Management's Discussion & Analysis

The following Management's Discussion and Analysis ("MD&A") and the Company's audited consolidated financial statements were approved by the Audit Committee and the Board of Directors on March 15, 2012. The MD&A provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2011 compared with the fiscal year ended December 31, 2010. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2011 and 2010 and the notes thereto.

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

The Company's audited consolidated financial statements are prepared in accordance with 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 Company's financial statements were previously prepared in accordance with Canadian generally accepted accounting principles ("CA GAAP").

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 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 nineteen 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-eight facilities are located in six Canadian provinces and fifteen American states. The Company's workforce currently numbers approximately 970 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.

Reconciliation of EBITDA and operating income to net income	**Three-month periods ended**		**Fiscal years ended**	
(thousands of dollars)	**Dec. 31, 2011**	Dec. 31, 2010	**Dec. 31, 2011**	Dec. 31, 2010
Net income for the period	**13,367**	10,650	**55,709**	34,441
Plus:				
Provision for income taxes	**5,120**	5,730	**24,220**	15,684
Financial expenses	**1,912**	2,814	**8,039**	10,565
Operating income	**20,399**	19,194	**87,968**	60,690
Depreciation and amortization	**2,325**	2,735	**8,715**	10,355
EBITDA	**22,724**	21,929	**96,683**	71,045

MAJOR ACHIEVEMENTS OF 2011

The year ended December 31, 2011 marked the Company's eleventh consecutive year of uninterrupted growth in net income. Stella-Jones also continued to execute its operating strategy based on continental expansion.

On December 7, 2011, Stella-Jones completed the acquisition of Thompson Industries, Inc. ("Thompson"), a provider of treated wood products to the railroad industry. Founded in 1981, Thompson produced treated wood products, mainly railway ties and timbers, at a facility located in Russellville, Arkansas. Thompson's sales for its fiscal year ended September 30, 2011 were approximately US$49.0 million. The purchase price totalled approximately $35.2 million (US$34.9 million). Stella-Jones financed the acquisition through existing credit facilities and an unsecured vendor note of $6.6 million (US$6.5 million).

Sales for the year ended December 31, 2011 reached $640.1 million, up $79.1 million, or 14.1%, from last year's sales, primarily as a result of robust demand for the Company's core railway tie and utility pole product categories. Organically, sales increased approximately 11.0%, while 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 $21.3 million when compared with the previous year. In addition, the operating facilities acquired from Tangent Rail Corporation ("Tangent") on April 1, 2010 added sales of approximately $37.7 million in the first quarter of 2011, while Thompson contributed sales of $1.7 million in the last three weeks of the fourth quarter of 2011.

Reflecting higher business activity and greater efficiencies throughout its plant network, Stella-Jones' annual operating income reached $88.0 million, or 13.7% of sales, in 2011. This represents a 44.9% increase over $60.7 million, or 10.8% of sales, in the prior year. As a result, net income for the year grew 61.8% to $55.7 million, or $3.48 per share, fully diluted, compared with $34.4 million, or $2.26 per share, fully diluted, a year ago.

Stella-Jones' solid performance produced strong cash flows in 2011. Cash flow from operating activities, before changes in non-cash working capital components and interest and income tax paid, amounted to $99.6 million, up 27.6% from $78.1 million in 2010. This performance allowed the Company to maintain a sound financial position. Although the Thompson acquisition was mostly financed through existing credit facilities and completed shortly before year end, Stella-Jones' total debt to total capitalization ratio improved to 0.35:1 as at December 31, 2011, while the ratio of total debt to trailing 12-month EBITDA also improved to 1.89:1 when compared to December 31, 2010.

KEY PERFORMANCE INDICATORS

For the years ended December 31	2011 (IFRS)	2010 (IFRS)	2009 (CA GAAP)
Operating margin	**13.7%**	10.8%	12.2%
Return on average equity	**18.2%**	15.0%	17.6%
Working capital ratio	**5.77**	3.38	3.01
Total debt** to total capitalization	**0.35:1**	0.36:1	0.44:1
Total debt** to trailing 12-month EBITDA	**1.89**	2.22	2.43
Dividend per share	**0.50**	0.38	0.36

SELECTED ANNUAL FINANCIAL INFORMATION (years ended December 31)

Income (thousands of dollars, except per share data)	**2011 (IFRS)** $	2010 (IFRS) $	2009 (CA GAAP) $
Sales	**640,148**	561,046	411,119
Operating income	**87,968**	60,690	50,268
Net income	**55,709**	34,441	30,069
Basic earnings per common share	**3.49**	2.27	2.38
Diluted earnings per common share	**3.48**	2.26	2.37

Financial Position (thousands of dollars)	**2011 (IFRS)** $	2010 (IFRS) $	2009 (CA GAAP) $
Current assets	**330,519**	269,042	254,578
Total assets	**617,056**	520,958	370,795
Long-term debt*	**180,094**	125,828	87,080
Total debt**	**182,679**	157,751	143,199
Shareholders' equity	**331,912**	280,102	179,978

** Including current portion*

*** Including short-term bank indebtedness*

FOREIGN EXCHANGE

The table below shows exchange rates applicable to the years ended December 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.

	2011		2010	
Cdn$/US$	**Average**	**Closing**	Average	Closing
First Quarter	**0.9892**	**0.9696**	1.0576	1.0158
Second Quarter	**0.9615**	**0.9645**	1.0250	1.0646
Third Quarter	**0.9665**	**1.0482**	1.0531	1.0290
Fourth Quarter	**1.0217**	**1.0170**	1.0253	0.9946
Fiscal Year	**0.9847**	**1.0170**	1.0403	0.9946

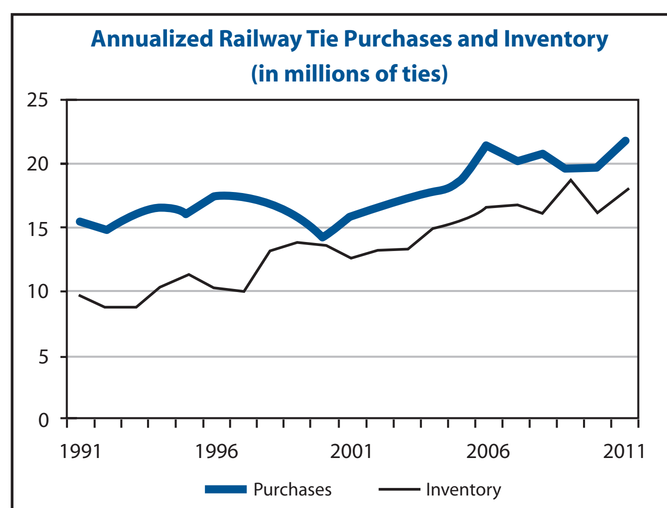
INDUSTRY OVERVIEW

Railway ties

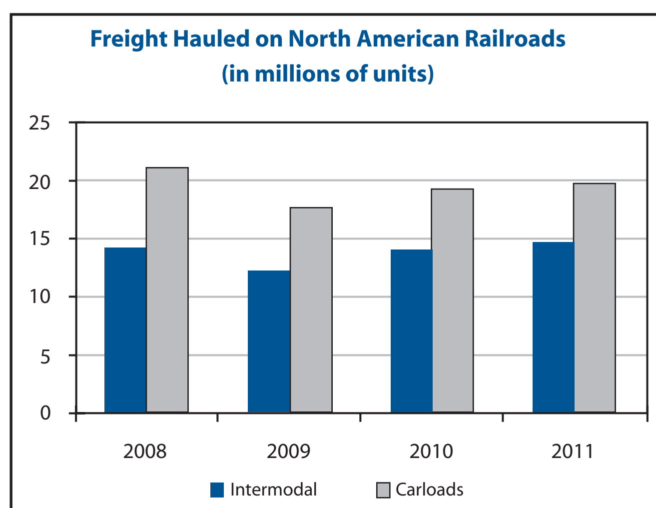
As reported by the Railway Tie Association, railway tie purchases for 2011 rose approximately 10% to reach 21.7 million ties, the highest annual total of the last 20 years. This high demand further reduced the inventory-to-sales ratio to 0.79:1 as at December 31, 2011, from a revised 0.82:1 twelve months earlier.

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

Reflecting further improvement in the North American economy, the number of carloads hauled on North American railroads increased by 2.5% in 2011, while the volume of intermodal trailers and containers was up 5.3% from 2010 levels, according to data released by the Association of American Railroads.



Source: Railway Tie Association



Source: Association of American Railroads

OPERATING RESULTS

SALES

Sales for the year ended December 31, 2011 totalled $640.1 million, an increase of $79.1 million, or 14.1%, over last year's sales of $561.0 million. The operating facilities acquired from Tangent on April 1, 2010, contributed additional sales of approximately $37.7 million in the first quarter of 2011, while the facility acquired from Thompson on December 7, 2011, contributed sales of $1.7 million. 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 $21.3 million when compared with last year. Excluding these factors, sales increased approximately 11.0%, as demand remained robust for the Company's core railway tie and utility pole product categories. Increased demand reflects requirements for regular maintenance as well as special projects.

SALES BY PRODUCT CATEGORY

Railway ties

Railway tie sales for 2011 amounted to $338.8 million, up $55.6 million over sales of $283.2 million in 2010. This 19.6% increase reflects solid market demand, as well as additional tie sales of approximately $29.5 million from the Tangent operations in the first quarter of 2011 and $1.5 million from the Thompson facility in the fourth quarter of 2011. Adjusting for a negative foreign exchange effect of $14.9 million due to a lower average conversion rate on U.S. dollar denominated tie sales, year-over-year comparable railway tie sales increased approximately 14.0%. Railway tie sales accounted for 52.9% of the Company's total sales in 2011.

Utility poles

Utility pole sales amounted to $194.8 million in 2011, up 16.9% over sales of $166.7 million in 2010. The increase is mostly attributable to robust demand for transmission poles related to orders for special projects. Meanwhile, distribution pole sales remained relatively steady due mainly to regular maintenance demand. A lower year-over-year average conversion rate reduced the value of U.S. dollar denominated pole sales by $3.6 million in 2011. Utility pole sales accounted for 30.5% of the Company's total sales in 2011.

Industrial products

Industrial product sales decreased 3.1% in 2011, reaching $78.9 million, compared with $81.4 million in 2010. Excluding additional contributions in 2011 of $8.2 million and $0.2 million from the Tangent and Thompson operations, respectively, and net of a negative conversion effect of $2.8 million on U.S. dollar denominated sales, industrial product sales declined approximately $8.1 million. This decline is mainly attributable to the withdrawal from certain non-core market areas following the sale of certain assets of the Terre Haute, Indiana facility in the fourth quarter of 2010. Demand remained solid for the balance of the Company's principal products and services in this category for both Canada and the United States. Industrial products represented 12.3% of sales in 2011.

Residential lumber

Sales in the residential lumber category totalled $27.7 million in 2011, down 7.1% from $29.8 million in 2010. The decrease essentially reflects lower demand in Canada due to less favourable weather compared with the prior year in the first half of 2011. The Company does not sell residential lumber in the U.S. market. Residential lumber accounted for 4.3% of Stella-Jones' sales in 2011.

SALES BY DESTINATION

Sales in the United States amounted to $412.2 million, or 64.4% of sales, in 2011, representing an increase of $66.5 million, or 19.2%, over 2010. The increase mainly reflects higher sales of railway ties and utility poles, as well as the additional contribution of $37.7 million and $1.7 million from the Tangent and Thompson operations, respectively, partially offset by a lower conversion rate on U.S. dollar denominated sales. Sales of products exported to the United Stated from the Canadian based facilities totalled $13.0 million in 2011, compared with $10.7 million in 2010, as the Company continues to optimize its asset base through plant specialization.

Sales in Canada in 2011 increased $12.6 million, or 5.9%, to $228.0 million, representing 35.6% of Stella-Jones' total sales. The increase in year-over-year sales is mainly attributable to higher sales of railway ties and utility poles.

COST OF SALES

Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $515.3 million, or 80.5% of sales, in 2011. This compares with $467.8 million, or 83.4% of sales, in 2010. The increase in absolute dollars essentially reflects higher business activity, partially offset by a lower average rate applied to convert U.S. dollar denominated costs. The decrease as a percentage of sales mainly stems from a different product mix, more heavily weighted towards utility poles than a year ago, as well as from greater efficiencies throughout the Company's plant network.

Depreciation and amortization charges totalled $8.7 million for the year ended December 31, 2011, down from $10.4 million in the year ended December 31, 2010. In 2011, depreciation and amortization of cutting rights, standing timber and roads were included in inventory or cost of sales as part of wood costs, resulting in this reduction.

As a result, gross profit reached $124.9 million or 19.5% of sales in 2011, up from $93.3 million or 16.6% of sales in 2010.

SELLING AND ADMINISTRATIVE

Selling and administrative expenses for 2011 were $35.8 million, compared with expenses of $32.5 million in 2010. This $3.3 million increase is mainly attributable to the Company's profit sharing program and to expenses from the Tangent operations for the full year, as opposed to nine months in 2010. As a percentage of sales, selling and administrative expenses were 5.6% of sales in 2011, compared to 5.8% in the prior year.

Of note, this year's selling and administrative expenses included an asset impairment charge of $2.2 million related to the non-cash reversal of a customer relationship intangible asset, as well as acquisition costs of $423,000 directly related to the purchase of Thompson. Meanwhile, last year's selling and administrative expenses included expenses of approximately $5.3 million in connection with severance expenses, a provision for an unfavourable legal judgement, as well as acquisition costs directly related to the purchase of Tangent. The Company also recorded asset impairment charges of $3.0 million for the Spencer, West Virginia facility and the former U.S. corporate office in Ripley, West Virginia. Conversely, net revenues of $2.6 million related to the sale of certain assets of the Terre Haute, Indiana facility were recorded in the fourth quarter of 2010.

OTHER LOSSES, NET

Stella-Jones' other net losses of $1.1 million for the year ended December 31, 2011 included a foreign exchange loss of $554,000 and a loss on disposal of property, plant and equipment of $505,000. In 2010, other net losses of $25,000 included a foreign exchange loss of $44,000 partially offset by a non-cash gain on derivative financial instruments of $19,000.

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 and to U.S. dollar denominated long-term debt held by its Canadian companies. Stella-Jones U.S. Holding Corporation ("SJ Holding"), the Company's wholly-owned U.S. subsidiary, is a foreign operation that has a different functional currency from that of the Company and 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 foreign exchange forward contracts for the sale of U.S. dollars and purchasing certain goods and services in U.S. dollars. The Company will also consider foreign exchange forward 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 2011 amounted to $8.0 million, down from $10.6 million in 2010. This decrease in financial expenses is due to lower interest rates resulting from the July 28, 2011 amendment and restatement of existing credit agreements (see "Statement of Financial Position" below), the early repayment of certain higher interest bearing long-term obligations on April 1, 2011 (US$15.0 million) and in the fourth quarter of 2010 ($11.5 million and US$4.1 million), and to 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 $79.9 million, or 12.5% of sales, in 2011. This represents an increase of $29.8 million, or 59.5%, over income before income taxes of $50.1 million, or 8.9% of sales, in 2010.

Excluding the aforementioned items (see "Selling and Administrative" above), income before income taxes was $82.6 million, or 12.9% of sales, in 2011 and approximately $55.8 million, or 9.9% of sales, in 2010.

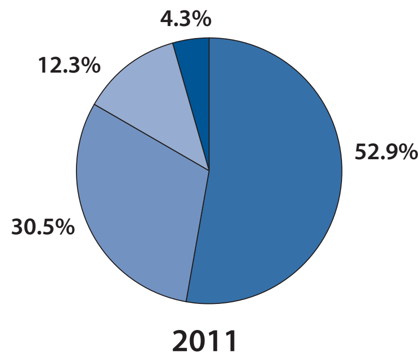
Stella-Jones' provision for income taxes totalled $24.2 million in 2011, representing an effective tax rate of 30.3%. In 2010, the income tax expense stood at $15.7 million, equivalent to an effective tax rate of 31.3%. The lower effective tax rate for 2011 is attributable to a decrease in the statutory tax rates.

NET INCOME

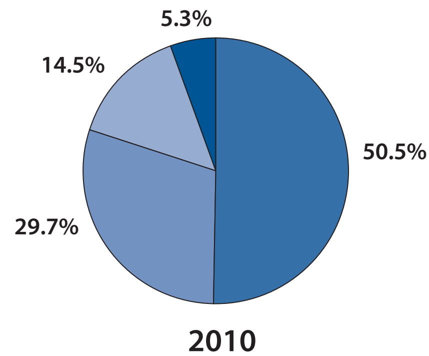
Net income for the year ended December 31, 2011 reached $55.7 million, or $3.48 per share, fully diluted, compared with $34.4 million, or $2.26 per share, fully diluted, in 2010. This represents a year-over-year increase in net income of $21.3 million, or 61.8%.

SALES BY PRODUCT (% of revenues)

- Railway ties: 52.9% (2010 – 50.5%)
- Utility poles: 30.5% (2010 – 29.7%)
- Industrial products: 12.3% (2010 – 14.5%)
- Residential lumber: 4.3% (2010 – 5.3%)



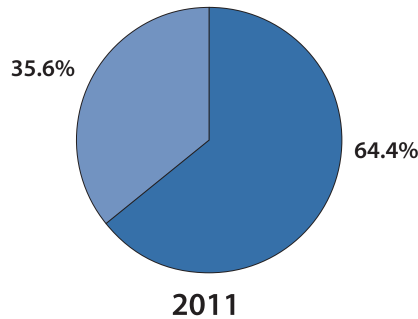
2011



2010

SALES BY GEOGRAPHIC REGION (% of revenues)

- United States: 64.4% (2010 – 61.6%)
- Canada: 35.6% (2010 – 38.4%)



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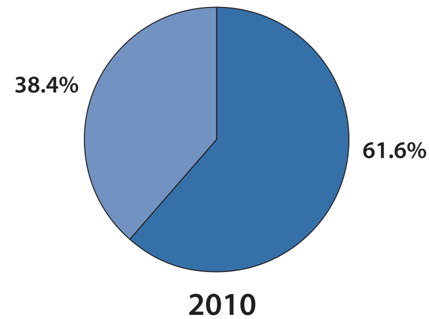

2010

BUSINESS ACQUISITION

On December 7, 2011, the Company completed the acquisition of 100% of the shares of Thompson, a provider of treated wood products to the railroad industry. Thompson produced treated wood products, mainly railway ties and timbers, at a facility located in Russellville, Arkansas. Total cash outlay associated with the acquisition was approximately $29.0 million (US$28.7 million), excluding acquisition costs of approximately $0.4 million (US$0.4 million).

The following fair value determination of the net assets acquired and liabilities assumed is preliminary and is based on Management's best estimates and information known at the time of preparing the consolidated financial statements. This fair value is expected to be completed within 12 months of the acquisition date and consequently, changes could occur mainly with respect to intangible assets, goodwill and deferred income taxes. Immediately following the acquisition, Thompson was merged with Stella-Jones Corporation ("SJ Corp") and the surviving corporation was SJ Corp. The results of operations of the acquiree have been included in the Company's consolidated financial statements from the acquisition date.

The following is a summary of the net assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date. The original transaction was made in U.S. dollars and converted into Canadian dollars as at the acquisition date.

Assets acquired	**$**
Non-cash working capital	11,018
Property, plant and equipment	9,452
Cash surrender value of life insurance	150
Customer relationships	12,225
Customer backlog	273
Non-deductible goodwill	15,975
	49,093
Liabilities assumed	
Accounts payable and accrued liabilities	2,835
Long-term debt	3,460
Deferred income tax liabilities	7,587
Total net assets acquired and liabilities assumed	35,211
Consideration transferred	
Cash	29,015
Unsecured note payable to vendor	5,322
Consideration payable	874
Consideration transferred for shares	35,211

The Company's valuation of intangible assets has identified customer relationships and customer backlog. The assigned useful lives for customer relationships are 25 years and 10 months for customer backlog. Goodwill is not amortized nor deductible for tax purposes, and represents the future economic value associated with the increased railroad network access, acquired workforce and synergies with the Company's operations. Note 9 to the Company's consolidated financial statements for the years ended December 31, 2011 and 2010 provides a roll-forward of the net book value balances of intangible assets and goodwill.

The Company financed the acquisition through existing credit facilities and an unsecured vendor note of $6.6 million (US$6.5 million), bearing interest at 2.67% and repayable in equal instalments over a 10-year period. The vendor note was fair-valued at $5.3 million (US$5.3 million) using an interest rate of 7.0%.

In the period from December 7 to December 31, 2011, the acquiree's sales and loss before income taxes amounted to $1.7 million and $102,000, respectively. On a pro forma basis, Management's estimate of sales and income before income taxes of the combined operations of the Company and Thompson for the 12-month period ended December 31, 2011 would have been approximately $687.5 million and $84.3 million respectively, had the Thompson acquisition occurred as of January 1, 2011. To arrive at the pro forma estimates, Management considered the financing structure resulting from the acquisition as well as other adjustments related to the acquisition.

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.

In 2011, the Company achieved strong year-over-year revenue and net income growth in all quarters. While the Tangent operations provided an additional contribution in the first quarter of 2011, robust demand for the Company's core products yielded solid organic revenue growth in the last three quarters. This greater business activity, combined with increased efficiencies throughout the Company's plant network and a more favourable product mix, more heavily weighted towards utility poles in the peak summer season, further enhanced operating income.

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

2011

For the quarters ended (thousands of dollars, except per share data)	**March 31** **$**	**June 30** **$**	**Sept. 30** **$**	**Dec. 31** **$**	**Total** **$**
Sales	**130,485**	**180,331**	**181,812**	**147,520**	**640,148**
Operating income before depreciation of property, plant and equipment and amortization of intangible assets [1]	**16,970**	**29,966**	**27,023**	**22,724**	**96,683**
Operating income [1]	**14,418**	**27,582**	**25,569**	**20,399**	**87,968**
Net income for the period	**8,500**	**17,271**	**16,569**	**13,369**	**55,709**
Earnings per common share					
Basic	**0.53**	**1.08**	**1.04**	**0.84**	**3.49**
Diluted	**0.53**	**1.08**	**1.03**	**0.83**	**3.48**

2010

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
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	0.46	0.35	0.78	0.67	2.27
Diluted	0.45	0.35	0.78	0.67	2.26

[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 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.

FOURTH QUARTER RESULTS

Sales for the fourth quarter of 2011 totalled $147.5 million, up from $133.1 million reported for the same period in 2010. This $14.4 million, or 10.9% increase, is attributable to solid industry demand for the Company's core products, including strong advanced deliveries of railway ties, as well as a $1.7 million contribution from the Thompson operations, acquired on December 7, 2011. The conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, had a marginal negative impact of $0.4 million on the value of U.S. dollar denominated sales when compared with last year. Excluding these factors, sales increased approximately 10.0%.

Fourth quarter sales of railway ties amounted to $74.4 million in 2011, up from $62.4 million in the fourth quarter of 2010. This $12.0 million, or 19.2% increase, reflects strong industry demand, including advanced deliveries, and a $1.5 million contribution from the Thompson operations. Utility pole sales rose 3.8% to $50.6 million, compared with $48.7 million a year earlier, as a result of higher sales of transmission poles related to special projects. Industrial product sales stood at $20.6 million, up from $19.8 million a year ago, in part due to the contribution of the Thompson operations. Residential lumber sales were $2.0 million, versus $2.2 million last year.

Operating income amounted to $20.4 million, or 13.8% of sales, in the fourth quarter of 2011, compared with $19.2 million, or 14.4% of sales, in the fourth quarter of 2010. Of note, results for the fourth quarter of 2011 included an asset impairment charge of $2.2 million related to the non-cash reversal of a customer relationship intangible asset, whereas results for the fourth quarter of 2010 included several items representing net revenues of $1.8 million, principally due to the sale of certain assets of the Terre Haute, Indiana facility. Excluding these elements, operating income for the fourth quarter of 2011 was $22.6 million, compared with $17.4 million a year earlier.

Net income for the period reached $13.4 million, or $0.83 per share, fully diluted, compared with $10.7 million, or $0.67 per share, fully diluted, in 2010. This represents a year-over-year increase in net income of $2.7 million, or 25.5%.

STATEMENT OF FINANCIAL POSITION

The Company's working capital at December 31, 2011 was $273.2 million, an increase of $83.7 million over a working capital balance of $189.5 million at December 31, 2010. This variation is mostly attributable to increases of $38.3 million and $20.2 million in inventories and accounts receivable, respectively, and to a $29.3 million reduction in bank indebtedness, as explained below.

Current assets amounted to $330.5 million as at December 31, 2011 compared with $269.0 million at December 31, 2010. Most of this increase is attributable to higher inventories and accounts receivable.

The value of accounts receivable was $76.5 million as at December 31, 2011 compared with $56.3 million as at December 31, 2010. This variation of $20.2 million reflects increased business activity and, to a lesser extent, the acquisition of the Thompson operations shortly before year end and the effect of local currency appreciation on U.S. based accounts receivable.

Inventories stood at $243.6 million as at December 31, 2011, up from $205.3 million as at December 31, 2010. This increase reflects the inventory build-up ahead of anticipated sales growth and to a lesser extent, the acquisition of the Thompson operations shortly before year end and the effect of local currency appreciation on U.S. based inventories.

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 credit facilities are adequate to meet its working capital requirements for the foreseeable future.

Property, plant and equipment stood at $119.4 million as at December 31, 2011, compared with $104.8 million as at December 31, 2010. This increase is essentially related to the acquisition of the Thompson operations and to the purchase of property, plant and equipment for the year ($7.8 million) exceeding depreciation ($4.5 million).

The value of intangible assets reached $71.1 million as at December 31, 2011. Intangible assets include customer relationships, the discounted value of the non-compete agreements, a creosote registration, cutting rights and standing timber. As at December 31, 2010, intangible assets were $64.2 million. The increase mainly stems from the Thompson acquisition ($12.5 million) and from the effect of local currency appreciation on U.S. based intangible assets, partially offset by an amortization charge of $4.2 million for 2011 and an asset impairment charge of $2.2 million related to the non-cash reversal of a customer relationship intangible asset.

As at December 31, 2011, the value of goodwill stood at $91.7 million, up from $74.0 million a year earlier. The $17.7 million increase in goodwill reflects the Thompson acquisition ($16.0 million) and, to a lesser extent, the effect of local currency appreciation on U.S. based goodwill.

On July 28, 2011, the Company and SJ Holding, as borrowers, entered into an agreement to amend and restate in its entirety their existing revolving credit agreement. The existing demand revolving facility ($50.0 million and US$75.0 million) made available by a syndicate of bank lenders under the March 24, 2010 amendment was replaced by a committed revolving facility in the amount of $170.0 million, to be used to repay and refinance existing indebtedness and for working capital and general corporate purposes. The $170.0 million committed revolving facility is being made available for a five-year term by a syndicate of lenders. Borrowings may be obtained in the form of prime rate loans, bankers' acceptances, U.S. base rate loans, LIBOR loans in U.S. dollars and letters of credit.

The interest rate margin with respect to Canadian prime rate loans and U.S. base rate loans will range from 0.25% to 1.50% based on a pricing grid (previously 0.75%). The interest rate margin with respect to bankers' acceptances, LIBOR loans and fees for letters of credit will range from 1.25% to 2.50% based on a pricing grid (previously 2.0%). As collateral for the committed revolving facility, the bank lenders hold a first ranking charge over the majority of the assets, tangible and intangible, present and future of Stella-Jones, SJ Holding and their material subsidiaries.

As a result of this agreement, all bank indebtedness is now considered long-term debt with the exception of the Company's proportion of the operating line of its joint venture. Consequently, bank indebtedness stood at $2.6 million as at December 31, 2011, down from $31.9 million as at December 31, 2010.

The Company's long-term debt, including the current portion, rose to $180.1 million as at December 31, 2011, from $125.8 million as at December 31, 2010. The increase essentially reflects the new credit agreement. On April 1, 2011, Stella-Jones proceeded with the advanced repayment of US$15.0 million in the capital amount of a non-convertible debenture. As at December 31, 2011, an amount of $125.0 million had been drawn against the Company's committed revolving facility of $170.0 million.

Shareholders' equity was $331.9 million as at December 31, 2011 compared with $280.1 million as at December 31, 2010. This increase of $51.8 million is mainly attributable to net income of $55.7 million and a $5.2 million decrease in accumulated other comprehensive loss, partially offset by dividends on common shares totalling $8.0 million. Book value stood at $20.80 per common share as at December 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	**Fiscal years ended**	
	December 31, 2011	December 31, 2010
(thousands of dollars)	**$**	$
Operating activities	**32,794**	81,608
Financing activities	**4,862**	7,775
Investing activities	**(37,656)**	(89,383)
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, long-term debt, and the issuance of common shares. The Company's committed revolving facility is made available for a five-year term and is thus considered long-term debt.

Cash flow from operating activities before changes in non-cash working capital components and interest and income tax paid was $99.6 million for the year ended December 31, 2011, compared with $78.1 million for 2010. This increase mostly reflects a higher net income for the year.

Changes in non-cash working capital components reduced liquidity by $36.4 million in 2011, as increases of $12.0 million and $30.2 million, respectively, in accounts receivable and inventories were partially offset by a $6.2 million increase in accounts payable and accrued liabilities. These variations essentially reflect higher business activity. In 2010, changes in non-cash working capital components had provided liquidity of $27.2 million, mainly due to a $31.3 million reduction in inventories.

Interest and income tax paid further reduced liquidity by $8.6 million and $21.8 million, respectively, in 2011, versus $10.0 million and $13.7 million, respectively, a year earlier. The reduction in interest paid mainly stems from lower interest rates resulting from the July 28, 2011 amendment and restatement of existing credit agreements and to the early repayment of certain higher interest bearing long-term obligations on April 1, 2011 and in the fourth quarter of 2010, as mentioned above. Meanwhile, the increase in income tax paid reflects the higher income for the year.

As a result, cash flows provided by operating activities were $32.8 million in 2011, versus $81.6 million in 2010.

Financing activities for the year ended December 31, 2011 provided liquidity of $4.9 million. The main factors explaining this cash generation were the increase of long-term debt totalling $98.3 million, partially offset by a $80.1 million repayment in long-term debt. These factors are mainly related to the July 28, 2011 amendment and restatement of the Company's credit agreement as mentioned above. The Company also paid dividends on common shares of $8.0 million. For the year ended December 31, 2010, financing activities provided liquidity of $7.8 million.

Investing activities required $37.7 million in cash during 2011, as the acquisition of Thompson resulted in a cash outlay of $29.0 million, while purchases of property, plant and equipment, mainly for the addition of various equipment upgrades and expansion, required an investment of $7.8 million. For 2010, cash flows from investing activities decreased liquidity by $89.4 million as a result of the Tangent acquisition.

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

(in thousands of dollars)	Carrying Amount ($)	Contractual Cash flow ($)	Less than 1 year ($)	1 – 3 years ($)	4 – 5 years ($)	More than 5 years ($)
Bank indebtedness[1]	2,585	2,657	2,657	—	—	—
Accounts payable and accrued liabilities	43,693	43,693	43,693	—	—	—
Long-term debt obligations[1]	180,094	207,154	7,715	21,288	170,325	7,826
Net settled interest swaps	—	3,996	1,134	1,815	1,047	—
Other contractual obligations	—	27,984	6,901	8,846	3,453	8,784
Non-compete agreements	2,582	2,848	1,265	1,583	—	—
Total	228,954	288,332	63,365	33,532	174,825	16,610

[1] Amounts include capital and interest

SHARE AND STOCK OPTION INFORMATION

As at December 31, 2011, the capital stock issued and outstanding consisted of 15,955,303 common shares (15,922,668 as at December 31, 2010). The following table presents the outstanding capital stock activity for the year ended December 31, 2011:

Year Ended December 31, 2011	Number of shares (in '000s)
Balance – Beginning of year	**15,923**
Stock option plan	**22**
Employee share purchase plans	**10**
Balance – End of year	**15,955**

As at March 15, 2012, the capital stock issued and outstanding consisted of 15,961,330 common shares.

As at December 31, 2011, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 158,800 (December 31, 2010 – 181,000) of which 119,500 (December 31, 2010 – 128,300) were exercisable. As at March 15, 2012, the number of outstanding options was 155,200, of which 115,900 were exercisable.

DIVIDENDS

On March 15, 2012, the Board of Directors modified its dividend policy to consider the declaration of a dividend on a quarterly rather than on a semi-annual basis. Immediately thereafter, the Board approved a quarterly dividend of $0.15 per common share payable on April 30, 2012 to shareholders of record at the close of business on April 2, 2012. On August 10, 2011, the Board of Directors declared a semi-annual dividend of $0.26 per common share payable on October 7, 2011 to shareholders of record at the close of business on September 2, 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 covenants in its loan documentation as well as its financial performance and cash requirements. There can be no assurance as to the amount or timing of such dividends in the future.

COMMITMENTS AND CONTINGENCIES

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

The Company has issued guarantees amounting to $27.9 million (2010 – $30.7 million) under letters of credit and various bid and performance bonds. The Company's management does not believe these guarantees are likely to be called on and, as such, no provisions have been recorded in the financial statements.

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

CURRENT ECONOMIC CONDITIONS

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 remain solid in 2012. Increased freight volume on North American railroads should lead to continued investments in the continental rail network, including ties, as operators constantly seek optimal line efficiency. Demand is expected to hold for 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 December 31, 2011, the Company is in full compliance with its debt covenants and contractual obligations. In addition, as at December 31, 2011, an amount of $125.0 million had been drawn against the Company's committed revolving facility of $170.0 million.

Accounts receivable increased in 2011, mostly due to strong demand for the Company's core products. Management considers that all recorded 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 also increased in 2011 mainly due to higher projected sales volumes. To ensure efficient treating 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

ECONOMIC CONDITIONS

The continuing difficulties in global credit markets, softening economies and an apprehension among customers may negatively impact the markets the Company serves in all of its operating categories. Additionally, the current negative economic conditions may affect most or all of the markets it serves at the same time, reducing demand for its products and adversely affecting its operating results. These economic conditions may also impact the financial condition of one or more of the Company's key suppliers, which could affect its ability to secure raw materials and components to meet its customers' demand for its products.

DEPENDENCE ON MAJOR CUSTOMERS

The Company is dependent on major customers for a significant portion of its sales, and the loss of one or more of its major customers could result in a significant reduction in its profitability as a whole or the profitability at a particular payment. For the year ended December 31, 2011, the Company's top ten customers accounted for approximately 47% of its sales. During this same period, the Company's two largest customers accounted for approximately 14% and 6%, respectively, of its total sales.

AVAILABILITY AND COST OF RAW MATERIALS

Management considers that the Company may be affected by the industry-wide concerns of long-term availability of competitively priced wood and potential fluctuations in wood prices. While the Company has entered into long-term cutting licenses and benefits from long-standing relationships with private woodland owners and other suppliers, there can be no assurance that such licenses will be respected or renewed on expiry, or that its suppliers will continue to provide adequate timber to the Company.

In addition, there are a limited number of suppliers for certain of the preservatives that the Company employs in its production process, which lessens the availability of alternate sources of supply in the event of unforeseen shortages or disruptions of production. While the Company is mitigating this risk by researching and identifying alternate suppliers outside of its traditional sources of supply, there can be no assurance that it will be able to secure the supply of all materials required to manufacture its products.

ENVIRONMENTAL RISK

The Company is subject to a variety of environmental laws and regulations, including those relating to emission to the air, discharges into water, releases of hazardous and toxic substances, and remediation of contaminated sites. These environmental laws and regulations require the Company to obtain various environmental registrations, licenses, permits and other approvals, as well as carry out inspections, compliance testing and meet timely reporting requirements in order to operate its manufacturing and operating facilities.

The enforcement of these environmental laws and regulations by regulatory agencies will continue to affect the Company's operations by imposing operating and maintenance costs and capital expenditures required for compliance. Failure to comply could result in civil or criminal enforcement actions, which could result, among others, in the payment of substantial fines, often calculated on a daily basis, or in extreme cases, the disruption or suspension of operations at the affected facility.

Under various federal, provincial, state and local laws and regulations, the Company could, as the owner, lessor or operator, be liable for the costs of removal or remediation of contamination at its sites. The remediation costs and other costs required to clean up or treat contaminated sites could be substantial. However, in certain cases, the Company benefits from indemnities from the former owners of its sites. Contamination on and from the Company's sites may subject it to liability to third parties or governmental authorities for injuries to persons, property or the environment and could adversely affect the Company's ability to sell or rent its properties or to borrow money using such properties as collateral.

The possibility of major changes in environmental laws and regulations is another risk faced by the Company. While it is not possible to predict the outcome and nature of these changes, they could substantially increase the Company's capital expenditures and compliance costs at the facilities affected.

While the Company has been party to environmental litigation in the past, which have included, among others, claims for adverse physical effects and diminution of property value, the outcomes and associated costs have not been material. There is, however, no guarantee that this will continue to be the case in the future, as the result of disputes regarding environmental matters and conclusions of environmental litigation cannot be predicted.

The Company's business has grown and its image strengthened, in large part by its consistent production and delivery of high quality products, while maintaining as well, a high level of environmental responsibility. Claims of environmentally irresponsible practices by regulatory authorities or local communities could harm the reputation of the Company. Adverse publicity resulting from actual or perceived violations of environmental laws and regulations could negatively impact customer loyalty, reduce demand, lead to a weakening of confidence in the marketplace and ultimately, a reduction in the Company's share price. These effects could result even if the allegations are not valid and the Company is not found liable.

RISKS RELATED TO ACQUISITIONS

As part of its growth strategy, the Company intends to acquire additional complementary businesses where such transactions are economically and strategically justified. There can be no assurance that the Company will succeed in effectively managing the integration of other businesses which it might acquire. If the expected synergies do not materialize, or if the Company fails to successfully integrate such new businesses into its existing operations, this could have a material adverse effect on the Company's business, operating results, profitability and financial position. The Company may also incur costs and direct Management's attention to potential acquisitions which may never be consummated.

In addition, although the Company performs due diligence investigations in connection with its acquisitions, an acquired business could have liabilities that the Company fails or is unable to uncover prior to acquisition and for which the Company may be responsible. Such liabilities could have a material adverse effect on the Company's business operating results, profitability and financial position.

LITIGATION RISK

The Company is subject to the risk of litigation in the ordinary course of business by employees, customers, suppliers, competitors, shareholders, government agencies, or others through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The outcome of litigation is difficult to assess or quantify. Claimants in these types of lawsuits or claims may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to these lawsuits or claims may remain unknown for substantial periods of time. Regardless of outcome, litigation could result in substantial costs to the Company. In addition, litigation could divert Management's attention and resources away from the day-to-day operations of the Company's business.

INSURANCE COVERAGE

The Company maintains property, casualty, general liability and workers' compensation insurance, but such insurance may not cover all risks associated with the hazards of its business and is subject to limitations, including deductibles and maximum liabilities covered. The Company may incur losses beyond the limits, or outside the coverage of its insurance policies, including liabilities for environmental compliance and remediation. In addition, from time to time, various types of insurance for companies in the Company's industry have not been available on commercially acceptable terms, or, in some cases, have not been available at all. In the future, the Company may not be able to obtain coverage at current levels, and its premiums may increase significantly on coverage that it maintains.

CURRENCY RISK

The Company is exposed to currency risks due to its export of goods manufactured in Canada.

The Company strives to mitigate such risks by purchases of goods and services denominated in U.S. dollars. The Company may also use foreign exchange forward contracts to hedge contracted net cash inflows and outflows of U.S. dollars. The use of such currency hedges involves special risks including the possible default by the other party to the transaction, illiquidity and to the extent that the assessment of certain market movements is incorrect, the risk that the use of hedges result in losses greater than if hedging had not been used.

INTEREST RATE FLUCTUATIONS

As at December 31, 2011, approximately 15% of the Company's long-term debt was at variable rates, thereby exposing the Company to interest rate risk. The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its long-term debt. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as cash flow hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps. However, if interest rates increase, the debt service obligations on the variable rate indebtedness of the Company would increase even though the amount borrowed remained the same, and this could have a material adverse effect on the Company's business operating results, profitability and financial position.

CUSTOMERS' CREDIT RISK

The Company carries a substantial level of trade accounts receivable on its statement of financial position. This value is spread amongst numerous contracts and clients. Trade accounts receivable include an element of credit risk should the counterparty be unable to meet its obligations. Although the Company reduces this risk by dealing primarily with Class 1 railways, as well as utility and telecommunication companies, and other major corporations, there can be no assurance that outstanding accounts receivable will be paid on a timely basis or at all.

INFLUENCE BY STELLA JONES INTERNATIONAL S.A.

As at December 31, 2011, Stella Jones International S.A. ("SJ International") owned or controlled 8,187,909 common shares of the Company, which represented approximately 51.3% of the outstanding common shares. On February 6, 2012, a secondary offering was completed pursuant to which SJ International sold to a syndicate of underwriters, on a bought deal basis, 2,000,000 of the Stella-Jones common shares held by SJ International at a price of $42.00 per share.

After giving effect to this offering, SJ International beneficially owns or controls, directly or indirectly, 6,187,909 common shares of the Company, which represents approximately 38.8% of the outstanding common shares. As a result, SJ International has the ability to significantly influence all matters submitted to the shareholders for approval, including, without limitation, the election and removal of directors, amendments to the articles of incorporation and by-laws and the approval of any business combination. The interests of SJ International may not in all cases be aligned with the interests of the other shareholders.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in note 2 to the December 31, 2011 and 2010 audited consolidated financial statements.

The Company prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA"). In 2010, the CICA Handbook was revised to incorporate IFRS as issued by the International Accounting Standard Board ("IASB") and to require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company commenced reporting on this basis in the March 2011 and 2010 interim consolidated financial statements. In the audited consolidated financial statements for the years ended December 31, 2011 and 2010, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The audited consolidated financial statements for the years ended December 31, 2011 and 2010 represent the first annual financial statements of the Company and its subsidiaries prepared in accordance with IFRS. Subject to certain transition elections disclosed below, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position as at January 1, 2010 and throughout all periods presented as if these policies had always been in effect. Note 4 to the December 31, 2011 and 2010 audited consolidated financial statements discloses the impact of the transition to IFRS on the Company's reported consolidated statements of financial position, income, comprehensive income and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010, prepared under Canadian GAAP.

The preparation of financial statements in conformity with IFRS requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to estimates and assumptions include the estimated useful life of assets, impairment of goodwill and impairment of long-lived assets. It is possible that actual results could differ from those estimates, and such differences could be material. Estimates are reviewed periodically and, as adjustments become necessary, they are reported in the consolidated statement of income in the period in which they become known.

CHANGES IN ACCOUNTING POLICIES

ADOPTION OF IFRS

The Company's annual consolidated financial statements for the year ended December 31, 2011 are the first annual consolidated financial statements that comply with IFRS. For all accounting periods prior to this, the Company prepared its financial statements under Canadian GAAP. In accordance with IFRS 1, *First-time Adoption of IFRS*, 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 Company's annual consolidated financial statements for the years ended December 31, 2011 and 2010.

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 is December 31, 2011. However, it also provides for certain optional exemptions and certain mandatory exceptions for first-time adopters.

INITIAL ELECTIONS UPON ADOPTION

IFRS 1 optional exemptions:

Business combinations – Under IFRS 1, 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 – Under IFRS 1, a first-time adopter may elect to recognize all cumulative actuarial 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 – Under IFRS 1, a first-time adopter may elect to be exempt from the requirements of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, 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.

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

Leases – The Company has elected, under IFRS 1, to apply the exemption from the full retrospective application of International Financial Reporting Interpretations Committee Interpretation 4 ("IFRIC 4"), *Determining Whether an Arrangement Contains a Lease*, 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 – Under IFRS 1, a first-time adopter may choose not to apply IFRS 2, *Share-based Payment,* to all equity instruments of share-based payments that have vested at the Transition Date and not to apply IFRS 2 for all cash-settled share-based payments that have 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.

IFRS 1 mandatory exceptions:

Hedge accounting – Hedge accounting can only be applied prospectively from the Transition Date to transactions that satisfy the hedge accounting criteria in IAS 39 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

IFRS 1 requires an entity to reconcile equity and comprehensive income for periods prior to January 1, 2011. The reconciliations from Canadian GAAP to IFRS for the consolidated statements of financial position as at January 1, 2010 and December 31, 2010, and the consolidated statement of income and comprehensive income for the year ended December 31, 2010 are summarized in note 4 to the December 31, 2011 and 2010 audited consolidated financial statements.

Reconciliations of total operating, investing and financing cash flows are not provided, as the changes to these cash flows are not material.

IMPACT OF ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

IFRS 9, *Financial Instruments*, was issued in November 2009. It addresses the 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 they do not clearly represent 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. In December 2011, the effective date of implementation of IFRS 9, which was originally for accounting periods beginning on or after January 1, 2013, was deferred to annual periods beginning on or after January 1, 2015. The Company has not yet assessed the impact of this standard on its financial statements.

In May 2011, the IASB issued the following standards which have not yet been adopted by the Company: IFRS 10, *Consolidated Financial Statements;* IFRS 11, *Joint Arrangements*; IFRS 12, *Disclosure of Interests in Other Entities*; IAS 27, *Separate Financial Statements*; IFRS 13, *Fair Value Measurement*; and amended IAS 28, *Investments in Associates and Joint Ventures*. 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.

In June 2011, the IASB amended IAS 19, *Employee Benefits*, and IAS 1, *Presentation of Financial Statements*, which has not yet been adopted by the Company. The Company has not yet begun the process of assessing the impact that the amended standards will have on its financial statements.

In December 2011, the IASB amended IAS 32, *Financial Instruments: Presentation*, which has not yet been adopted by the Company. The Company has not yet begun the process of assessing the impact that the amended standard will have on its financial statements.

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*, and IAS 28, *Investments in Associates and Joint Ventures*. 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, 11, 12 and 13.

IAS 19 – Employee Benefits

IAS 19 has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of all employee benefits.

The amended standard removes the option to use the "corridor approach" whereby actuarial gains and losses are deferred, and it also removes the option to recognize actuarial gains and losses immediately through income. Instead, it requires immediate recognition of actuarial gains and losses in other comprehensive income as they arise, without subsequent recycling to net income. Past service cost (which will now include curtailment gains and losses) will no longer be recognized over a service period. Instead, past service costs will be recognized immediately in the period of a plan amendment.

Pension benefit cost will be split between (i) the cost of benefits accrued in the current period (service cost) and benefit changes (past service cost, settlements and curtailments); and (ii) finance expense or income. The finance expense or income component will be calculated based on the net defined benefit asset or liability. The amendments clarify that benefits requiring future services (e.g. stay bonuses) are not termination benefits in the scope of IAS 19, and this may result in a different pattern of recognition of such costs.

A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment taxes related to benefit plans, guidance on risk/cost sharing features, and expanded disclosures.

The new requirements are effective for annual periods beginning on or after January 1, 2013, with earlier application permitted.

IAS 1 – Presentation of Financial Statements

Presentation of items of other comprehensive income ("OCI"):

IAS 1 has been amended to change the disclosure of items presented in OCI, including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to the statement of income in the future.

The new requirements are effective for annual periods beginning on or after July 1, 2012.

IAS 32 – Financial Instruments: Presentation

The IAS 32 amendments clarify some of the requirements for offsetting financial assets and financial liabilities in the statement of financial position.

The current offsetting model in IAS 32 requires an entity to offset a financial asset and financial liability only when the entity currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The amendments clarify that the right of set-off must be available immediately and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy.

Gross settlement mechanisms with features that both (i) eliminate credit and liquidity risk and (ii) process receivables and payables in a single settlement process, are effectively equivalent to net settlement; they would, therefore, satisfy the IAS 32 criterion in these instances.

The IAS 32 changes are retrospectively applied, with an effective date of annual periods beginning on or after January 1, 2014.

DISCLOSURE CONTROLS

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

The President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company have evaluated, or caused the evaluation of, under their direct supervision, the effectiveness of the Company's disclosure controls and procedures (as defined in Regulation 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) as at December 31, 2011, and have concluded that such disclosure controls and procedures were designed and operating effectively.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In accordance with the Canadian Securities Administrators' Regulation 52-109 (Certification of Disclosure in Issuers' 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 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. Other than the adoption of IFRS, no other changes were made to the design of ICFR during the year ended December 31, 2011 that have had a material effect on the Company's ICFR.

OUTLOOK

Management expects demand for the Company's core products to remain solid in 2012. In the railway tie market, increased freight volume on North American railroads is leading to greater investments in the continental rail network, as operators constantly seek optimal line efficiency. Meanwhile, demand is expected to hold 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.

As one of the largest North American providers of industrial treated wood products, Stella-Jones will leverage the strength of its continental network to capture more of its existing clients' business in its core railway tie and utility pole markets, while diligently seeking new market opportunities. The Company will also remain focused on improving operating efficiencies throughout the organization.

In the short-term, the Company will continue to focus on cash generation and to maintain a prudent use of leverage. The integration of the Thompson operations is another priority and the Company believes it will benefit from greater market penetration, synergies and additional operating efficiencies from a larger network.

Over the long-term, the Company's strategic vision, focused on continental expansion, remains intact. A solid financial position will allow Stella-Jones to continue to seek targets in its core markets that meet its stringent investment requirements, provide synergistic opportunities, and add value for shareholders.

March 15, 2012