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 21, 2013. The MD&A provides a review of the significant developments and results of operations of the Company during the fiscal year ended December 31, 2012 compared with the fiscal year ended December 31, 2011. The MD&A should be read in conjunction with the Company's audited consolidated financial statements for the years ended December 31, 2012 and 2011 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. Unless required to do so under applicable securities legislation, the Company's management does not assume any obligation to update or revise forward-looking statements to reflect new information, future events or other changes.

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.

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. 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 twenty-three wood treating plants, ten pole peeling facilities, a coal tar distillery and a facility providing railway tie pickup and disposal services. These facilities are located in five Canadian provinces and fourteen American states and are complemented by an extensive distribution network across North America. As at December 31, 2012, Stella-Jones' workforce numbered approximately 1,380 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, 2012**	Dec. 31, 2011	**Dec. 31, 2012**	Dec. 31, 2011
Net income for the period	**16,546**	13,367	**73,070**	55,709
Plus:				
Provision for income taxes	**2,197**	5,120	**28,207**	24,220
Financial expenses	**2,384**	1,912	**8,319**	8,039
Operating income	**21,127**	20,399	**109,596**	87,968
Depreciation and amortization	**3,044**	2,325	**10,705**	8,715
EBITDA	**24,171**	22,724	**120,301**	96,683

MAJOR ACHIEVEMENTS OF 2012

Stella-Jones recorded a solid performance in the year ended December 31, 2012. With regards to network expansion, the Company completed the largest acquisition in its history and began construction of a new wood treating facility in the United States. On the operating front, Stella-Jones registered record sales and net income, while maintaining a healthy financial position. Going forward, the Company will focus on executing its operating strategy based on continental expansion in its core railway tie and utility pole markets.

Network expansion

On November 30, 2012, Stella-Jones completed the acquisition of McFarland Cascade Holdings, Inc. ("McFarland"), a provider of treated wood products based in the state of Washington. 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, 2012 were approximately US$286.9 million and EBITDA for 2012 was approximately US$29.2 million.

The total cash outlay was approximately $230.2 million, subject to post closing adjustments, including approximately US$130.8 million of net working capital and the assumption of certain liabilities. Financing for the transaction was secured through an $80.0 million private placement of subscription receipts, subsequently exchanged for common shares of the Company on the basis of one common share per subscription receipt, as well as through bank financing resulting from an increase in the Company's committed revolving credit facility to $350.0 million.

On November 8, 2012, Stella-Jones announced that it has begun construction of a new wood treating facility on a 40-acre tract of land in Cordele, Georgia, approximately 225 kilometers south of Atlanta. The project represents an investment of approximately US$11.0 million. The Cordele facility will be primarily devoted to the production of railway ties, with an ultimate annual capacity of two million ties. Initial wood trimming activities began in February 2013 and treating activities should begin near mid-year.

OPERATING RESULTS

Sales for the year ended December 31, 2012 reached $717.5 million, up 12.1% from last year's sales of $640.1 million. The operating facilities acquired from McFarland contributed utility pole and residential lumber sales of $15.9 million over a one-month period, while the Russellville, Arkansas operating facility acquired from Thompson Industries, Inc. on December 7, 2011 ("Russellville facility") generated railway tie and industrial product sales of approximately $45.6 million in 2012, versus $1.7 million in the last three weeks of 2011. 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 $8.6 million when compared with the previous year. Excluding these factors, sales increased approximately $9.0 million. While demand remained healthy for the Company's core railway tie and utility pole product categories, sales of industrial products declined mainly due to a planned reduction in the tie recycling business.

Reflecting higher business activity and greater efficiencies throughout its plant network, Stella-Jones' annual operating income reached $109.6 million, or 15.3% of sales, in 2012. This represents a 24.6% increase over $88.0 million, or 13.7% of sales, in the prior year. As a result, net income for the year grew 31.2% to $73.1 million, or $4.53 per share, fully diluted, compared with $55.7 million, or $3.48 per share, fully diluted, a year ago. The Company generated a solid 18.3% return on average equity in 2012.

Stella-Jones produced strong cash flows in 2012 with cash flow from operating activities, before changes in non-cash working capital components and interest and income tax paid, amounting to $120.8 million, up 20.4% from $99.6 million in 2011. This performance allowed the Company to maintain a sound financial position and to increase its annual dividend payout for the eighth consecutive year. As the acquisition of McFarland was mostly financed through existing credit facilities, and completed shortly before year end, Stella-Jones' total debt to total capitalization ratio rose to 0.44:1 as at December 31, 2012, from 0.35:1 twelve months earlier.

SELECTED ANNUAL FINANCIAL INFORMATION (years ended December 31)

Income (thousands of dollars, except per share data)	**2012** **$**	2011 $	2010 $
Sales	**717,494**	640,148	561,046
Operating income	**109,596**	87,968	60,690
Net income	**73,070**	55,709	34,441
Basic earnings per common share	**4.54**	3.49	2.27
Diluted earnings per common share	**4.53**	3.48	2.26

Financial Position (thousands of dollars)	**2012** **$**	2011 $	2010 $
Current assets	**534,863**	330,519	269,042
Total assets	**955,863**	617,056	517,288
Long-term debt*	**349,608**	180,094	125,828
Total debt**	**363,608**	182,679	157,751
Shareholders' equity	**468,751**	331,912	280,102

* Including current portion

** Including short-term bank indebtedness

KEY PERFORMANCE INDICATORS

For the years ended December 31	**2012**	2011	2010
Operating margin	**15.3%**	13.7%	10.8%
Return on average equity	**18.3%**	18.2%	15.0%
Working capital ratio	**5.94**	5.77	3.38
Total debt to total capitalization	**0.44:1**	0.35:1	0.36:1
Total debt to trailing 12-month EBITDA	**3.02**	1.89	2.22
Dividend per share	**0.62**	0.50	0.38

FOREIGN EXCHANGE

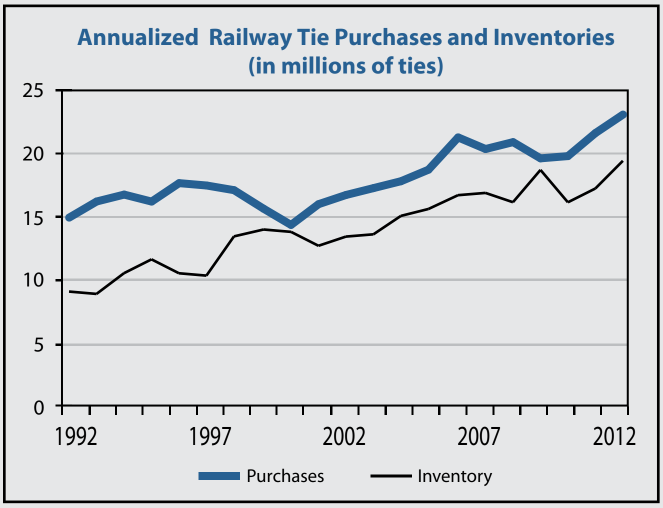
The table below shows exchange rates applicable to the years ended December 31, 2012 and 2011. Average rates are used to translate sales and expenses for the periods mentioned, while closing rates translate assets and liabilities of foreign operations and monetary assets and liabilities of the Canadian operations.

	2012		2011	
Cdn$/US$	**Average**	**Closing**	Average	Closing
First Quarter	**1.0031**	**0.9975**	0.9892	0.9696
Second Quarter	**1.0061**	**1.0181**	0.9615	0.9645
Third Quarter	**1.0022**	**0.9832**	0.9665	1.0482
Fourth Quarter	**0.9919**	**0.9949**	1.0217	1.0170
Fiscal Year	**1.0008**	**0.9949**	0.9847	1.0170

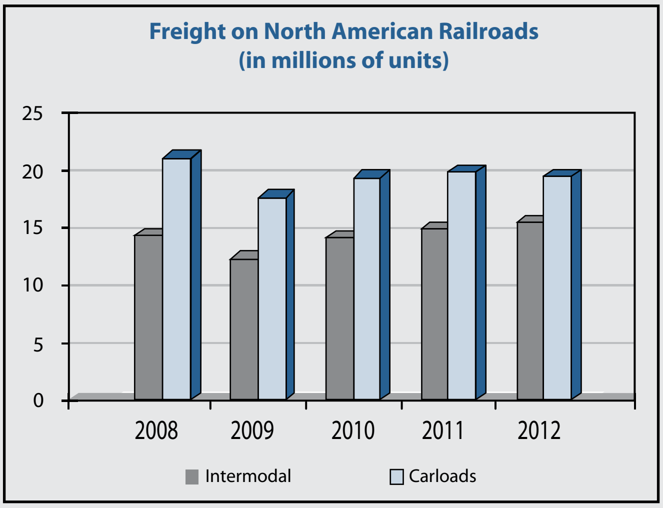
INDUSTRY OVERVIEW

Railway ties

As reported by the Railway Tie Association, railway tie purchases for 2012 rose 6.4% to reach 23.1 million ties, the highest annual total of the last 20 years. This high demand led to increased production. As a result, the inventory-to-sales ratio stood at 0.84:1, as at December 31, 2012, up from 0.79:1 twelve months earlier, but in line with the average ratio of the last ten years.



Source: Railway Tie Association



Source: Association of American Railroads

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.

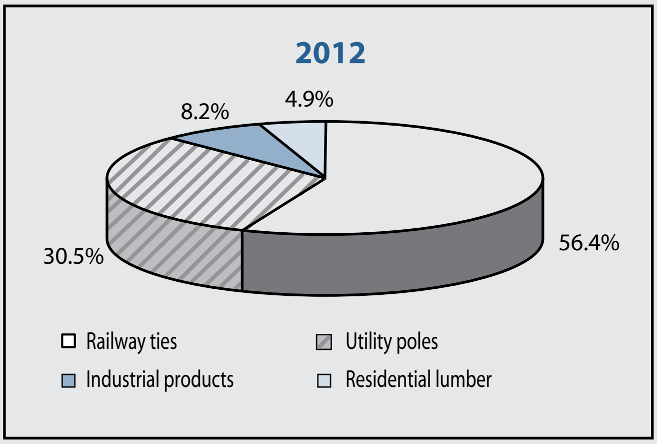
Despite economic uncertainty, total traffic on North American railroads increased by 0.6% in 2012, according to data released by the Association of American Railroads. While the number of carloads decreased by 2.0% in 2012, essentially due to lower shipments of coal and grain, the volume of intermodal trailers and containers was up 4.1% from 2011 levels.

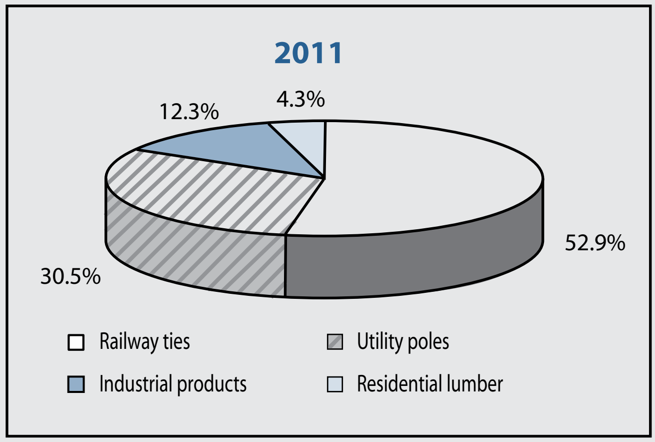
OPERATING RESULTS

Sales

Sales for the year ended December 31, 2012 totalled $717.5 million, up 12.1% over last year's sales of $640.1 million. The operating facilities acquired from McFarland on November 30, 2012 contributed sales of approximately $15.9 million over a one-month period in 2012, while the Russellville facility contributed additional sales of approximately $43.9 million in 2012. 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 $8.6 million when compared with last year. Excluding these factors, sales increased approximately $9.0 million. While demand remained healthy for the Company's core railway tie and utility pole product categories, sales of industrial products declined due to a planned reduction in the tie recycling business.

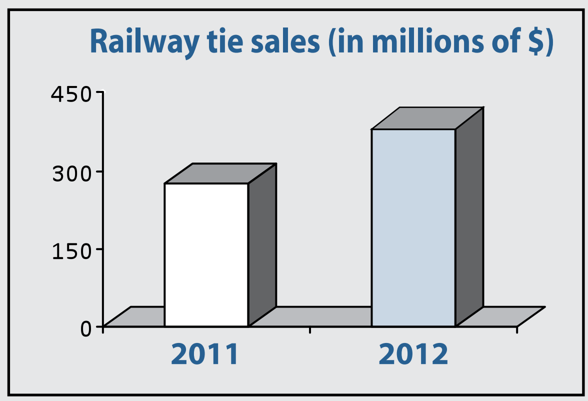
Sales by product category (% of revenues)





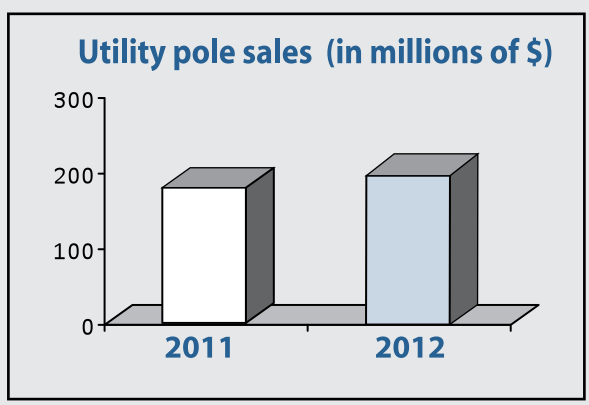
Railway ties

Railway tie sales for 2012 amounted to $404.5 million, up $65.7 million over sales of $338.8 million in 2011. This 19.4% increase reflects solid market demand, as well as additional tie sales of approximately $43.4 million from the Russellville facility. Adjusting for a favourable foreign exchange effect of $6.6 million due to a higher average conversion rate on U.S. dollar denominated tie sales, year-over-year comparable railway tie sales increased approximately $15.7 million, or 4.6%. Railway tie sales accounted for 56.4% of the Company's total sales in 2012.



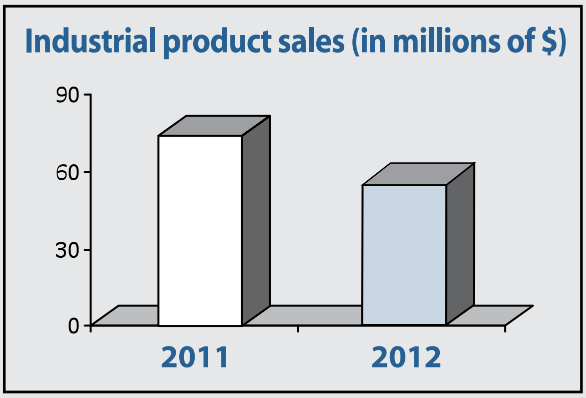
Utility poles

Utility pole sales reached $218.5 million in 2012, up 12.2% over sales of $194.8 million in 2011. McFarland added utility pole sales of $13.6 million during the last month of 2012, while a higher year-over-year average conversion rate increased the value of U.S. dollar denominated pole sales by $1.0 million in 2012. Excluding these factors, utility pole sales rose approximately $9.1 million, or 4.7%, driven by higher sales of distribution poles, reflecting solid maintenance demand, while sales of transmission poles declined slightly due to the year-over-year timing difference in orders. Utility pole sales accounted for 30.5% of the Company's total sales in 2012.



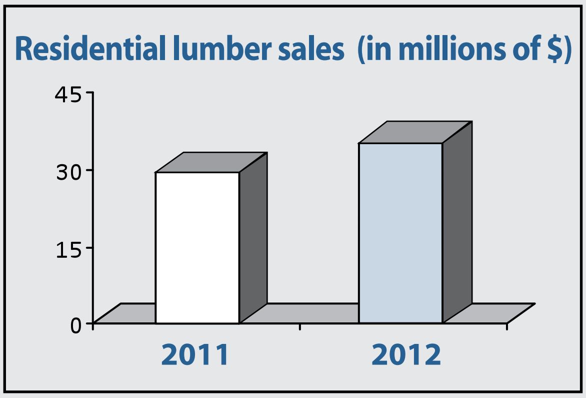
Industrial products

Industrial product sales were $59.0 million in 2012, compared with $78.9 million in 2011. This $19.9 million, or 25.2% decrease, is mainly attributable to a planned reduction in the tie recycling business. The Russellville facility contributed additional sales of $0.5 million in 2012, while the year-over-year conversion effect increased U.S. dollar denominated sales by approximately $1.0 million. Excluding these factors, demand remained steady for the balance of the Company's principal products and services in this category for both Canada and the United States. Industrial products represented 8.2% of sales in 2012.

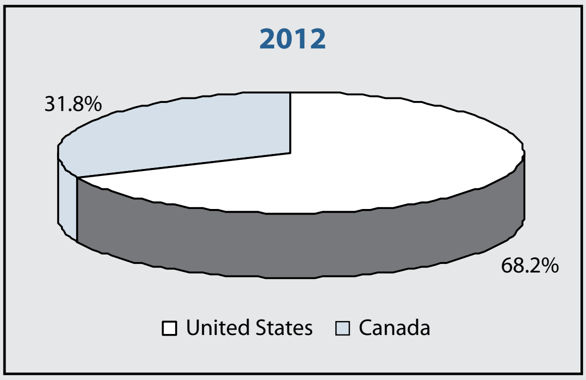


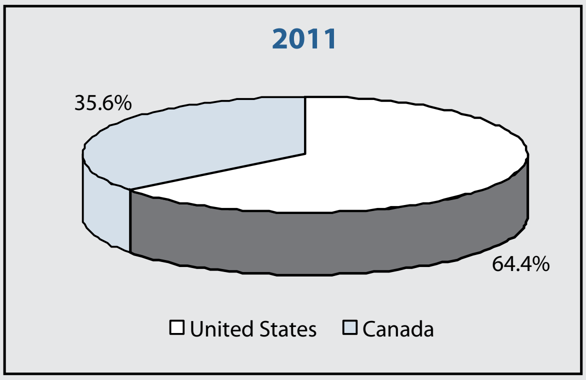
Residential lumber

Sales in the residential lumber category totalled $35.5 million in 2012, up from $27.7 million in 2011. This $7.8 million, or 28.4% increase, essentially reflects stronger demand in Western Canada and residential lumber sales of $2.3 million from the McFarland operations. McFarland sells residential lumber products to approximately 120 home renovation centres in the U.S. Northwest. Residential lumber accounted for 4.9% of Stella-Jones' sales in 2012.



Sales by geographic region (% of revenues)





Sales in the United States amounted to $489.1 million, or 68.2% of sales, in 2012, representing an increase of $76.9 million, or 18.7%, over 2011. The increase mainly reflects higher sales of railway ties and utility poles, the additional contribution of $43.9 million and $15.4 million from the Russellville facility and McFarland's U.S.-based operations, respectively, as well as a higher conversion rate on U.S. dollar denominated sales. Sales of products exported directly to customers located in the United Stated from facilities located in Canada totalled $6.7 million in 2012, compared with $13.0 million in 2011, as the Company continues to optimize its asset base through plant specialization.

Sales in Canada in 2012 increased $0.4 million, or 0.2%, to $228.4 million, representing 31.8% of Stella-Jones' total sales. The year-over-year sales variation is attributable to lower sales of railway ties and utility poles, the latter mainly due to year-over-year timing differences in transmission pole orders, partially offset by higher residential lumber sales and a $0.5 million contribution from McFarland's Canadian operations.

Cost of sales

Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $565.7 million, or 78.8% of sales, in 2012. This compares with $515.3 million, or 80.5% of sales, in 2011. The increase in absolute dollars essentially reflects higher business activity, the acquisitions of the Russellville facility and of McFarland, as well as a higher average rate applied to convert U.S. dollar denominated costs. The decrease as a percentage of sales mainly stems from a better absorption of fixed costs resulting from increased business activity and from greater efficiencies throughout the Company's plant network.

Depreciation and amortization charges totalled $10.7 million for the year ended December 31, 2012, versus $8.7 million in the year ended December 31, 2011. The increase is mainly attributable to the depreciation and amortization charges related to the tangible and intangible assets of the Russellville facility and of McFarland.

As a result, gross profit reached $151.8 million or 21.2% of sales in 2012, up from $124.9 million or 19.5% of sales in 2011.

Selling and administrative

Selling and administrative expenses for 2012 were $42.5 million, or 5.9% of sales, compared with expenses of $35.8 million, or 5.6% of sales, in 2011. This $6.7 million increase is mainly attributable to the additions of the Russellville facility and of McFarland for the full-year and one-month periods, respectively, and higher compensation charges related to the Company's profit sharing program.

Also, this year's selling and administrative expenses included approximately $4.1 million in acquisition costs, of which $3.0 million were related to the McFarland transaction. Last year's selling and administrative expenses included a non-cash impairment charge of $2.2 million related to a customer relationship intangible asset, as well as acquisition costs of $423,000 related to the purchase of the Russellville facility.

Other losses (gains), net

Stella-Jones' other net gains of $313,000 for the year ended December 31, 2012 included a $1.6 million gain on the revaluation of assets previously held in a joint venture, now wholly owned by the Company, and a foreign exchange gain of $891,000, partially offset by net losses of $2.2 million on asset disposals at several facilities, of which $1.5 million resulted from the donation to local economic development authorities of land located in Stanton, Kentucky. In 2011, other net losses of $1.1 million included a foreign exchange loss of $554,000 and a loss on disposal of property, plant and equipment of $505,000.

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 reached $8.3 million in 2012, up slightly from $8.0 million in 2011, as increased borrowings related to the acquisition of McFarland were partially offset by the full-year effect of lower interest rates resulting from the amendment of the Company's credit agreements on July 28, 2011.

Income before income taxes and income tax expense

Stella-Jones generated income before income taxes of $101.3 million, or 14.1% of sales, in 2012. This represents an increase of 26.7%, over income before income taxes of $79.9 million, or 12.5% of sales, in 2011.

Stella-Jones' provision for income taxes totalled $28.2 million in 2012, representing an effective tax rate of 27.9%. In 2011, the income tax expense stood at $24.2 million, equivalent to an effective tax rate of 30.3%. The lower effective tax rate for 2012 is due to a tax benefit resulting from the donation of land located in Stanton, Kentucky, appraised at $3.1 million, and to the deductibility of acquisition costs related to the McFarland transaction.

Net income

Net income for the year ended December 31, 2012 reached $73.1 million, or $4.53 per share, fully diluted, compared with $55.7 million, or $3.48 per share, fully diluted, in 2011. This represents a year-over-year increase in net income of $17.4 million, or 31.2%.

BUSINESS ACQUISITIONS

McFarland Cascade Holdings, Inc.

On November 30, 2012, the Company completed the acquisition of McFarland, a provider of treated wood products based in the state of Washington. 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.

Total cash outlay associated with the acquisition was approximately $230.2 million (US$231.6 million), excluding acquisition costs of approximately $3.0 million (US$2.9 million), recognized in the consolidated statement of income under Selling and administrative expenses. This amount includes $162.9 million (US$163.9 million) paid to McFarland's shareholders and $67.3 million (US$67.7 million) used to reimburse McFarland's debts with financial institutions.

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 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, goodwill, consideration payable and deferred income tax.

The following is a preliminary 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	
Non-cash working capital	153,374
Property, plant and equipment	59,636
Cutting rights	1,159
Customer relationships	27,427
Customer backlog	379
Goodwill	44,504
Deferred income tax assets	1,867
	288,346
Liabilities assumed	
Bank indebtedness	18,500
Accounts payable and accrued liabilities	22,550
Long-term debt	67,277
Site remediation provision	5,910
Employee future benefits	2,765
Deferred income tax liabilities	1,308
Total net assets acquired and liabilities assumed	170,036
Consideration transferred	
Cash	230,165
Payment of long-term debt	(67,277)
Consideration payable	7,148
Consideration transferred for shares	170,036

The Company's valuation of intangible assets has identified customer relationships and customer backlog. The assigned useful lives for customer relationships are 20 years and 4 months for customer backlog. Significant assumptions used in the determination of intangible assets, as defined by Management, are year-over-year growth, discount rate and income before interest, taxes, depreciation and amortization margin. Goodwill is amortized and deductible for tax purposes, and represents the future economic value associated with the increased distribution network, acquired workforce and synergies with the Company's operations. For impairment test purposes, goodwill is allocated to cash-generating units. In the case of the McFarland acquisition, goodwill is allocated to plants specialized in the treatment of utility poles. Note 8 to the consolidated financial statements provides a roll-forward of the net book value balances of intangible assets and goodwill.

The fair value of trade receivables, included in non-cash working capital, is $35.5 million and the contractual amount is $35.9 million, of which $349,000 is expected to be uncollectible.

Consideration payable represents a purchase consideration adjustment related to actual net working capital and certain other assets acquired on closing. As at December 31, 2012, Management has not received all information required to finalize the amount payable and therefore it is considered preliminary. Adjustments to the estimated purchase consideration, if any, will affect the amount of goodwill recognized on the acquisition.

Financing for the acquisition was secured through private placements of subscription receipts which successfully closed on November 30, 2012, as well as a draw-down of $152.6 million (US$153.6 million) on the Company's committed revolving credit facility. With respect to the private placements, the Company issued 1,176,500 subscription receipts at a price of $68.00 per subscription receipt for aggregate gross proceeds of $80.0 million. A syndicate of underwriters took up a private placement of 721,200 subscription receipts and Stella Jones International S.A. purchased 455,300 subscription receipts on a private placement basis. The subscription receipts were exchanged on the basis of one common share of the Company per subscription receipt. Total proceeds net of legal and underwriting fees of the subscription receipts were $77.6 million. The transaction was recorded at $78.2 million, net of a deferred income tax adjustment of $652,000. On November 21, 2012, the Company amended and restated its committed revolving credit facility to increase its borrowing limit to $350.0 million.

In the month of December 2012, McFarland's sales and loss before income taxes amounted to $15.9 million and $0.1 million, respectively. On a pro forma basis, Management's estimate of sales and income before income taxes of the combined operations of the Company and McFarland for the 12-month period ended December 31, 2012 would have been approximately $986.6 million and $111.6 million respectively, had the McFarland acquisition occurred as of January 1, 2012. To arrive at the pro forma estimates, Management considered the financing structure resulting from the acquisition as well as the adjustment of fair value and harmonization of accounting policies and assumed that the fair value adjustment made at the acquisition date would have been the same had the acquisition occurred on January 1, 2012.

PLS Pole Yard, Inc.

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 $396,000 (US$394,000), recognized in the consolidated statement of income under selling and administrative expenses, and was financed through existing credit facilities.

The following fair value determination of the net assets acquired and liabilities assumed is based on Management's best estimates. No significant adjustments were made to the preliminary fair value determination.

The following is a final 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	800
Goodwill	1,285
	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. The assigned useful life for customer relationships is 18 years and 6 months. Significant assumptions used in the determination of intangible assets, as defined by management, are year-over-year growth, discount rate and income before interest, taxes, depreciation and amortization margin. Goodwill is amortized and deductible for tax purposes, and represents the future economic value associated with raw material sourcing, acquired workforce and synergies with the Company's operations. For impairment test purposes, goodwill is allocated to cash-generating units. In the case of the PLS acquisition, goodwill is allocated to plants specialized in the treatment of utility poles.

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 impractical to provide the required pro forma disclosures on post-acquisition sales and income before taxes for these assets as the Company does not maintain such detailed financial information.

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 2012, the Company achieved year-over-year revenue and net income growth in all quarters. The Russellville facility contributed for all of 2012, as opposed to three weeks in 2011, while the McFarland operations contributed for a one-month period in 2012. Organically, sustained demand for the Company's core products throughout most of the year was partially offset by a planned reduction in the tie recycling business. This greater business activity, combined with increased efficiencies throughout the Company's plant network, 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:

2012

For the quarters ended (thousands of dollars, except per share data)	March 31 $	June 30 $	Sept. 30 $	Dec. 31 $	Total $
Sales	**158,795**	**203,919**	**195,435**	**159,345**	**717,494**
Operating income before depreciation of property, plant and equipment and amortization of intangible assets [1]	**26,508**	**35,160**	**34,462**	**24,171**	**120,301**
Operating income [1]	**24,090**	**32,580**	**31,799**	**21,127**	**109,596**
Net income for the period	**15,006**	**20,835**	**20,683**	**16,546**	**73,070**
Earnings per common share					
Basic	**0.94**	**1.30**	**1.29**	**1.01**	**4.54**
Diluted	**0.94**	**1.30**	**1.29**	**1.00**	**4.53**

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]	16,593	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

[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 2012 amounted to $159.3 million, up from $147.5 million for the same period in 2011. This $11.8 million, or 8.0% increase, is attributable to a $15.9 million contribution from the McFarland operations, as well as an additional contribution of $12.0 million from the Russellville facility. The conversion effect from fluctuations in the value of the Canadian dollar, versus the U.S. dollar, had a negative impact of $2.5 million on the value of U.S. dollar denominated sales when compared with last year. Excluding these factors, sales decreased approximately $13.6 million due to lower advanced deliveries of railway ties in the fourth quarter of 2012, compared with the fourth quarter of 2011, and a planned reduction in the tie recycling business.

Fourth quarter sales of railway ties reached $73.7 million in 2012, versus $74.4 million in 2011. This slight decrease reflects lower year-over-year advanced deliveries, partially offset by the additional contribution from the Russellville facility. Utility pole sales rose $18.9 million to $70.2 million due to a $13.6 million contribution from the McFarland operations and higher sales of distribution poles. Industrial product sales were $10.4 million, versus $19.9 million a year ago, as a result of a planned reduction in the tie recycling business. Finally, residential lumber sales reached $5.1 million, up from $2.0 million last year, mainly due to additional sales of $2.3 million from the McFarland operations.

Gross profit amounted to $33.2 million, or 20.8% of sales, in the fourth quarter of 2012, up from $30.3 million, or 20.6% of sales, in the fourth quarter of 2011. The increase in absolute dollars reflects the contribution of the Russellville facility for the full period and of McFarland for a one-month period. The increase as a percentage of sales mainly stems from greater efficiencies throughout the Company's plant network, partially offset by lower margins at the McFarland operations.

Operating income was $21.1 million, or 13.3% of sales, in the fourth quarter of 2012, versus $20.4 million, or 13.8% of sales, in the fourth quarter of 2011. Results for the fourth quarter of 2012 include acquisition costs of $2.4 million related to the McFarland transaction, while results for the fourth quarter of 2011 included a non-cash impairment charge of $2.2 million related to a customer relationship intangible asset and acquisition costs of $423,000 related to the purchase of the Russellville facility. Excluding these elements, operating income for the fourth quarter of 2012 was $23.5 million, or 14.8% of sales, compared with $23.0 million, or 15.6% of sales, a year earlier. The increase in absolute dollars reflects the contribution of the Russellville facility for the full period and of McFarland for a one-month period, partially offset by higher compensation expenses. The decrease as a percentage of sales mainly stems from lower margins at the McFarland operations.

Net income for the period reached $16.5 million, or $1.00 per share, fully diluted, compared with $13.4 million, or $0.83 per share, fully diluted, last year. This represents a year-over-year increase in net income of 23.8%. Net income for the fourth quarter of 2012 also reflects tax benefits of $3.1 million resulting from the donation of land in Stanton, Kentucky, and the deductibility, for income tax purposes, of acquisition costs related to the acquisition of McFarland.

STATEMENT OF FINANCIAL POSITION

Assets

As at December 31, 2012, total assets reached $955.9 million, up from $617.1 million as at December 31, 2011. This increase is mainly attributable to the McFarland acquisition.

Current assets amounted to $534.9 million as at December 31, 2012 compared with $330.5 million at December 31, 2011. This variation is mostly attributable to increases in inventories and accounts receivable related to the acquisition of McFarland, as explained below. As at December 31, 2012, current assets included cash of $14.0 million, representing amounts held as collateral against banker's acceptance loans, presented under bank indebtedness, of an equivalent amount and maturing in January and February 2013.

The value of accounts receivable was $89.6 million as at December 31, 2012 compared with $76.5 million as at December 31, 2011. This increase of $13.1 million reflects the acquisition of McFarland shortly before year end. Excluding McFarland, accounts receivable were $63.1 million due to lower business activity in the fourth quarter of 2012, compared with the same period in 2011.

Inventories reached $413.4 million as at December 31, 2012, up from $243.6 million on December 31, 2011. This increase is mainly due to the acquisition of McFarland shortly before year end. Excluding the latter's operations, inventories were $292.6 million, as the Company proceeded with a planned increase 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 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 $189.0 million as at December 31, 2012, compared with $119.4 million as at December 31, 2011. This increase is essentially related to the McFarland ($59.6 million) and PLS ($0.7 million) acquisitions as well as to purchases of property, plant and equipment for the year ($14.8 million) exceeding depreciation ($5.3 million). Excluding McFarland, the value of property, plant and equipment was $128.5 million.

The value of intangible assets reached $93.1 million as at December 31, 2012. 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, 2011, intangible assets were $71.1 million. The year-over-year increase mainly stems from the McFarland ($29.0 million) and PLS ($0.8 million) acquisitions, partially offset by an amortization charge of $5.4 million for 2012 and the effect of local currency translation on U.S.-based intangible assets.

As at December 31, 2012, the value of goodwill stood at $135.8 million, up from $91.7 million a year earlier. This $44.1 million increase in goodwill reflects the McFarland ($44.5 million) and PLS ($1.3 million) acquisitions, partially offset by the effect of local currency translation on U.S.-based goodwill.

Liabilities

As at December 31, 2012, Stella-Jones' total liabilities stood at $487.1 million, up from $285.1 million as at December 31, 2011. This variation reflects the acquisition of McFarland, including the additional long-term debt required to finance the transaction.

The value of current liabilities was $90.1 million as at December 31, 2012, up from $57.3 million a year earlier. This variation is essentially due to a $22.1 million increase in accounts payable and accrued liabilities, mainly resulting from the acquisition of McFarland, and to an $11.4 million increase in bank indebtedness representing banker's acceptance loans of $14.0 million, maturing in January and February 2013, still outstanding as at December 31, 2012.

The Company's long-term debt, including the current portion, rose to $349.6 million as at December 31, 2012, from $180.1 million as at December 31, 2011. The increase essentially reflects the additional long-term debt required to finance the acquisition of McFarland. To partially finance the transaction, the Company's committed revolving credit facility was increased from $170.0 million to $350.0 million. As at December 31, 2012, an amount of $298.1 million had been drawn against the Company's committed revolving facility.

Shareholders' equity

Shareholders' equity was $468.8 million as at December 31, 2012, compared with $331.9 million as at December 31, 2011. This increase is mainly attributable to net income of $73.1 million and net proceeds of $78.2 million from private placements of subscription receipts to partially finance the acquisition of McFarland. These factors were partially offset by dividends on common shares totalling $10.1 million. Book value stood at $27.30 per common share as at December 31, 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	**Fiscal Year Ended**	
	December 31, 2012	December 31, 2011
(thousands of dollars)	**$**	$
Operating activities	**28,516**	32,794
Financing activities	**163,541**	4,862
Investing activities	**(178,057)**	(37,656)
Cash and cash equivalents	**14,000**	—

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 credit 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 $120.8 million for the year ended December 31, 2012, up 21.2% from $99.6 million in 2011. This increase mostly reflects a higher net income for the year.

Changes in non-cash working capital components reduced liquidity by $48.6 million in 2012. Main elements of this variation include an increase of $60.1 million in inventories and a decrease of $15.2 million in accounts payable and accrued liabilities, partially offset by a $32.2 million decrease in accounts receivable. The inventory fluctuation reflects a planned increase of air-dried wood, both to improve future treating cycles and meet anticipated sales growth, while variations in accounts receivable and accounts payable and accrued liabilities result from lower business activity in the fourth quarter of 2012, compared with the same period in 2011. In 2011, changes in non-cash working capital components had reduced liquidity by $36.4 million, mainly due to a $30.2 million inventory increase.

Interest and income tax paid further reduced liquidity by $7.2 million and $36.5 million, respectively, in 2012, versus $8.6 million and $21.8 million, respectively, a year earlier. The reduction in interest paid mainly stems from lower interest rates resulting from the July 28, 2011 amendment of existing credit agreements. Meanwhile, the increase in income tax paid reflects the higher income for the year.

As a result, cash flows provided by operating activities were $28.5 million in 2012, versus $32.8 million in 2011.

Financing activities for the year ended December 31, 2012 provided liquidity of $163.5 million. The main factors explaining this cash generation were a net increase of long-term debt totalling $104.4 million, including $67.3 million in connection with the acquisition of McFarland, proceeds from the issuance of common shares of $78.5 million, primarily related to private placements of subscription receipts to partially finance the acquisition of McFarland, and an $11.4 million increase in bank indebtedness. These factors were partially offset by the payment of dividends on common shares totalling $10.1 million. For the year ended December 31, 2011, financing activities had provided liquidity of $4.9 million.

Investing activities required $178.1 million in cash during 2012, as the acquisition of McFarland resulted in a cash consideration of $162.9 million, while purchases of property, plant and equipment, required an investment of $14.8 million, including $4.5 million to begin construction of a new treating facility in Cordele, Georgia. In 2011, cash flows from investing activities had decreased liquidity by $37.7 million as a result of the acquisition of the Russellville facility.

The following table details the maturities of the financial obligations as at December 31, 2012:

(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	**14,000**	**14,000**	**14,000**	**—**	**—**	**—**
Accounts payable and accrued liabilities	**65,836**	**65,836**	**65,836**	**—**	**—**	**—**
Long-term debt obligations	**349,608**	**388,324**	**15,188**	**18,457**	**346,440**	**8,239**
Net settled interest swaps	**—**	**5,010**	**1,355**	**2,427**	**1,228**	**—**
Minimum payments under operating lease obligations	**—**	**50,133**	**10,789**	**14,020**	**7,834**	**17,490**
Non-compete agreements	**2,704**	**2,953**	**1,740**	**915**	**298**	**—**
Total	**432,148**	**526,256**	**108,908**	**35,819**	**355,800**	**25,729**

SHARE AND STOCK OPTION INFORMATION

As at December 31, 2012, the capital stock issued and outstanding consisted of 17,168,425 common shares (15,955,303 as at December 31, 2011). The following table presents the outstanding capital stock activity for the year ended December 31, 2012:

Year Ended December 31, 2012	**Number of shares (in '000s)**
Balance – Beginning of year	**15,955**
Stock option plan	**29**
Issuance of common shares	**1,176**
Employee share purchase plans	**8**
Balance – End of year	**17,168**

As at March 21, 2013, the capital stock issued and outstanding consisted of 17,169,860 common shares.

As at December 31, 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 99,700 (December 31, 2011 – 119,500) were exercisable. As at March 21, 2013, the number of outstanding options was 130,100, of which 99,700 were exercisable.

DIVIDENDS

On March 15, 2012, the Board of Directors modified the Company's dividend policy to consider the declaration of a dividend on a quarterly rather than on a semi-annual basis. Following this modification, the Board declared the following quarterly dividends in 2012:

- $0.15 per common share payable on April 30, 2012 to shareholders of record at the close of business on April 2, 2012.
- $0.15 per common share payable on June 30, 2012 to shareholders of record at the close of business on June 1, 2012.
- $0.16 per common share payable on September 28, 2012 to shareholders of record at the close of business on September 4, 2012.
- $0.16 per common share payable on December 20, 2012 to shareholders of record at the close of business on December 3, 2012.

Subsequent to the end of the year, on March 21, 2013, the Board declared a quarterly dividend of $0.20 per common share payable on April 30, 2013 to shareholders of record at the close of business on April 2, 2013.

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 $44.1 million (2011 – $27.9 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 healthy in 2013. In the railway tie market, increased freight volume on North American railroads is resulting in further investments in the continental rail network, as operators constantly seek optimal line efficiency. In the utility pole market, demand is expected to hold, 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.

Liquidity

As at December 31, 2012, the Company was in full compliance with its debt covenants and contractual obligations. In addition, as at December 31, 2012, an amount of $298.1 million had been drawn against the Company's committed revolving credit facility of $350.0 million.

Excluding McFarland, the Company's accounts receivable decreased in 2012 mostly due to lower business activity in the fourth quarter of 2012, compared with the same period in 2011. Management considers that all recorded accounts receivable 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.

Also excluding McFarland, inventories increased in 2012, mainly due to a planned increase of air-dried wood, both to improve future treating cycles and meet anticipated sales growth. 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 certain 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. For the year ended December 31, 2012, the Company's top ten customers (excluding McFarland's customers) accounted for approximately 45.4% of its sales. During this same period, the Company's two largest customers accounted for approximately 13.6% and 5.3%, respectively, of its total sales.

Availability and Cost of Raw Materials

Management considers that the Company may be affected by 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.

Compliance with these environmental laws and regulations will continue to affect the Company's operations by imposing operating and maintenance costs and requiring capital expenditures. 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, 2012, approximately 33% 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, 2012, Stella Jones International S.A. ("SJ International") owned or controlled 6,643,209 common shares of the Company, which represented approximately 38.7% of the outstanding common shares. As a result of this share ownership, SJ International has the ability to 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 interests of the other shareholders.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the December 31, 2012 and 2011 audited consolidated financial statements.

The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

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

Accounting pronouncement implemented

The IASB has amended the following accounting standard which was adopted by the Company:

IAS 1 – Presentation of Financial Statements

Presentation of items of other comprehensive income ("OCI"):
IAS 1 had been amended to require entities to separate items presented in OCI into two groups, based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled such as revaluation gains on property, plant and equipment will be presented separately from items that may be recycled in the future, such as deferred gains and losses on cash flow hedges. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

The title used by IAS 1 for the statement of comprehensive income has changed to *Statement of profit or loss and other comprehensive income*. However, IAS 1 still permits entities to use other titles.

The Company applied the amended standard effective July 1, 2012, and this application had no significant impact on the Company's consolidated financial statements.

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 consolidated 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 assessed that the adoption of these standards will not have a significant impact on its consolidated financial statements.

In June 2011, the IASB amended IAS 19, Employee Benefits, which has not yet been adopted by the Company. The Company has assessed that the adoption of this standard will not have a significant impact on its consolidated 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 assessed that the adoption of this standard will not have a significant impact on its consolidated 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 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 equity 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 AND PROCEDURES

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 ("DC&P") are designed to provide reasonable assurance that information required to be disclosed in the annual filings, interim filings or other reports filed under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to Management, including its certifying officers, as appropriate to allow timely decisions regarding required disclosure.

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 design and operating effectiveness of the Company's DC&P (as defined in Regulation 52-109 - Certification of Disclosure in Issuer's Annual and Interim Filings) as at December 31, 2012, and have concluded that such DC&P were designed and operating effectively.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

Management has evaluated the design and operating effectiveness of its ICFR (as defined in Regulation 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings). The evaluation was based on the criteria established in the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This evaluation was performed by the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer of the Company with the assistance of other Company Management and staff to the extent deemed necessary. Based on this evaluation, the President and Chief Executive Officer and the Senior Vice-President and Chief Financial Officer concluded that the ICFR were appropriately designed and operating effectively, as at December 31, 2012.

In spite of its evaluation, Management does recognize that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No changes were made to the design of ICFR during the period from October 1, 2012 to December 31, 2012 that have materially affected or are reasonably likely to materially affect the Company's ICFR.

LIMITATION ON SCOPE OF DESIGN OF DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

Our assessment of and conclusion on the design and effectiveness of the Company's DC&P and ICFR as at December 31, 2012, did not include the controls or procedures of the operations of McFarland, which were acquired on November 30, 2012 and are included in the December 31, 2012 consolidated financial statements. The Company has accordingly availed itself of provision 3.3(1)(b) of Regulation 52-109, which permits exclusion of this acquisition in the design and operating effectiveness assessment of its DC&P and ICFR for a maximum period of 365 days from the date of acquisition.

The following table summarizes the financial information for McFarland following its acquisition:

(thousands of dollars)	**One month period ended December 31, 2012**
Sales	**15,937**
Loss before income taxes	**(77)**

(thousands of dollars)	**As at December 31, 2012**
Current assets	**161,809**
Non-current assets	**136,012**
Current liabilities	**27,767**
Non-current liabilities	**4,985**

OUTLOOK

Management expects demand for the Company's core products to remain healthy in 2013. In the railway tie market, increased freight volume on North American railroads is resulting in further investments in the continental rail network, as operators constantly seek optimal line efficiency. The Association of American Railroads projects that major freight railway operators will invest US$13.0 billion in capital expenditures in 2013 to upgrade or enhance rail network capacity[1], a level comparable to last year. In the utility pole market, demand is expected to hold, 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. The integration of the McFarland operations is a key priority, and the Company believes it will benefit from greater market penetration, synergies and additional operating efficiencies from a larger network.

In the short-term, the Company will continue to focus on cash generation and on maintaining a prudent use of leverage. The solid cash flow provided by operating activities will be used to reduce debt, invest in working capital as well as in property, plant and equipment and in maintaining an optimal dividend policy to the benefit of shareholders.

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 21, 2013

[1] Association of American Railroads press release, February 6, 2013