recovery of the North American economy. Meanwhile, industry inventory remained relatively stable in the first quarter of 2011, reaching 16.3 million ties as at March 31, 2011. As at that same date, the inventory-to-sales ratio stood at 0.79:1, a level in keeping with the average value of the previous decade.

Also driven by the economic recovery, the number of carloads hauled on North American railroads increased by 4.2% in the first three months of 2011, while the volume of intermodal trailers and containers was up 7.9% from 2010 levels, according to data released by the Association of American Railroads.

OPERATING RESULTS

Sales

Sales for the quarter ended March 31, 2011 totalled $130.5 million, an increase of $31.1 million, or 31.3%, over last year's sales of $99.4 million. The operating facilities acquired from Tangent Rail Corporation ("Tangent"), on April 1, 2010, contributed sales of approximately $37.7 million during the quarter. The conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, decreased the value of U.S. dollar denominated sales by about $3.4 million when compared with the previous year.

Organically, sales decreased approximately 3.0%, primarily reflecting lower sales of industrial products and residential lumber. This marginal decrease in the first quarter of 2011 is also attributable to strong advanced deliveries of railway ties in the late stages of the fourth quarter in 2010. Conversely, lower advanced deliveries of railway ties in the fourth quarter of 2009 had caused an increase in sales during the first quarter of 2010.

Sales by product category

Railway ties

Railway tie sales for the first quarter of 2011 amounted to $76.5 million, an increase of $28.3 million, or 58.7% over sales of $48.2 million in the first quarter of 2010. These results reflect the contribution from the Tangent operations, which added tie sales of approximately $29.5 million, as well as increased market demand. Excluding Tangent's sales and adjusting for a negative foreign exchange effect of $2.5 million due to a lower average conversion rate on U.S. dollar denominated tie sales, year-over-year comparable railway tie sales increased $1.3 million. As anticipated, demand was lower in the early part of the period, as a result of strong fourth-quarter sales in 2010, but increased steadily in the latter stages. Railway tie sales accounted for 58.7% of the Company's first-quarter sales.

Utility poles

Utility pole sales amounted to $35.7 million in the first quarter of 2011, a decrease of 2.3% over sales of $36.5 million in the corresponding period in 2010. The decrease of $857,000 in utility pole sales is mainly attributable to a negative conversion effect of $720,000 on U.S. dollar denominated sales. First-quarter sales of transmission poles rose over last year due to orders for special projects, while sales of distribution poles were lower as severe winter weather postponed demand in Canada. Utility pole sales accounted for 27.3% of the Company's total sales in the first quarter of 2011.

Industrial products

Industrial product sales rose 49.6% in the first quarter of 2011, reaching $15.1 million, compared with $10.1 million in 2010. This $5.0 million increase is attributable to Tangent's operations related to coal tar distillation and lifecycle solutions, including used tie pickup and disposal services. Excluding the Tangent contribution, sales declined by approximately $3.0 million due to severe winter weather in Canada and the eastern United States. Industrial products represented 11.6% of sales in the three-month period ended March 31, 2011.

Residential lumber

Sales in the residential lumber category totalled $3.2 million in the first quarter of 2011, down 29.8% from $4.5 million a year earlier. The decrease reflects reduced demand in Canada as a result of less favourable weather compared with last year. The Company does not sell residential lumber into the U.S. market. Residential lumber accounted for 2.4% of Stella-Jones' sales in the first quarter of 2011.

Sales by destination

Sales in Canada in the first quarter of 2011 declined $4.2 million, or 8.8%, to $43.4 million, representing 33.2% of Stella-Jones' total sales. The decrease in year-over-year sales is mainly attributable to lower sales of industrial products and residential lumber.

Sales in the United States amounted to $87.1 million, or 66.8% of sales, in the first quarter of 2011, representing an increase of $35.3 million, or 68.3%, over the corresponding period in 2010. The increase reflects the Tangent acquisition, which contributed $37.7 million in sales in the quarter, partially offset by a lower conversion rate on other U.S. dollar denominated sales.

Cost of sales

Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $109.6 million, or 84.0% of sales, for the three-month period ended March 31, 2011. This compares with $83.0 million, or 83.5% of sales, in the three-month period ended March 31, 2010. The increase in absolute dollars essentially reflects the Tangent operations, partially offset by a lower average rate applied to convert U.S. dollar denominated costs. The increase as a percentage of sales mainly stems from a different product mix, more heavily weighted towards railway ties, as well as from higher amortization charges.

Depreciation and amortization charges totalled $2.6 million for the first three months of 2011, up from $1.7 million in the first three months of 2010. The increase essentially reflects the depreciation of Tangent's property, plant and equipment as well as amortization of intangible assets.

As a result, gross profit reached $20.9 million or 16.0% of sales in the first quarter of 2011, up from $16.4 million or 16.5% of sales in the first quarter of 2010.

Selling and administrative

Selling and administrative expenses for the first quarter of 2011 were $7.0 million, compared with expenses of $5.9 million in the first quarter of 2010. This increase is mostly attributable to expenses from the Tangent operations. Of note, last year's selling and administrative expenses included expenses of approximately $1.8 million directly related to the acquisition of Tangent. As a percentage of sales, selling and administrative expenses were 5.3% of sales in the three-month period ended March 31, 2011, compared to 6.0% in the prior year.

Other losses (gains), net

Stella-Jones' other net gains of $506,000 for the three-month period ended March 31, 2011, were with respect to foreign exchange. Last year's net loss of $8,000 included a foreign exchange loss of $24,000, a loss on derivative financial instruments of $15,000 and a gain on disposal of property, plant and equipment of $31,000.

The Company's exposure to foreign exchange gains or losses from currency fluctuations is related to its sales and purchases in U.S. dollars by its Canadian based operations. Stella-Jones U.S. Holding Corporation, the Company's wholly-owned U.S. subsidiary, is a foreign operation that has a different functional currency from that of the Company 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.

Financial expenses

Financial expenses for the first quarter of 2011 amounted to $2.3 million, up from $1.8 million in the first quarter of 2010. This increase in financial expenses is due to higher borrowings to partially finance the acquisition of Tangent, partly offset by lower Canadian dollar interest charges on the conversion of U.S. dollar denominated debt.

Income before income taxes and income tax expense

Stella-Jones generated income before income taxes of $12.1 million, or 9.3% of sales, in the first quarter of 2011. This represents an increase of $3.4 million, or 39.5%, over income before income taxes of $8.7 million, or 8.7% of sales, in the first quarter of 2010.

Stella-Jones' provision for income taxes totalled $3.6 million in the first quarter of 2011, representing an effective tax rate of 29.7%. In the first quarter of 2010, the income tax expense stood at $2.9 million, equivalent to an effective tax rate of 33.2%. The lower effective tax rate for 2011 is attributable to a decrease in the Canadian statutory tax rate and the absence this year of any significant tax true-up adjustments versus last year's first quarter.

Net income

Net income for the period totalled $8.5 million, or $0.53 per share, fully diluted, compared with $5.8 million, or $0.45 per share, fully diluted, in 2010. This represents a year-over-year increase in net income of $2.7 million, or 46.9%. The exchange of subscription receipts for common shares on April 1, 2010 to partially finance the Tangent acquisition increased the weighted average number of shares outstanding used for the calculation of fully diluted earnings per share in the first quarter of 2011 by approximately 25.6% over the corresponding period of 2010.

SUBSEQUENT EVENTS

On April 1, 2011, the Company entered into an agreement to amend and restate a US$25.0 million unsecured and non-convertible debenture and repaid US$15.0 million of the capital amount. The amended debenture bears interest at 7.27% (previously 7.89%) and is repayable in a single instalment of US$10.0 million on April 1, 2016 (previously annual principal repayments of US$2.5 million starting on April 1, 2011 and a final payment of US$12.5 million on April 1, 2018). No advance repayment will be permitted under the amended agreement. The amended debenture was designated as a hedge of net investment of foreign operations.

On April 1, 2011, the Company entered into an agreement to amend and restate a US$25.0 million unsecured, subordinated and non-convertible debenture. The amended debenture bears interest at 7.27% (previously 9.75%) and is repayable in a single instalment of US$25.0 million on April 1, 2016 (previously repayable in a single instalment of US$25.0 million on April 1, 2015). No advance repayment will be permitted under the amended agreement. The amended debenture was designated as a hedge of net investment of foreign operations.

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. Residential lumber 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 nine quarters and accounting policies applicable to such financial information.

2011 (IFRS)

For the quarters ended	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
(thousands of dollars, except per share data)	**$**	**$**	**$**	**$**	**$**
Sales	130,485				
Operating income before depreciation of property, plant and equipment and amortization of intangible assets [1]	16,970				
Operating income [1]	14,418				
Net income for the period	8,500				
Earnings per common share Basic Diluted	 0.53 0.53				

2010 (IFRS)

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(thousands of dollars, except per share data)	$	$	$	$	$
Sales	99,360	167,317	161,298	133,071	561,046
Operating income before depreciation of property, plant and equipment and amortization of intangible assets [1]	12,241	14,155	22,720	21,929	71,045
Operating income [1]	10,474	11,278	19,744	19,194	60,690
Net income for the period	5,788	5,563	12,440	10,650	34,441
Earnings per common share Basic Diluted	 0.46 0.45	 0.35 0.35	 0.78 0.78	 0.67 0.67	 2.27 2.26

2009 (Previous Canadian GAAP)

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 income before depreciation of property, plant and equipment and amortization of intangible assets [1]	15,924	20,976	15,272	6,851	59,023
Operating income [1]	13,313	18,475	13,376	5,104	50,268
Net income for the period	7,687	11,021	8,320	3,041	30,069
Earnings per common share Basic Diluted	 0.61 0.61	 0.87 0.87	 0.66 0.65	 0.24 0.24	 2.38 2.37

[1] Operating income before depreciation of property, plant and equipment and amortization of intangible assets and operating income are financial measures not prescribed by IFRS or 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 income before depreciation of property, plant and equipment and amortization of intangible assets and operating income are readily reconcilable to net income presented in our IFRS 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.

STATEMENT OF FINANCIAL POSITION

The Company's working capital at March 31, 2011 was $191.5 million, an increase of $2.0 million over a working capital balance of $189.5 million at December 31, 2010. Current assets amounted to $310.0 million as at March 31, 2011 compared with $269.0 million three months earlier. Most of this increase is attributable to higher accounts receivable and inventories, as explained below.

The value of accounts receivable was $74.1 million as at March 31, 2011 compared with $56.3 million as at December 31, 2010. This increase essentially reflects stronger sales in the latter stages of the first quarter.

Inventories stood at $223.5 million as at March 31, 2011, up from $205.3 million as at December 31, 2010. This increase reflects the normal seasonal inventory build-up ahead of peak demand in the second and third quarters.

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.

Property, plant and equipment stood at $103.4 million as at March 31, 2011, compared with $104.8 million as at December 31, 2010. This $1.4 million decrease is essentially related to local currency depreciation on U.S. based property, plant and equipment, as capital expenditures for the period were approximately the same as depreciation.

The value of intangible assets and goodwill reached $61.7 million and $72.1 million, respectively, as at March 31, 2011. Intangible assets include customer relationships, the discounted value of the non-compete agreements Tangent's creosote registration, cutting rights and standing timber. As at December 31, 2010, intangible assets, and goodwill were $64.2 million and $74.0 million, respectively. The decrease in the value of intangible assets and goodwill stems from the effect of local currency depreciation on U.S. based intangible assets and goodwill, while the value of intangible assets also reflects an amortization charge of $1.2 million in the first quarter of 2011.

Bank indebtedness at the end of the first quarter of 2011 was $66.2 million, up from $31.9 million at the end of 2010. This $34.3 million increase essentially reflects higher working capital. As at March 31, 2011, the credit facilities supporting bank indebtedness include a $50.0 million demand operating loan ($50.0 million as at December 31, 2010), as well as a US$75.0 million demand operating loan (US$75.0 million as at December 31, 2010), both made available by a syndicate of bank lenders. Combined availability under the Company's Canadian and U.S. demand operating loans was $57.3 million as at March 31, 2011.

The Company believes that these demand operating loans, combined with its cash flows from operating activities 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 March 31, 2011, the Company's long-term debt, including the current portion, amounted to $118.7 million, down from $125.8 million as at December 31, 2010. This decrease is due to the repayment of long-term debt amounting to $4.5 million in the first quarter of 2011 and to a lower rate applied to convert U.S. dollar denominated debt.

Shareholders' equity was $281.0 million as at March 31, 2011 compared with $280.1 million as at December 31, 2010. This increase of $0.9 million is mostly attributable to net income of $8.5 million, partially offset by dividend payments on common shares totalling $3.8 million and a $4.3 million increase in the accumulated other comprehensive loss. Book value stood at $17.63 per common share as at March 31, 2011, up from $17.59 per share as at December 31, 2010.

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**	
(thousands of dollars)	**March 31, 2011**	**March 31, 2010**
Operating activities	($28,652)	$8,848
Financing activities	$30,264	$135,168
Investing activities	($1,612)	($144,016)
Cash and cash equivalents	$---	$---

The Company's activities, acquisitions and purchases of property, plant and equipment 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 and interest and income tax paid was $17.6 million for the three-month period ended March 31, 2011, compared with $12.8 million for the same period in 2010. This increase mostly reflects the $2.7 million increase in net income and a $567,000 positive variation in the non-cash amortization of intangible assets.

Changes in non-cash working capital components reduced liquidity by $40.0 million, as opposed to a liquidity decrease of $2.9 million a year ago. The reduction in the first quarter of 2011 principally mirrors a $20.9 million increase in inventories and an $18.5 million increase in accounts receivable. As a result, operating activities required funds of $28.7 million for the three-month period ended March 31, 2011, versus providing funds of $8.8 million a year earlier.

Financing activities for the quarter ended March 31, 2011 provided funds of $30.3 million. Main factors explaining this cash generation include a $34.8 million increase in bank indebtedness due to working capital requirements, partially offset by repayment of long-term debt amounting to $4.5 million. For the quarter ended March 31, 2010, financing activities had generated liquidity of $135.2 million due to proceeds of $76.9 million from the issuance of subscription receipts and of a $66.0 million increase in long-term debt. Both variations were in connection with the Tangent acquisition on April 1, 2010.

Investing activities required $1.6 million in cash during the first quarter of 2011, of which $1.4 million represented purchases of property, plant and equipment, mainly for the addition of various equipment upgrades and expansion. For the quarter ended March 31, 2010, cash flows from investing activities reduced liquidity by $144.0 million due to an increase of $142.9 million in restricted cash pending the completion of the Tangent acquisition.

The following table details the maturities of the financial obligations as at March 31, 2011:

(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]	66,180	67,650	67,650	-	-	-
Accounts payable and accrued liabilities	40,047	40,047	40,047	-	-	-
Long-term debt obligations[1]	118,706	150,216	15,690	35,470	55,572	43,484
Interest rate swaps						
Outflow	-	2,148	898	873	377	-
Inflow	-	(519)	(219)	(213)	(87)	-
Other contractual obligations	-	23,272	5,689	6,783	2,091	8,709
Non-compete agreements	3,171	3,729	1,243	2,486	-	-
Total	228,104	286,543	130,998	45,399	57,953	52,193

[1] Amounts include capital and interest

SHARE AND STOCK OPTION INFORMATION

As at March 31, 2011, the capital stock issued and outstanding consisted of 15,938,915 common shares (15,922,668 as at December 31, 2010). The following table presents the outstanding capital stock activity for the three-month period ended March 31, 2011:

Three-month Period Ended March 31, 2011	**Number of shares (in '000s)**
Balance – Beginning of period	15,923
Stock option plan	14
Employee share purchase plans	2
Balance – End of period	15,939

As at June 1, 2011, the capital stock issued and outstanding consisted of 15,947,485 common shares.

As at March 31, 2011, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 167,000 (December 31, 2010 – 181,000) of which 114,300 (December 31, 2010 – 128,300) were exercisable. As at June 1, 2011, the number of outstanding options was 158,800, of which 107,600 were exercisable.

DIVIDENDS

On March 10, 2011, the Board of Directors declared a semi-annual dividend of $0.24 per common share payable on May 13, 2011 to shareholders of record at the close of business on April 1, 2011.

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 2010 Annual Report.

CURRENT ECONOMIC CONDITIONS

Operations

The Company's core railway tie and utility pole product categories are integral to the North American basic transportation and utility infrastructure. Such infrastructure needs to be regularly maintained which provides Stella-Jones with relatively steady demand for its core products. In periods of economic growth, the Company may also benefit from additional demand stemming from expansions to the railway and telecommunication networks.

Based on current market conditions, Management continues to expect business activity to further improve in the upcoming quarters. Increased freight volume on North American railroads should lead to greater investments in the continental rail network, including ties, as operators constantly seek optimal line efficiency. Demand is expected to steadily progress in utility poles, as regular maintenance projects provide a stable business flow for distribution poles, while the vigour of the transmission pole market is more correlated to the timing of orders, mostly for special projects.

Liquidity

As at March 31, 2011, the Company is in full compliance with its debt covenants and contractual obligations. In addition, it has a combined availability under the Company's Canadian and U.S. demand operating loans of $57.3 million as at March 31, 2011.

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.

Inventories increased during the first quarter of 2011 due to the normal seasonal inventory build-up in anticipation of higher projected peak sales volumes in the second and third quarters. 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 2010 Annual Report.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the March 31, 2011 interim consolidated financial statements.

The Company prepares its consolidated financial statements in conformity with IFRS which 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 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 the financial statements of the period in which they become known.

Significant items subject to estimates and assumptions include the estimated useful life of assets, impairment of goodwill and impairment of long-lived assets.

CHANGES IN ACCOUNTING POLICIES

Conversion to IFRS

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.

The interim unaudited consolidated financial statements for the period ended March 31, 2011 are the Company's first financial statements prepared under IFRS. For all accounting periods prior to this, the Company prepared its financial statements under Canadian GAAP Part V. In accordance with IFRS 1, certain disclosures relating to the transition to IFRS are provided below. These disclosures are prepared under IFRS as set out in the basis of presentation in Note 2 to the March 31, 2011 interim consolidated financial statements.

IFRS 1 requires that comparative financial information be provided. The date at which the Company began applying IFRS, January 1, 2010, is recognized as the "Transition Date". IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Company will be December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time adopters.

Initial elections upon adoption

<u>IFRS 1 optional exemptions:</u>

Business combinations – IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3, *Business Combinations*, retrospectively to business combinations that occurred before the Transition Date. The Company has taken advantage of this election.

Employee future benefits – IFRS 1 indicates that a first-time adopter may elect to recognize all cumulative gains or losses deferred under Canadian GAAP in opening retained earnings at the Transition Date. The Company has taken advantage of this election.

Cumulative translation adjustment – IFRS 1 allows a first-time adopter to be exempt from the requirements of IAS 21, *The Effects of Changes in Foreign Exchange Rate*s, for cumulative translation differences that existed at the Transition Date. It permits cumulative translation differences to be reset to zero at the Transition Date. The Company has chosen to apply this election and has eliminated the cumulative translation difference and adjusted retained earnings by the same amount at the Transition Date.

Leases – The exemption provided in IFRS 1 from the full retrospective application of International Financial Reporting Interpretations Committee Interpretation 4 ("IFRIC 4"), *Determining whether and Arrangement Contains a Lease*, has been applied to determine whether an arrangement existing as of January 1, 2010 contains a lease based on the facts and circumstances existing at that date.

Share-based payments – IFRS 1 allows a first-time adopter not to apply IFRS 2, *Share-Based Payments*, to all equity instruments of share-based payments that had vested at the Transition Date and not to apply IFRS 2 for all cash-settled share-based payments that had been settled before the Transition Date. The Company has elected not to take advantage of this exemption and to apply IFRS 2 to all stock options.

Asset retirement obligation – The Company applied the requirements of IFRIC 1, *Changes in Existing Decommissioning, Restoration and Similar Liabilities*, which retrospectively requires specified changes, in decommissioning, restoration or similar liabilities to be added to or deducted from the cost of the asset to which it relates and the adjusted depreciable amount of the asset to then be depreciated prospectively over its remaining useful life. The Company elected not to comply with the requirements of IFRIC 1 for changes that occurred in such liabilities before the Transition Date.

Borrowing costs – IFRS 1 allows an entity to adopt IAS 23, *Borrowing Costs*, prospectively and to capitalize borrowing costs to projects for which the capitalization commencement date is after the Transition Date. The Company has taken advantage of this election.

<u>IFRS 1 mandatory exceptions:</u>

Hedge accounting – Hedge accounting can only be applied prospectively from the Transition Date to transactions that satisfy the hedge accounting criteria in IAS 39, *Financial Instruments: Recognition and Measurement*, at that date. Hedging relationships cannot be designated retrospectively and the supporting documentation cannot be created retrospectively. As a result, only hedging relationships that satisfied the hedge accounting criteria as at the Transition Date are reflected as hedges in the Company's results under IFRS.

Estimates – In accordance with IFRS 1, an entity's estimates under IFRS at the Transition Date must be consistent with estimates made for the same date under previous GAAP, unless there is objective evidence that those estimates were in error. The Company's estimates as at January 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

Impact of transition to IFRS

The differences between IFRS and Canadian GAAP identified as having a significant effect on the Company's previously reported consolidated financial performance and financial position are summarized in Note 4 to the March 31, 2011 interim consolidated financial statements, which provides a summary of the impacts resulting from the transition to IFRS.

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

IFRS 9, *Financial Instruments*, was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple classification and measurement models in IAS 39 for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments, and such instruments are recognized either at fair value through profit and loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return on investment, are recognized through profit and loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated other comprehensive loss indefinitely. This standard is required to be applied for accounting periods beginning on or after January 1, 2013, with earlier adoption permitted. The Company has not yet assessed the impact of the other standard or determined whether it will adopt it early.

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, Consolidated Financial Statements (IFRS 10), IFRS 11, Joint Arrangements (IFRS 11), IFRS 12, Disclosure of Interests in Other Entities (IFRS 12), IAS 27, Separate Financial Statements (IAS 27), IFRS 13, Fair Value Measurement (IFRS 13) and amended IAS 28, Investments in Associates and Joint Ventures (IAS 28). Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards:

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation—Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 11 - Joint Arrangements

IFRS 11 requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting whereas for a joint operation the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, *Interests in Joint Ventures*, and SIC-13, *Jointly Controlled Entities—Non-monetary Contributions by Venturers.*

IFRS 12 – Disclosure of Interests in Other Entities

IFRS 12 establishes disclosure requirements for interests in other entities, such as joint arrangements, associates, special purpose vehicles and off balance sheet vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interests in other entities.

IFRS 13 - Fair Value Measurement

IFRS 13 is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

Amendments to Other Standards

In addition, there have been amendments to existing standards, including IAS 27, *Separate Financial Statements* (IAS 27), and IAS 28, *Investments in Associates and Joint Ventures* (IAS 28). IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

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").

On January 1, 2011, the Company adopted IFRS as its standard for financial reporting. In connection with the adoption of IFRS, the Company updated its ICFR, as necessary, to facilitate the respective IFRS convergence and transition activities performed. As mentioned in the "Conversion to IFRS" section, the impact from these changes was minimal. Other than the adoption of IFRS, no other changes were made to the design of ICFR during the three months ended March 31, 2011 that have had a material effect on the Company's ICFR.

OUTLOOK

As global economic conditions continue to improve, Management expects demand for the Company's core products to further accelerate in 2011. In the railway tie market, increased freight volume on North American railroads should lead to greater investments in the continental rail network, as operators constantly seek optimal line efficiency. Meanwhile, demand is expected to steadily progress in utility poles, as regular maintenance projects provide a stable business flow for distribution poles, while the strength of the transmission pole market is more correlated to the timing of orders, mostly for special projects.

The successful integration of the Tangent operations will continue to be a performance driver in 2011. This transaction solidified Stella-Jones' position as the second largest North American provider of railway ties and the Company is poised to realize the full potential of its expanded network. 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. 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 financial position will allow Stella-Jones to continue its acquisition strategy. 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.

June 1, 2011