MANAGEMENT'S DISCUSSION & ANALYSIS

Three-month period ended September 30, 2012 compared with the three-month period ended September 30, 2011

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 November 8, 2012. The MD&A provides a review of the significant developments and results of operations of the Company during the three-month period ended September 30, 2012 compared with the three-month period ended September 30, 2011. The MD&A should be read in conjunction with the Company's condensed interim unaudited consolidated financial statements for the periods ended September 30, 2012 and 2011 and the notes thereto, as well as the Company's annual consolidated financial statements and MD&A for the year ended December 31, 2011. 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 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, one facility providing railway tie pickup and disposal services, two distribution centres, three pole peeling facilities and has a 50% interest in a fourth pole peeling operation. These twenty-seven facilities are located in six Canadian provinces and thirteen American states. The Company's workforce currently numbers approximately 1,000 employees. During the third quarter of 2012, the Company consolidated its railway tie pickup and disposal activities, resulting in all business previously carried out at three facilities being combined at a new location in Superior, Wisconsin.

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 (thousands of dollars)	**Three-month periods ended**		**Nine-month periods ended**	
	Sept. 30, 2012	**Sept. 30, 2011**	**Sept. 30, 2012**	**Sept. 30, 2011**
Net income for the period	20,683	16,569	56,524	42,340
Plus:				
Provision for income taxes	9,309	7,191	26,010	19,102
Financial expenses	1,807	1,809	5,935	6,127
Operating income	31,799	25,569	88,469	67,569
Depreciation and amortization	2,663	2,101	7,661	6,390
EBITDA	34,462	27,670	96,130	73,959

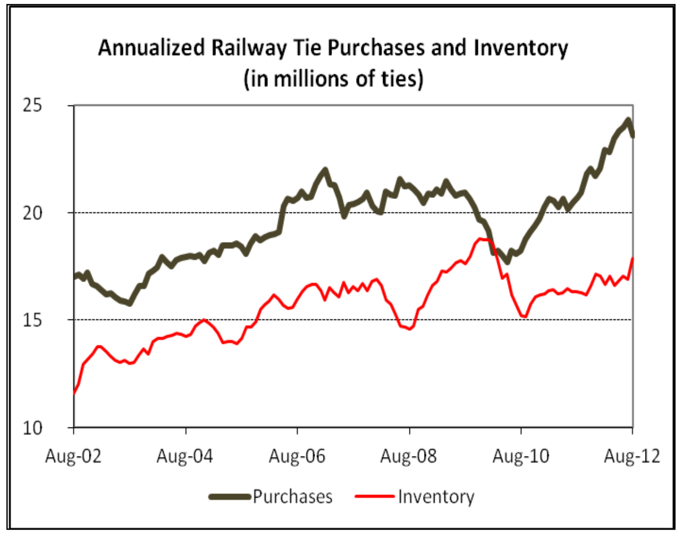
FOREIGN EXCHANGE

The table below shows exchange rates applicable to the periods ended September 30, 2012 and 2011. 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$/US$	**2012**		**2011**	
	Average	**Closing**	**Average**	**Closing**
Third Quarter	1.0022	0.9832	0.9665	1.0482

INDUSTRY OVERVIEW

Railway ties
As reported by the Railway Tie Association, railway tie purchases for the first eight months of 2012 were 13.0% higher than in the corresponding period a year earlier. As a result, industry purchases for the 12-month period ended August 31, 2012 reached 23.6 million ties. This solid demand resulted in industry inventories of 17.9 million ties as at August 31, 2012, equivalent to an inventory-to-sales ratio of 0.76:1, below the previous ten-year average ratio of 0.80:1.



Source: Railway Tie Association

According to data released by the Association of American Railroads, total traffic on North American railroads increased by 0.2% in the first nine months of 2012. While the number of carloads decreased by 2.5%, intermodal trailer and container volume was up 3.6% from 2011 levels.

OPERATING RESULTS

Sales
Sales for the quarter ended September 30, 2012 totalled $195.4 million, an increase of $13.6 million, or 7.5%, over last year's sales of $181.8 million. The Russellville, Arkansas operating facility acquired from Thompson Industries, Inc. on December 7, 2011 ("Russellville Facility") contributed railway tie and industrial product sales of approximately $12.3 million, while the conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, increased the value of U.S. dollar denominated sales by about $4.1 million when compared with the previous year. Excluding these factors, sales decreased approximately $2.8 million essentially due to a reduction in industrial product sales. With regards to the Company's core product categories, industry demand for railway ties remained strong, while utility pole sales declined slightly.

For the nine-month period ended September 30, 2012, sales reached $558.1 million, up $65.5 million, or 13.3% from $492.6 million in the nine-month period ended September 30, 2011. The Russellville Facility contributed sales of approximately $32.0 million, while the conversion effect from fluctuations in the value of the Canadian dollar versus the U.S. dollar, increased the year-over-year value of U.S. dollar denominated sales by about $11.1 million. Excluding these factors, sales increased approximately $22.4 million.

Sales by product category

Railway ties
Railway tie sales for the third quarter of 2012 amounted to $114.7 million, an increase of $22.3 million, or 24.2%, over sales of $92.3 million in the third quarter of 2011. These results reflect solid market demand as well as a $12.2 million contribution from the Russellville Facility. Railway tie sales accounted for 58.6% of the Company's third-quarter sales. For the first nine months of 2012, railway tie sales reached $330.8 million, representing a year-over-year increase of 25.1%, or $66.4 million. The Russellville Facility contributed sales of $31.3 million during the nine-month period.

Utility poles
Utility pole sales totalled $53.1 million in the third quarter of 2012, down slightly from $55.5 million in the corresponding period a year earlier. The variation reflects the year-over-year timing difference in orders for transmission poles related to special projects, which had resulted in stronger sales in the third quarter of 2011. Meanwhile, sales of distribution poles held steady, reflecting regular demand for maintenance projects. Utility

pole sales accounted for 27.2% of the Company's total sales in the third quarter of 2012. In the first nine months of 2012, utility pole sales stood at $148.3 million, up 3.3% from $143.6 million for the same period in 2011.

Industrial products
Industrial product sales reached $15.4 million in the third quarter of 2012, compared with $23.3 million in the third quarter of 2011. This variation reflects a reduction in the tie recycling business, as well as lower demand for marine applications in Canada. Industrial products represented 7.9% of sales in the three-month period ended September 30, 2012. For the first nine months of 2012, industrial product sales were $48.6 million, versus $59.0 million in the first nine months of 2011.

Residential lumber
Sales in the residential lumber category totalled $12.3 million in the third quarter of 2012, up 14.9% from $10.7 million a year earlier. The increase reflects more favourable weather compared with the same period last year and a stronger demand in Western Canada. Residential lumber accounted for 6.3% of Stella-Jones' sales in the third quarter of 2012. For the nine-month period ended September 30, 2012, sales of residential lumber products reached $30.4 million, up from $25.7 million for the nine-month period ended September 30, 2011.

Sales by destination

Sales in the United States amounted to $127.3 million, or 65.2% of sales, in the third quarter of 2012, representing an increase of $13.5 million, or 11.8%, over the corresponding period in 2011. The year-over-year increase mainly reflects higher sales of railway ties and the contribution from the Russellville Facility, partially offset by lower industrial product sales. Sales of products exported directly to customers located in the United States from facilities located in Canada were $1.1 million in the third quarter of 2012, compared with $3.5 million a year earlier, as the Company continues to optimize its asset base through plant specialization. For the first nine months of 2012, sales in the United States reached $378.0 million, up 21.6% from $311.0 million in the first nine months of 2011.

Sales in Canada accounted for 34.8% of Stella-Jones' total sales, reaching $68.1 million in the third quarter of 2012, versus $67.9 million in the third quarter of 2011. The slight increase is essentially attributable to higher railway tie and residential lumber sales offset by lower sales of transmission poles, due to the timing of orders for special projects, and of industrial products. For the first nine months of 2012, sales in Canada totalled $180.2 million, versus $181.6 million in the corresponding period a year earlier.

Cost of sales

Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $152.6 million, or 78.1% of sales, for the three-month period ended September 30, 2012. This compares with $144.2 million, or 79.3% of sales, in the three-month period ended September 30, 2011. The increase in absolute dollars essentially reflects higher business activity and the addition of the Russellville Facility. The decrease as a percentage of sales mainly stems from a better absorption of fixed costs resulting from higher business activity and greater efficiencies throughout the Company's plant network. Depreciation and amortization charges totalled $2.7 million for the three-month period ended September 30, 2012, compared to $2.1 million in the corresponding period of 2011. As a result, gross profit reached $42.8 million, or 21.9% of sales, in the third quarter of 2012, up from $37.6 million, or 20.7% of sales, in the third quarter of 2011.

For the nine-month period ended September 30, 2012, cost of sales was $439.5 million, or 78.7% of sales, versus $398.1 million, or 80.8% of sales, in the nine-month period ended September 30, 2011. Depreciation and amortization charges totalled $7.7 million in the first nine months of 2012, up from $6.4 million a year earlier. As a result, gross profit reached $118.7 million, or 21.3% of sales in the first nine months of 2012, compared with $94.5 million, or 19.2% of sales in the first nine months of 2011.

Selling and administrative

Selling and administrative expenses for the three-month period ended September 30, 2012 were $11.4 million, up from $10.9 million in the three-month period ended September 30, 2011. The year-over-year increase is primarily related to the acquisition costs for transactions discussed in "Business Acquisition" and "Subsequent Events" below.

For the first nine months of 2012, selling and administrative expenses amounted to $29.9 million, including acquisition costs of approximately $1.9 million, compared with $26.1 million in the first nine months of 2011. The year-over-year increase also reflects the addition of the Russellville Facility and higher compensation charges related to the Company's profit sharing plan.

As a percentage of sales, selling and administrative expenses were 5.8% and 5.4% of sales, respectively, in the three- and nine-month periods ended September 30, 2012, compared to 6.0% and 5.3% of sales, respectively, in the three- and nine-month periods ended September 30, 2011.

Other losses (gains), net

Stella-Jones' other net gains of $349,000 for the three-month period ended September 30, 2012 were primarily with respect to foreign exchange, while net losses of $303,000 for the nine-month period ended September 30, 2012 also included losses related to the disposal of buildings and equipment at the Russellville and Gatineau facilities. Last year's net losses of $1.2 million and $897,000 for the three- and nine-month periods ended September 30, 2011 were essentially related to foreign exchange.

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, 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 amounted to $1.8 million for each of the three-month periods ended September 30, 2012 and 2011. Higher year-over-year borrowings in the third quarter of 2012, versus the same period in 2011, and higher Canadian dollar interest charges on the conversion of U.S. dollar denominated debt were offset by lower interest rates resulting from the amendment of the Company's credit agreements on July 28, 2011.

In the first nine months of 2012, financial expenses totalled $5.9 million, versus $6.1 million in the first nine months of 2011. This decrease is due to the favourable effect of lower interest rates resulting from the July 28, 2011 amendment of credit agreements that more than offset higher year-over-year borrowings and higher 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 $30.0 million, or 15.3% of sales, in the third quarter of 2012. This represents an increase of $6.2 million, or 26.2%, over income before income taxes of $23.8 million, or 13.1% of sales, in the third quarter of 2011. For the nine-month period ended September 30, 2012, income before income taxes stood at $82.5 million, or 14.8% of sales, up from $61.4 million, or 12.5% of sales, in the nine-month period ended September 30, 2011.

Stella-Jones' provision for income taxes totalled $9.3 million in the third quarter of 2012, representing an effective tax rate of 31.0%. In the third quarter of 2011, the income tax expense stood at $7.2 million, equivalent to an effective tax rate of 30.3%. The higher effective tax rate for the three-month period ended September 30, 2012 is due to a greater proportion of income generated in the U.S., where the statutory tax rate is higher, compared to the same period last year. For the first nine months of 2012, the provision for income tax rate reached $26.0 million, equivalent to an effective tax rate of 31.5%, versus an income tax provision of $19.1 million, equivalent to an effective tax rate of 31.1%, in the first nine months of 2011.

Net income

Net income for the three-month period ended September 30, 2012 reached $20.7 million, or $1.29 per share, fully diluted, compared with $16.6 million, or $1.03 per share, fully diluted, in the three-month period ended September 30, 2011. This represents a year-over-year increase in net income of 24.8%.

For the nine-month period ended September 30, 2012, net income amounted to $56.5 million, or $3.52 per share, fully diluted, up 33.5% from $42.3 million, or $2.65 per share, fully diluted, in the corresponding period a year earlier.

BUSINESS ACQUISITION

On July 3, 2012, the Company acquired certain assets of PLS Pole Yard, Inc. ("PLS"), a provider of untreated wood poles operating a wood pole peeling yard located in Rochester, Washington. The total cash outlay associated with the acquisition was $4.4 million (US$4.3 million), excluding acquisition costs of $241,000 (US$240,000), and was financed through existing credit facilities.

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 these condensed interim consolidated financial statements. This fair value determination is expected to be completed within 12 months of the acquisition date and consequently, changes could occur mainly with respect to intangible assets and goodwill.

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.

(tabular information presented in thousands of dollars)	**$**
Assets acquired	
Inventories	1,971
Property, plant and equipment	713
Customer relationships	659
Non-compete agreement	191
Fiber supply agreement	182
Non-deductible goodwill	1,053
	4,769
Liabilities assumed	
Non-compete agreement	191
Fiber supply agreement	182
Total net assets acquired and liabilities assumed	4,396
Consideration transferred	
Cash	4,396
Consideration transferred for shares	4,396

The Company’s valuation of intangible assets has identified customer relationships, a non-compete agreement and a fiber supply agreement. The assigned useful life for customer relationships is 18 years and 6 months. The non-compete agreement and the fiber supply agreement are amortized over the terms of the agreements which are 5 and 2 years respectively. Goodwill is not amortized nor deductible for tax purposes, and represents the future economic value associated with raw material sourcing, acquired workforce and synergies with the Company’s operations.

The newly acquired pole peeling assets have been integrated directly into the Company's existing operations and are now used for the Company’s internal requirements. Accordingly, it is impracticable to provide the pro-forma disclosures on post acquisition sales and income before taxes for these assets as the Company does not maintain such discrete financial information.

SUBSEQUENT EVENTS

On November 2, 2012, Stella-Jones announced that it has signed a non-binding letter of intent to acquire the shares of McFarland Cascade Holdings, Inc. (“McFarland”), a provider of treated wood products based in the state of Washington.

The letter of intent contemplates a total cash outlay of US$230.0 million, of which approximately US$150.0 million will be paid to the shareholders of McFarland and approximately US$80.0 million will be used to reimburse McFarland’s debts with financial institutions. The transaction, if finalized, is expected to close in November 2012 and is subject to customary closing conditions, including entry into a definitive purchase agreement, customary approvals and satisfactory due diligence. Stella-Jones has already received U.S. antitrust clearance with regard to the proposed acquisition. Stella-Jones plans to finance the transaction through a combination of term financing and equity.

Founded in 1916, McFarland is one of North America’s long-standing suppliers of utility poles, as well as crossarms, piling and crane mats. It is also a provider of treated lumber for outdoor home projects, including composite decking, railings and related accessories. It serves its customer base through four wood treating facilities located in Tacoma, Washington; Eugene, Oregon; Electric Mills, Mississippi; and Galloway, British Columbia; as well as through an extensive distribution network. McFarland’s sales for its fiscal year ended December 31, 2011 were approximately US$255.0 million. Sales for its fiscal year ended December 31, 2012 are expected to reach approximately US$280.0 million and EBITDA for 2012 is expected to be approximately US$29.0 million.

On November 8, 2012, the Company announced that it has begun the construction of a new wood treating facility located in Cordele, Georgia. This new facility will be primarily devoted to the production of railway ties. As at September 30, 2012, the capital asset purchase commitments for the project were $5.3 million.

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 last eleven quarters.

2012

For the quarters ended	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
(thousands of dollars, except per share data)	**$**	**$**	**$**	**$**	**$**
Sales	158,795	203,919	195,435		
Operating income before depreciation of property, plant and equipment and amortization of intangible assets [1]	26,508	35,160	34,462		
Operating income [1]	24,090	32,580	31,799		
Net income for the period	15,006	20,835	20,683		
Earnings per common share					
Basic	0.94	1.30	1.29		
Diluted	0.94	1.30	1.29		

2011

For the quarters ended	**March 31**	**June 30**	**Sept. 30**	**Dec. 31**	**Total**
(thousands of dollars, except per share data)	**$**	**$**	**$**	**$**	**$**
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]	16,593	29,696	27,670	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	**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	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 full year total.

STATEMENT OF FINANCIAL POSITION

The Company's working capital at September 30, 2012 was $318.2 million, an increase of $45.0 million over a working capital balance of $273.2 million at December 31, 2011. The variation is essentially attributable to increases in accounts receivable and inventories, resulting from higher sales.

Current assets amounted to $382.4 million as at September 30, 2012 compared with $330.5 million at December 31, 2011. This increase is mostly attributable to higher accounts receivable and inventories.

The value of accounts receivable was $99.3 million as at September 30, 2012 compared with $76.5 million as at December 31, 2011. This $22.8 million increase reflects the solid sales growth during the nine-month period ended September 30, 2012.

Inventories stood at $269.3 million as at September 30, 2012, up from $243.6 million as at December 31, 2011. This increase mainly reflects higher planned inventory levels of air-dried wood, both to improve future treating cycles and meet anticipated sales growth.

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 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.

The value of property, plant and equipment stood at $118.2 million as at September 30, 2012, compared with $119.4 million as at December 31, 2011. This reduction is essentially related to depreciation charges totalling $3.8 million and to the effect of local currency depreciation on converting the value of U.S. based property, plant and equipment. This reduction is partially offset by purchases of property, plant and equipment amounting to $6.3 million for the nine-month period ended September 30, 2012 and the acquisition of property, plant and equipment from PLS.

The value of intangible assets and goodwill reached $64.2 million and $90.0 million, respectively, as at September 30, 2012. Intangible assets include customer relationships, the discounted value of the non-compete agreements, a creosote registration, a fiber supply agreement, cutting rights and standing timber. As at December 31, 2011, intangible assets and goodwill were $71.1 million and $91.7 million, respectively. The decrease in the value of intangible assets stems from an amortization charge of $3.8 million in the first nine months of 2012 and from the effect of local currency depreciation on converting the value of U.S. based intangible assets, partially offset by the acquisition of intangible assets related to the PLS acquisition. The decrease in the value of goodwill also reflects the effect of local currency depreciation on converting the value of U.S. based goodwill, partially offset by goodwill acquired in connection with the PLS transaction.

Bank indebtedness stood at $3.5 million as at September 30, 2012, up from $2.6 million as at December 31, 2011. Bank indebtedness consists of the Company's proportion of the operating line of its pole peeling joint venture.

The Company's long-term debt, including the current portion, was $184.8 million as at September 30, 2012, up from $180.1 million as at December 31, 2011. This increase is essentially attributable to higher working capital requirements in response to greater business activity. As at September 30, 2012, an amount of $132.8 million had been drawn against the Company's committed revolving facility of $170.0 million.

Shareholders' equity rose to $373.7 million as at September 30, 2012 compared with $331.9 million as at December 31, 2011. This increase of $41.8 million is mainly attributable to net income of $56.5 million, partially offset by dividends on common shares totalling $7.4 million. Book value stood at $23.37 per common share as at September 30, 2012, up from $20.80 per share as at December 31, 2011.

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**		**Nine-Month Periods Ended**	
(thousands of dollars)	**Sept. 30, 2012**	**Sept. 30, 2011**	**Sept. 30, 2012**	**Sept. 30, 2011**
Operating activities	$11,660	$15,325	$7,430	$1,323
Financing activities	($4,772)	($13,665)	$2,970	$4,213
Investing activities	($6,888)	($1,660)	($10,400)	($5,536)
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 its committed revolving facility and long-term debt and the issuance of common shares. The Company's committed revolving facility has been made available for a five-year term.

Cash flow from operating activities before changes in non-cash working capital components and interest and income tax paid was $35.3 million for the three-month period ended September 30, 2012, compared with $28.4 million for the same period in 2011. This increase reflects higher net income for the period.

Changes in non-cash working capital components reduced liquidity by $13.2 million in the third quarter of 2012 mainly due to an increase in inventories and to a decrease in accounts payable and accrued liabilities. In the third quarter of 2011, changes in non-cash working capital components had used liquidity of $4.5 million. Interest and income tax paid further reduced liquidity by $922,000 and $9.5 million, respectively, in the third quarter of 2012, versus $1.4 million and $7.2 million, respectively, a year earlier. As a result, cash flows provided by operating activities were $11.7 million in the third quarter of 2012, versus $15.3 million a year earlier.

For the first nine months of 2012, cash flow from operating activities before changes in non-cash working capital components and interest and income tax paid reached $98.4 million, up from $74.9 million in the first nine months of 2011. Changes in non-cash working capital components required liquidity of $58.6 million in the first nine months of 2012, compared with requiring $50.2 million in liquidity during the first nine months of 2011. Interest and income tax paid further reduced liquidity by $4.8 million and $27.6 million, respectively, in the first nine months of 2012, versus $6.4 million and $16.9 million, respectively, a year earlier. As a result, cash flows provided by operating activities amounted to $7.4 million in the nine-month period ended September 30, 2012, up from cash flows provided of $1.3 million in the corresponding period of 2011.

Financing activities for the quarter ended September 30, 2012 required funds of $4.8 million. This use of cash mainly stems from a $2.5 million payment of dividend on common shares and a $2.3 million net reduction in long-term debt during the period. For the quarter ended September 30, 2011, financing activities reduced liquidity by $13.7 million.

In the first nine months of 2012, financing activities generated liquidity of $3.0 million, as net increases of $9.6 million and $873,000, respectively, in long-term debt and bank indebtedness were partially offset by the payment of dividends on common shares totalling $7.4 million. In the first nine months of 2011, financing activities provided liquidity of $4.2 million.

Investing activities used $6.9 million in liquidity during the third quarter of 2012 reflecting the PLS acquisition ($4.4 million) as well as purchases of property, plant and equipment, essentially for the addition of various equipment upgrades and expansion ($2.8 million). For the quarter ended September 30, 2011, cash flows from investing activities decreased liquidity by $1.7 million.

For the nine-month period ended September 30, 2012, investing activities used funds of $10.4 million, mainly reflecting purchases of property, plant and equipment of $6.3 million and the $4.4 million PLS acquisition. This compares with a reduction in liquidity of $5.5 million in the nine-month period ended September 30, 2011.

The following table details the maturities of the financial obligations as at September 30, 2012:

(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]	3,457	3,561	3,561	-	-	-
Accounts payable and accrued liabilities	42,977	42,977	42,977	-	-	-
Long-term debt obligations[1]	184,762	211,593	15,913	14,860	173,731	7,089
Net settled interest rate swaps	-	2,986	917	1,615	454	-
Other contractual obligations	-	27,413	6,969	8,536	3,286	8,622
Non-compete and fiber supply agreements	2,086	2,285	1,384	803	98	-
Total	233,282	290,815	71,721	25,814	177,569	15,711

[1] Amounts include capital and interest based on current rates

SHARE AND STOCK OPTION INFORMATION

As at September 30, 2012, the capital stock issued and outstanding consisted of 15,990,478 common shares (15,955,303 as at December 31, 2011). The following table presents the outstanding capital stock activity for the three- and nine-month periods ended September 30, 2012:

Number of shares (in '000s)	Three-month Period Ended September 30, 2012	Nine-month Period Ended September 30, 2012
Balance – Beginning of period	15,989	15,955
Stock option plan	-	29
Employee share purchase plans	1	6
Balance – End of period	15,990	15,990

As at November 8, 2012, the capital stock issued and outstanding consisted of 15,990,478 common shares.

As at September 30, 2012, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 130,100 (December 31, 2011 – 158,800) of which 92,300 (December 31, 2011 – 119,500) were exercisable. As at November 8, 2012, the number of outstanding options was 130,100 of which 92,300 were exercisable.

DIVIDENDS

On November 8, 2012, the Board of Directors approved a quarterly dividend of $0.16 per common share payable on December 20, 2012 to shareholders of record at the close of business on December 3, 2012.

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 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 2011 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 remain strong in the upcoming quarters. Increased freight volume on North American railroads in recent years should lead to continued investments in the continental rail network, including ties, as operators constantly seek optimal line efficiency. Solid demand is expected to continue 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 September 30, 2012, the Company is in full compliance with its debt covenants and contractual obligations. In addition, as at September 30, 2012, an amount of $132.8 million had been drawn against the Company's committed revolving facility of $170.0 million.

Accounts receivable increased during the first nine months of 2012 as a result of solid sales growth during that period. 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 during the first nine months of 2012 due to higher planned inventory levels of air-dried wood, both to improve future treating cycles and meet anticipated sales growth. 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 2011 Annual Report.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the December 31, 2011 audited 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.

DISCLOSURE CONTROLS AND 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 ("DC&P") and on the design of internal control over financial reporting ("ICFR").

During the three-month period ended September 30, 2012, no changes were made to the design of ICFR 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 the last quarter of 2012 and in 2013. In the railway tie market, increased freight volume on North American railroads in recent years continues to result in 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 shown by the consolidation of the tie pickup and disposal operations, Stella-Jones is further enhancing its focus on core wood treating activities. As one of the largest North American providers of industrial treated wood products, the Company 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 opportunities in the treated wood products market. 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 disciplined acquisition strategy, as evidenced by the proposed acquisition of McFarland. The Company's long-term strategic vision, focused on continental expansion, remains intact. Stella-Jones will continue to seek targets in its core markets that meet its stringent investment requirements, provide synergistic opportunities, and add value for shareholders.

November 8, 2012