MANAGEMENT'S DISCUSSION & ANALYSIS

Three- and six-month periods ended June 30, 2018 compared with the three- and six-month periods ended June 30, 2017

The following is Stella-Jones Inc.'s management discussion and analysis ("MD&A"). Throughout this MD&A, the terms "Company" and "Stella-Jones" shall mean Stella-Jones Inc. and shall include its independent operating subsidiaries.

This MD&A and the Company's condensed interim unaudited consolidated financial statements were approved by the Audit Committee and the Board of Directors on August 7, 2018. The MD&A provides a review of the significant developments and results of operations of the Company during the three- and six-month periods ended June 30, 2018 compared with the three- and six-month periods ended June 30, 2017. The MD&A should be read in conjunction with the Company's condensed interim unaudited consolidated financial statements for the periods ended June 30, 2018 and 2017 and the notes thereto, as well as the Company's annual consolidated financial statements and MD&A for the year ended December 31, 2017.

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 condensed interim unaudited consolidated financial statements are reported in Canadian dollars and are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and Chartered Professional Accountants ("CPA") Canada Handbook Part I, applicable to the preparation of interim financial statements, including IAS 34, *Interim Financials Reporting*. 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 the SEDAR web site 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. is a leading producer and marketer of pressure treated wood products. The Company supplies North America's railroad operators with railway ties and timbers, and the continent's electrical utilities and telecommunication companies with utility poles. Stella-Jones also manufactures and distributes residential lumber and accessories to retailers for outdoor applications, as well as industrial products which include marine and foundation pilings, construction timbers, wood for bridges and coal tar based products. The Company's common shares are listed on the Toronto Stock Exchange (TSX: SJ).

As at August 7, 2018, the Company operated thirty-nine treating plants, twelve pole peeling facilities and a coal tar distillery. These facilities are located in six Canadian provinces and nineteen American states and are complemented by an extensive distribution network across North America. As at June 30, 2018, the Company's workforce numbered approximately 2,115 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.

HIGHLIGHTS

Second Quarter of 2018

Selected Key Indicators (in millions of dollars except margins, EPS and ratio)				
Operating results	**Q2-18**	**Q2-17**	**Variation ($)**	**Variation (%)**
Sales	662.3	594.2	68.1	11.5%
Gross profit[1]	96.7	99.0	(2.3)	(2.4%)
EBITDA[1]	79.6	83.1	(3.4)	(4.1%)
EBITDA margin[1]	12.0%	14.0%	n/a	(195 bps)
Operating income[1]	71.0	74.5	(3.5)	(4.6%)
Net income	48.1	48.9	(0.8)	(1.6%)
EPS – basic & diluted	0.69	0.71	(0.02)	(2.8%)
Cash Flow				
Cash flow from operating activities	62.4	94.4	(32.0)	
Cash flow from financing activities	(16.5)	(86.0)	69.5	
Cash flow from investing activities	(46.0)	(8.3)	(37.7)	
Financial position	**As at June 30, 2018**	**As at December 31, 2017**	**Variation ($)**	
Inventories	745.7	718.5	27.2	
Long-term debt[2]	581.2	455.6	125.6	
Total debt to EBITDA ratio[1]	2.51x	1.89x	0.62	

(1) This is a non-IFRS financial measure which does not have a standardized meaning prescribed by IFRS and may therefore not be comparable to similar measures presented by other issuers. Refer to the Non-IFRS financial measures section of this MD&A.
(2) Including current portion of long-term debt.
*Numbers are rounded.

- On April 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of Wood Preservers Incorporated ("WP"), located at its wood treating facility in Warsaw, Virginia.

Year-To-Date 2018

Selected Key Indicators (in millions of dollars except margins and EPS)				
Operating results	**YTD Q2-18**	**YTD Q2-17**	**Variation ($)**	**Variation (%)**
Sales	1,061.1	991.2	69.9	7.1%
Gross profit(1)	153.1	162.8	(9.7)	(6.0%)
EBITDA(1)	123.0	132.1	(9.1)	(6.9%)
EBITDA margin(1)	11.6%	13.3%	n/a	(174 bps)
Operating income(1)	106.5	115.3	(8.8)	(7.6%)
Net income	71.2	74.8	(3.6)	(4.8%)
EPS – basic & diluted	1.03	1.08	(0.05)	(4.6%)
Cash Flow				
Cash flow from operating activities	(2.1)	101.6	(103.7)	
Cash flow from financing activities	79.9	(80.7)	160.6	
Cash flow from investing activities	(84.2)	(22.4)	(61.8)	

(1) This is a non-IFRS financial measure which does not have a standardized meaning prescribed by IFRS and may therefore not be comparable to similar measures presented by other issuers. Refer to the Non-IFRS financial measures section of this MD&A.

*Numbers are rounded.

NON-IFRS FINANCIAL MEASURES

This MD&A contains financial measures which are not prescribed by IFRS and not likely to be comparable to similar measures presented by other issuers. These measures are as follows:

- Gross Profit: Sales less cost of sales
- 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”])
- EBITDA margin: EBITDA divided by sales for the corresponding period
- Operating income
- Operating margins: Operating income divided by sales for the corresponding period
- Cash flow from operating activities before changes in non-cash working capital components and interest and income taxes paid
- Total debt to EBITDA: Long-term debt (including the current portion) divided by the twelve-month rolling EBITDA

Management considers these non-IFRS measures to be useful information to assist knowledgeable investors regarding the Company’s financial condition and operating results as they provide additional measures about its performance.

Reconciliation of EBITDA and operating income to net income* (millions of dollars)	**Three-month periods ended**		**Six-month periods ended**	
	June 30, 2018	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Net income for the period	48.1	48.9	71.2	74.8
Plus:				
Provision for income taxes	17.7	19.5	25.8	29.7
Financial expenses	5.2	6.1	9.5	10.8
Operating income	71.0	74.5	106.5	115.3
Depreciation and amortization	8.6	8.6	16.5	16.8
EBITDA	79.6	83.1	123.0	132.1

* Numbers may not add exactly due to rounding.

FOREIGN EXCHANGE

The table below shows average and closing exchange rates applicable to Stella-Jones' quarters for the years 2017 and 2018. 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 denominated in U.S. dollars.

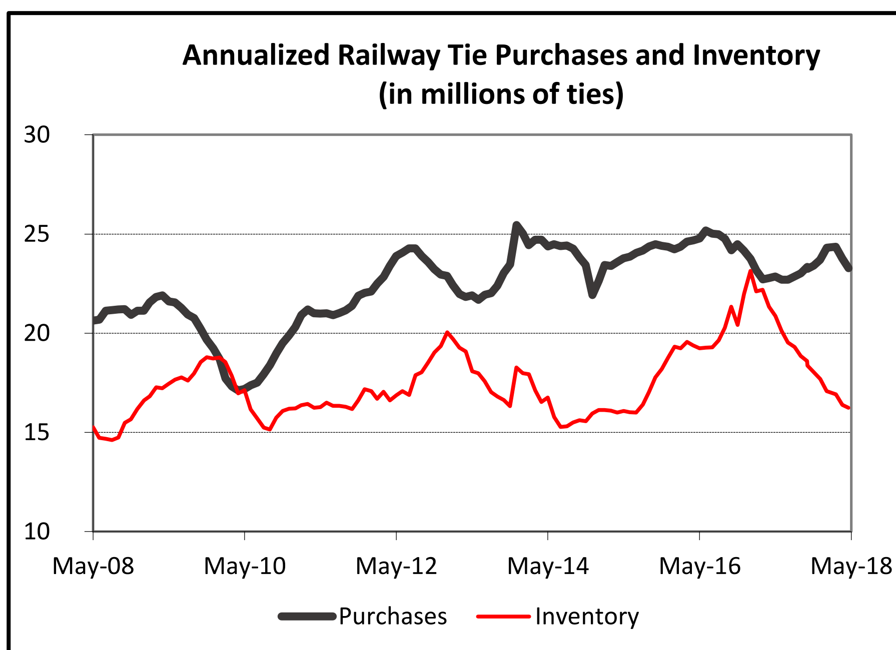
Cdn$/US$ rate	2018		2017	
	Average	Closing	Average	Closing
First Quarter	1.2549	1.2894	1.3240	1.3310
Second Quarter	1.2893	1.3168	1.3491	1.2977
Third Quarter			1.2664	1.2480
Fourth Quarter			1.2754	1.2545
Fiscal Year			1.3038	1.2545

For the second quarter:

- The depreciation of the U.S. dollar relative to the Canadian dollar from the second quarter of 2017 compared to the second quarter of 2018 (average rate), resulted in a negative impact on sales while benefiting costs of sales.
- The appreciation of the U.S. dollar relative to the Canadian dollar as at June 30, 2018, compared to December 31, 2017 (closing rate), resulted in a higher value of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

RAILWAY TIE INDUSTRY OVERVIEW

As reported by the Railway Tie Association ("RTA"), purchases for the first five months of 2018 were 8.9 million ties, versus 9.0 million ties for the same period in 2017, resulting in industry purchases of 23.3 million ties for the 12-month period ended May 31, 2018. The RTA calculates purchases based on the difference between monthly production and the change in inventory, as reported by its members. This high level of purchases led to lower industry inventory, which stood at 16.2 million ties as at May 31, 2018. As a result, the inventory-to-sales ratio was 0.71:1 as at May 31, 2018, beneath the previous ten-year average ratio of 0.79:1.



Source: Railway Tie Association

Total traffic on North American railroads increased 3.3% in the first six months of 2018, according to data released by the Association of American Railroads. Carload volume increased 1.2%, mainly due to higher shipments of petroleum and petroleum products, non-metallic minerals and chemicals, whereas the volume of intermodal trailers and containers rose 5.5% from 2017 levels.

OPERATING RESULTS

Sales

Sales for the second quarter of 2018 reached $662.3 million, versus sales of $594.2 million for the corresponding period last year. Acquisitions contributed sales of approximately $26.0 million, while the conversion effect from fluctuations in the value of the Canadian dollar, Stella-Jones' reporting currency, versus the U.S. dollar, had a negative impact of $18.6 million on the value of U.S. dollar denominated sales when compared with last year's second quarter. Excluding these factors, sales increased approximately $60.7 million, or 10.2%, due to higher residential lumber, utility pole, logs and lumber and to a lesser extent, industrial product sales, partially offset by lower railway tie sales, as detailed below.

(in millions of dollars)	Railway Ties	Utility Poles	Residential Lumber	Industrial Products	Logs & Lumber	Consolidated Sales
Q2-2017 Sales	**214.2**	**167.5**	**153.2**	**27.1**	**32.2**	**594.2**
Acquisitions	-	0.6	19.1	5.9	0.4	26.0
FX impact	(8.2)	(6.4)	(2.5)	(1.1)	(0.4)	(18.6)
Organic growth	(4.7)	17.6	33.8	0.9	13.1	60.7
Q2-2018 Sales	**201.3**	**179.3**	**203.6**	**32.8**	**45.3**	**662.3**
Organic growth %	(2.2%)	10.5%	22.1%	3.3%	40.7%	10.2%

* Numbers may not add exactly due to rounding.

For the first six months of 2018, sales amounted to $1.1 billion, versus $991.1 million for the corresponding period last year. Acquisitions contributed sales of $29.1 million, while the currency conversion effect had a negative impact of $34.8 million on the value of U.S. dollar denominated sales. Excluding these factors, sales increased approximately $75.7 million, or 7.6%, as detailed below.

(in millions of dollars)	Railway Ties	Utility Poles	Residential Lumber	Industrial Products	Logs & Lumber	Consolidated Sales
YTD 2017 Sales	**372.7**	**318.5**	**191.8**	**49.0**	**59.1**	**991.1**
Acquisitions	-	1.0	21.5	6.2	0.4	29.1
FX impact	(15.3)	(12.8)	(3.9)	(2.0)	(0.8)	(34.8)
Organic growth	(9.7)	25.6	44.5	0.4	14.9	75.7
YTD 2018 Sales	**347.7**	**332.3**	**253.9**	**53.6**	**73.6**	**1,061.1**
Organic growth %	(2.6%)	8.0%	23.2%	0.8%	25.2%	7.6%

* Numbers may not add exactly due to rounding

Railway ties

Railway tie sales for the second quarter of 2018 amounted to $201.3 million, representing a decrease of $12.9 million from sales of $214.2 million in the corresponding period last year. Excluding the currency conversion effect, railway tie sales declined approximately $4.7 million, or 2.2%, primarily as a result of the Company supporting the transition of a Class 1 railroad customer from a "treating services only" program to a full service "black-tie" program. Railway tie sales accounted for 30.4% of the Company's second-quarter sales.

For the first six months of 2018, railway tie sales totalled $347.7 million, versus $372.7 million for the corresponding period last year. Excluding the currency conversion effect, railway tie sales decreased approximately $9.7 million, or 2.6%.

Utility poles

Utility pole sales reached $179.3 million in the second quarter of 2018, up 7.1% from sales of $167.5 million in the corresponding period last year. The currency conversion effect reduced the value of U.S. dollar denominated sales by about $6.4 million when compared with the second quarter of last year. Excluding the contribution from acquisitions and the currency conversion effect, utility pole sales increased approximately $17.6 million, or 10.5%, driven by higher volume for replacement programs coupled with increased sales prices. Utility pole sales accounted for 27.1% of the Company's second-quarter sales.

For the first six months of 2018, utility pole sales totalled $332.3 million, versus $318.5 million for the corresponding period last year. Excluding the contribution from acquisitions and the currency conversion effect, utility pole sales increased approximately $25.6 million, or 8.0%.

Residential lumber

Sales in the residential lumber category totalled $203.6 million in the second quarter of 2018, versus $153.2 million for the corresponding period last year. Acquisitions contributed sales of approximately $19.1 million, while the currency conversion effect decreased the value of U.S. dollar denominated sales by about $2.5 million when compared with the same period last year. Excluding these factors, residential sales increased approximately $33.8 million, or 22.1% as a percentage of sales. This is primarily explained by higher selling prices, as a result of lumber cost escalations passed through to customers, and to increased volume due to the Company's expanding market presence. Residential lumber accounted for 30.7% of the Company's second-quarter sales.

For the first six months of 2018, residential lumber sales totalled $253.9 million, versus $191.8 million for the corresponding period last year. Excluding the contribution from acquisitions and the currency conversion effect, residential lumber sales increased approximately $44.5 million, or 23.2%.

Industrial products

Industrial product sales reached $32.8 million in the second quarter of 2018, compared with $27.1 million in the corresponding period last year. Excluding the contribution from acquisitions and the currency conversion effect, sales increased 3.3%, explained in most part by projects requiring treated laminated products. Industrial products represented 5.0% of the Company's second-quarter sales.

For the first six months of 2018, industrial product sales totalled $53.6 million, versus $49.0 million for the corresponding period last year. Excluding the contribution from acquisitions and the currency conversion effect, industrial product sales remained relatively stable.

Logs and lumber

Sales in the logs and lumber category totalled $45.3 million in the second quarter of 2018, compared with $32.2 million in the corresponding period last year. This significant variance reflects higher selling prices due to escalating lumber costs coupled with increased harvesting activity related to procurement activities to support strong pole sales. Since this product category does not generate any margin, sales growth will further reduce overall margins as a percentage of sales. Logs and lumber sales represented 6.8% of the Company's second-quarter sales.

For the first six months of 2018, logs and lumber sales totalled $73.6 million, versus $59.1 million for the corresponding period last year. Excluding the contribution from acquisitions and the currency conversion effect, logs and lumber sales increased approximately $14.9 million, or 25.2%.

Sales by destination

Sales in the United States in the second quarter of 2018 amounted to $409.9 million, representing 62.0% of total sales, versus $396.1 million in the corresponding period last year. This year-over-year increase is mainly attributable to higher sales in the residential lumber, logs and lumber, industrial products and utility poles product categories, partially offset by lower railway tie sales and the effect of local currency translation on U.S.-dollar denominated sales. For the first six months of 2018, sales in the United States stood at $708.9 million, up from $701.7 million in the corresponding period last year.

Sales in Canada in the second quarter of 2018 reached $252.4 million, representing 38.0% of total sales, compared with $198.1 million in the corresponding period last year. This year-over-year increase primarily reflects higher sales in the residential lumber product category, driven by acquisitions, organic growth and higher year-over-year selling prices due to increased lumber costs. Moreover, the increase was also impacted by higher sales in the utility pole and logs and lumber product categories. For the first six months of 2018, sales in Canada stood at $352.2 million, up from $289.4 million in the corresponding period last year.

Cost of sales
Cost of sales, including depreciation of property, plant and equipment, as well as amortization of intangible assets, was $565.6 million, or 85.4% of sales, in the second quarter of 2018. This compares with $495.2 million, or 83.3% of sales, for the corresponding period last year. The increase in absolute dollars is primarily explained by the sharp increase in untreated railway tie costs in the second quarter and the Company's support of the transition of a Class 1 railroad customer from a "treating services only" program to a full service "black-tie" program. To accelerate this transition, the Company acquired untreated railway ties from the Class 1 railroad customer which increased cost of sales once these ties were treated and sold. The increase is also attributable to higher operating costs in the U.S. Southeast where Stella-Jones continues to focus on reducing its cost base and improving logistical flow. In addition, the higher lumber costs, which are passed through towards customers via higher selling prices, have contributed to increased cost of sales but have also put downward pressure on margins as a percentage of sales. These cost increases were partially offset by the effect of currency translation. Depreciation and amortization charges reached $8.6 million in the second quarter of 2018, in line with the corresponding period last year. As a result, gross profit reached $96.7 million, or 14.6% of sales, in the second quarter of 2018, compared with $99.0 million, or 16.7% of sales, in the corresponding period last year.

For the first six months of 2018, cost of sales amounted to $907.9 million, or 85.6% of sales, versus $828.3 million, or 83.6% of sales, in the corresponding period last year. Depreciation and amortization reached $16.5 million in the first six months of 2018, versus $16.8 million in the corresponding period last year. As a result, gross profit stood at $153.1 million, or 14.4% of sales, in the first six months of 2018, compared with $162.8 million, or 16.4% of sales, in the corresponding period last year.

Selling and administrative
Selling and administrative expenses for the second quarter of 2018 were $25.8 million, compared with expenses of $26.2 million in the corresponding period last year. This decrease is explained by $835,000 in expenses transferred to cost of goods sold, coupled with the favourable effect of currency translation, partially offset by incremental acquisition costs of $477,000, as well as higher selling expenses. As a percentage of sales, selling and administrative expenses represented 3.9% of sales in the second quarter of 2018, down from 4.4% in the corresponding period last year.

For the first six months of 2018, selling and administrative expenses amounted to $48.0 million, or 4.5% of sales, compared with $49.1 million, or 4.9% of sales, in the corresponding period last year.

Other gains, net
Stella-Jones' other net gains of $150,000 for the second quarter of 2018, essentially consisted of a gain related to the mark-to-market effect of diesel and petroleum derivative commodity contracts. Last year's other net gains of $1.7 million essentially consisted of a $2.5 million reversal of a provision for site remediation as well as a $835,000 foreign exchange gain. These factors were partially offset by a $772,000 loss related to the mark-to-market effect of diesel and petroleum derivative commodity contracts and by a $535,000 expense on freight and distribution accruals.

In the first six months of 2018, other net gains totalled $1.4 million, as compared to $1.5 million in the corresponding period last year.

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 company. 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 for the three- and six-month periods ended June 30, 2018 amounted to $5.2 million and $9.5 million respectively, down from $6.1 million and $10.8 million respectively, in the corresponding periods last year. These variations reflect lower year-over-year borrowings, coupled with the effect of local currency conversion on financial expenses related to the Company's U.S. dollar denominated borrowings.

Income before income taxes and income tax expense

Stella-Jones generated income before income taxes of $65.8 million, or 9.9% of sales, in the second quarter of 2018, versus income before income taxes of $68.4 million, or 11.5% of sales, in the corresponding period last year. Stella-Jones' provision for income taxes totalled $17.7 million in the second quarter of 2018, representing an effective tax rate of 26.9%. In the second quarter of 2017, the income tax expense stood at $19.5 million, equivalent to an effective tax rate of 28.5%.

For the first half of 2018, income before income taxes stood at $97.0 million, or 9.1% of sales, while the provision for income taxes amounted to $25.8 million, representing an effective tax rate of 26.6%. In the first half of 2017, income before income taxes was $104.5 million, or 10.5% of sales, while the provision for income taxes amounted to $30.0 million, representing an effective tax rate of 28.4%.

For the three- and six-month periods ended June 30, 2018, the year-over-year decrease in income before income taxes resulted from the decrease in gross profit. The lower effective tax rate for the three- and six-month periods ended June 30, 2018 reflects changes to the U.S. Federal Corporate income tax rate following the enactment of the Tax Cuts and Jobs Act on December 22, 2017.

Net income

Net income for the second quarter of 2018 reached $48.1 million, or $0.69 per diluted share, versus net income of $48.9 million, or $0.71 per diluted share, in the corresponding period last year.

For the first six months of 2018, net income totalled $71.2 million, or $1.03 per diluted share, compared with $74.8 million, or $1.08 per diluted share, in the corresponding period last year.

BUSINESS ACQUISITIONS

Wood Preservers Incorporated

On April 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of WP, located at its wood treating facility in Warsaw, Virginia. WP manufactures, sells and distributes marine and foundation pilings and treated wood utility poles.

Total cash outlay associated with the acquisition was approximately $27.5 million (US$21.6 million), excluding acquisition costs of approximately $423,000 recognized in the interim consolidated statement of income under selling and administrative expenses. The Company financed the acquisition through its existing syndicated credit facilities. The consideration transferred also contains a balance of purchase price bearing no interest and payable annually on the anniversary of the transaction in six instalments of US$500,000. This balance of purchase price was recorded at a fair value of $3.3 million (US$2.6 million), using an effective interest rate of 4.17%.

The following fair value determination of the assets acquired and liabilities assumed is preliminary and is based on Management's best estimates and information known at the time of preparing the interim consolidated financial statements. This fair value determination is expected to be completed within twelve months of the acquisition date and consequently, significant changes could occur mainly with respect to intangible assets, goodwill and deferred income taxes.

The following is a summary of the 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 millions of dollars)	
Assets acquired	
Accounts receivable	3.9
Inventories	8.5
Property, plant and equipment	18.2
Customer relationships	0.2
Goodwill	2.4
Total assets acquired	**33.2**
Liabilities assumed	
Accounts payable and accrued liabilities	0.6
Deferred income tax liabilities	1.1
Total net assets acquired and liabilities assumed	**31.5**
Consideration transferred	
Cash	27.5
Consideration payable	0.7
Balance of purchase price	3.3
Consideration transferred	**31.5**

Prairie Forest Products

On February 9, 2018, the Company completed the acquisition of substantially all of the operating assets employed in the business of Prairie Forest Products ("PFP"), a division of Prendiville Industries Ltd., located at its wood treating facility in Neepawa, Manitoba, as well as at its peeling facility in Birch River, Manitoba. PFP manufactures treated wood utility poles as well as treated residential lumber.

Total cash outlay associated with the acquisition was approximately $27.0 million excluding acquisition costs of approximately $425,000 of which $159,000 was recognized in the 2017 consolidated statement of income under selling and administrative expenses. The Company financed the acquisition through its existing syndicated credit facilities.

The following fair value determination of the assets acquired and liabilities assumed is preliminary and is based on Management's best estimates and information known at the time of preparing the interim consolidated financial statements. This fair value determination is expected to be completed within twelve months of the acquisition date and consequently, significant changes could occur mainly with respect to intangible assets, goodwill and deferred income taxes.

The following is a summary of the assets acquired, the liabilities assumed and the consideration transferred at fair value as at the acquisition date.

(Tabular information presented in millions of dollars)	
Assets acquired	
Inventories	10.5
Property, plant and equipment	7.8
Customer relationships	5.9
Goodwill	4.0
Deferred income tax assets	0.2
Total assets acquired	**28.4**
Liabilities assumed	
Site remediation provision	1.4
Total net assets acquired and liabilities assumed	**27.0**
Consideration transferred	
Cash	27.0
Consideration transferred	**27.0**

SUBSEQUENT EVENT

On July 24, 2018, the Company announced the intention of Stella Jones International S.A. to sell its remaining share ownership in the Company through a bought public offering and concurrent private placement. In connection therewith, the Company filed a preliminary short form prospectus on July 30, 2018. The transaction is expected to close on or about August 14, 2018.

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. The table below sets forth selected financial information for the Company's last ten quarters.

2018

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(millions of dollars, except per share data)					
Sales	398.8	662.3			
EBITDA [(1)]	43.4	79.6			
Operating income [(1)]	35.5	71.0			
Net income for the period	23.1	48.1			
Earnings per common share Basic and diluted	0.33	0.69			

2017

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(millions of dollars, except per share data)					
Sales	396.9	594.2	517.6	377.4	1,886.1
EBITDA[(1)]	49.1	83.1	71.3	37.1	240.6
Operating income [(1)]	40.8	74.5	63.1	29.0	207.4
Net income for the period	25.9	48.9	42.0	51.1	167.9
Earnings per common share Basic and diluted	0.37	0.71	0.61	0.74	2.42

2016

For the quarters ended	March 31	June 30	Sept. 30	Dec. 31	Total
(millions of dollars, except per share data)					
Sales	421.0	563.1	512.6	341.7	1,838.4
EBITDA[(1)]	61.7	89.9	76.3	36.9	264.8
Operating income [(1)]	54.6	83.2	67.3	28.2	233.2
Net income for the period	35.0	54.7	45.7	18.5	153.9
Earnings per common share Basic and diluted	0.51	0.79	0.66	0.27	2.22

(1) Operating income before depreciation of property, plant and equipment and amortization of intangible assets ("EBITDA") 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 the 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 the interim consolidated financial statements, as there are no adjustments for unusual or non-recurring items.

Note: due to rounding, the sum of results for the quarters may differ slightly from the total shown for the full year.

STATEMENT OF FINANCIAL POSITION

As a majority of the Company's assets and liabilities are denominated in U.S. dollars, exchange rate variations may significantly affect their value. As such, the appreciation of the U.S. dollar relative to the Canadian dollar as at June 30, 2018, compared to December 31, 2017 (see "Foreign Exchange" on page 4), results in a higher value of assets and liabilities denominated in U.S. dollars, when expressed in Canadian dollars.

Assets

As at June 30, 2018, total assets reached $2.08 billion, versus $1.79 billion as at December 31, 2017. The higher balance of total assets mostly reflects an increase in current assets, as detailed below.

Assets (in millions of dollars)	**As at June 30, 2018**	**As at December 31, 2017**	**Variance**
Accounts Receivable	320.6	163.5	157.1
Inventories	745.7	718.5	27.2
Other current assets	41.9	26.4	15.5
Total current assets	**1,108.2**	**908.4**	**199.8**
Property, plant and equipment	531.9	472.0	59.9
Intangible assets	131.0	124.4	6.6
Goodwill	290.0	270.3	19.7
Other non-current assets	14.0	10.9	3.1
Total non-current assets	**966.9**	**877.6**	**89.3**
TOTAL ASSETS	**2,075.1**	**1,786.0**	**289.1**

* Numbers may not add exactly due to rounding.

The value of accounts receivable was $320.6 million as at June 30, 2018, compared with $163.5 million as at December 31, 2017. The increase is attributable to higher sales in the second quarter of 2018, when compared to the fourth quarter of 2017, as per normal seasonal demand patterns, coupled with the effect of local currency translation on U.S.-based accounts receivable. Management considers that all recorded receivables in the statement of financial position are fully collectible as major customers, mainly Class 1 railroad operators, large retailers and large-scale utility service providers, have good credit standing and limited history of default.

Inventories stood at $745.7 million as at June 30, 2018, up from $718.5 million as at December 31, 2017. This increase reflects the effect of local currency translation on U.S. dollar denominated inventories and the inventories pertaining to the PFP and WP acquisitions as well as the value of untreated railway ties acquired from a Class 1 railroad customer transitioning from a "treating services only" program to a full service "black-tie" program. This increase in inventories was partially offset by a normal seasonal decline in inventory volumes related to strong second quarter sales.

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. As such, inventory turnover has historically been relatively low. In addition, important raw material and finished goods inventory are required at certain times of the year to support the residential lumber product category. However, solid relationships and long-term contracts with customers enable the Company to better ascertain inventory requirements. Management continuously monitors the levels of inventory and market demand for its products. Production is adjusted accordingly to optimize efficiency and capacity utilization. The Company believes that its cash flow from operations and available syndicated credit facilities are adequate to meet its working capital requirements for the foreseeable future.

The value of property, plant and equipment stood at $531.9 million as at June 30, 2018, compared with $472.0 million as at December 31, 2017. This increase is mainly related to the purchase of property, plant and equipment of $27.0 million during the first six months of 2018, the additional property, plant and equipment from recent acquisitions totalling $26.0 million and the effect of local currency translation on U.S-based property, plant and equipment, partially offset by depreciation totalling $9.6 million for the period.

The value of intangible assets and goodwill reached $131.0 million and $290.0 million, respectively, as at June 30, 2018. Intangible assets include customer relationships, the discounted value of the non-compete agreements, a creosote registration, cutting rights, standing timber and a favourable lease agreement. As at December 31, 2017, intangible assets and goodwill were $124.4 million and $270.3 million, respectively. The increase in the value of intangible assets stems from the effect of local currency translation on U.S.-based intangible assets, coupled with $6.1 million of customer relationships acquired as part of the PFP and WP acquisitions, partially offset by an amortization charge of $6.9 million in the first six months of 2018. The increase in goodwill is primarily explained by acquisitions and the effect of local currency translation on U.S. dollar denominated goodwill.

Liabilities

As at June 30, 2018, Stella-Jones' total liabilities stood at $860.8 million, up from $670.4 million as at December 31, 2017. This variation mainly reflects an increase in non-current liabilities, as detailed below.

Liabilities (in millions of dollars)	**As at June 30, 2018**	**As at December 31, 2017**	**Variance**
Accounts payable & accrued liabilities	165.8	111.2	54.6
Current portion of long-term debt	9.9	5.7	4.2
Other current liabilities	11.4	12.1	(0.7)
Total current liabilities	**187.1**	**129.0**	**58.1**
Long-term debt	571.3	449.9	121.4
Other non-current liabilities	102.4	91.5	10.9
Total non-current liabilities	**673.7**	**541.4**	**132.3**
TOTAL LIABILITIES	**860.8**	**670.4**	**190.4**

* Numbers may not add exactly due to rounding.

The value of current liabilities was $187.1 million as at June 30, 2018, versus $129.0 million as at December 31, 2017. This variation is primarily attributable to a $54.6 million increase in accounts payable and accrued liabilities when compared to the fourth quarter of 2017, as a result of greater business activity in the second quarter of 2018, coupled with the effect of local currency translation on U.S. dollar denominated accounts payable and accrued liabilities.

The Company's long-term debt, including the current portion, was $581.2 million as at June 30, 2018, versus $455.6 million as at December 31, 2017. The increase mainly reflects higher working capital requirements, financing required for the acquisitions of PFP and WP, higher capital expenditures as well as the effect of local currency translation on U.S. dollar denominated long-term debt. As at June 30, 2018, an amount of $201.6 million was available against the Company's syndicated credit facilities of $559.6 million (US$425.0 million).

As at June 30, 2018, the Company is in full compliance with its debt covenants and contractual obligations.

Shareholders’ equity

Shareholders’ equity reached $1.21 billion as at June 30, 2018 compared with $1.12 billion as at December 31, 2017. This variation reflects an increase in retained earnings and accumulated other comprehensive income as detailed below.

Shareholders’ Equity (in millions of dollars)	**As at June 30, 2018**	**As at December 31, 2017**	**Variance**
Capital Stock	221.1	220.5	0.6
Contributed surplus	0.3	0.3	-
Retained earnings	864.3	809.0	55.3
Accumulated other comprehensive income	128.6	85.8	42.8
TOTAL SHAREHOLDERS’ EQUITY	**1,214.3**	**1,115.5**	**98.8**

* Numbers may not add exactly due to rounding.

The increase is attributable to net income of $71.2 million during the first six months of 2018 and a $42.8 million favourable variation in the value of accumulated other comprehensive gain resulting from the effect of currency fluctuations, partially offset by dividends of $16.6 million.

LIQUIDITY AND CAPITAL RESOURCES

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

Summary of cash flows	**Three-month periods ended**		**Six-month periods ended**	
(millions of dollars)	**June 30, 2018**	**June 30, 2017**	**June 30, 2018**	**June 30, 2017**
Operating activities	62.4	94.4	(2.1)	101.6
Financing activities	(16.5)	(86.0)	79.9	(80.7)
Investing activities	(46.0)	(8.3)	(84.2)	(22.4)
Net change in cash and cash equivalents during the period	-	0.1	(6.4)	(1.5)
Cash and cash equivalents - beginning	-	2.1	6.4	3.7
Cash and cash equivalents - end	**-**	**2.2**	**-**	**2.2**

* Numbers may not add exactly due to rounding.

The Company’s activities, acquisitions and purchases of property, plant and equipment are primarily financed by cash flows from operating activities, available cash, long-term debt and the issuance of common shares. The Company plans on spending between $30.0 million to $40.0 million on property, plant and equipment in 2018, half of which is related to efficiency improvements with the balance dedicated to sustaining operations. The Company’s syndicated credit facilities are made available for a five-year term and thus considered long-term debt.

Cash flows from operating activities

Cash flows provided by operating activities in the second quarter of 2018 was $62.4 million, versus $94.4 million for the corresponding period last year. This variation mainly reflects changes in non-cash working capital components, as detailed below.

Cash flow from operating activities (in millions of dollars)	**Q2-18**	**Q2-17**	**YTD Q2-18**	**YTD Q2-17**
Net income	48.1	48.9	71.2	74.8
Current income tax expense	10.1	13.8	15.9	22.2
Deferred income taxes	7.7	5.7	9.9	7.4
Other	15.8	14.8	29.7	29.1
Cash flow from operating activities before changes in non-cash working capital components & interest & income tax paid	**81.7**	**83.2**	**126.7**	**133.6**
Accounts receivable	(91.0)	(91.8)	(145.3)	(127.9)
Inventories	76.3	108.5	16.8	85.0
Prepaid expenses	(4.4)	(1.1)	(14.9)	3.2
Accounts payable & accrued liabilities	20.9	12.8	49.3	34.2
Other	(1.8)	(3.9)	(3.6)	(4.5)
Changes in non-cash working capital components	**-**	**24.5**	**(97.7)**	**(10.1)**
Interest paid	(3.4)	(3.0)	(9.4)	(7.8)
Income taxes paid	(15.9)	(10.4)	(21.6)	(14.2)
Cash flow from operating activities	**62.4**	**94.4**	**(2.1)**	**101.6**

* Numbers may not add exactly due to rounding.

Cash flow from operating activities before changes in non-cash working capital components and interest and income tax paid was $81.7 million in the second quarter of 2018, compared with $83.2 million for the corresponding period last year. This decrease mostly reflects a lower income tax expense.

Changes in non-cash working capital components was flat in the second quarter of 2018 as increases in accounts receivable and prepaid expenses of $91.0 million and $4.4 million, respectively, were offset by a decrease in inventories and an increase in accounts payable and accrued liabilities of $76.3 million and $20.9 million respectively. In the second quarter of 2017, changes in non-cash working capital components had increased liquidity by $24.5 million.

Interest and income taxes paid reduced liquidity by $3.4 million and $15.9 million, respectively, in the second quarter of 2018. This compares with interest paid of $3.0 million and income taxes paid of $10.4 million in the corresponding period last year.

For the first six months of 2018, cash flow from operating activities before changes in non-cash working capital components and interest and income tax paid stood at $126.7 million, compared with $133.6 million in the corresponding period last year. Changes in non-cash working capital components reduced liquidity by $97.7 million in the first six months of 2018, compared with a liquidity reduction of $10.1 million in the first six months of 2017. Interest and income taxes paid further reduced liquidity by $9.4 million and $21.6 million, respectively, in the first half of 2018, compared with liquidity reductions of $7.8 million and $14.2 million, respectively, a year earlier. As a result, cash flows used by operating activities was $2.1 million in the first six months of 2018, versus an inflow of $101.6 million in the corresponding period last year.

Cash flows from financing activities

Financing activities for the second quarter of 2018 reduced liquidity by $16.5 million, primarily related to $16.6 million in dividend payments on common shares. For the second quarter of 2017, financing activities reduced liquidity by $86.0 million due to a $60.1 million reduction in borrowings on the syndicated credit facilities, as the Company used its solid operating cash flow to reduce debt, combined with a $15.3 million dividend payment on common shares.

Cash flow from financing activities (in millions of dollars)	**Q2-18**	**Q2-17**	**YTD Q2-18**	**YTD Q2-17**
Net change in syndicated credit facilities	5.2	(60.1)	101.7	(249.9)
Increase in long-term debt	-	-	-	195.9
Dividends on common shares	(16.6)	(15.3)	(16.6)	(15.3)
Other	(5.1)	(10.6)	(5.2)	(11.4)
Cash flow from financing activities	**(16.5)**	**(86.0)**	**79.9**	**(80.7)**

* Numbers may not add exactly due to rounding.

For the first six months of 2018, financing activities increased liquidity by $79.9 million, as opposed to a reduction in liquidity of $80.7 million in the first six months of 2017.

Cash flows from investing activities

Investing activities used $46.0 million in liquidity in the second quarter of 2018, as compared to $8.3 million in the corresponding period last year. This variation is mainly explained by the business acquisition of WP for $27.5 million, a consideration adjustment of $500,000 for the PFP acquisition and the purchase of property, plant and equipment for $15.5 million as detailed below.

Cash flow from investing activities (in millions of dollars)	**Q2-18**	**Q2-17**	**YTD Q2-18**	**YTD Q2-17**
Business acquisitions	(28.0)	-	(54.5)	-
Purchase of property, plant and equipment	(15.5)	(9.0)	(27.0)	(20.7)
Other	(2.5)	0.7	(2.7)	(1.7)
Cash flow from investing activities	**(46.0)**	**(8.3)**	**(84.2)**	**(22.4)**

* Numbers may not add exactly due to rounding.

For the first six months of 2018, investing activities reduced liquidity by $84.2 million, driven by the PFP and WP acquisitions as well as purchases of property, plant and equipment of $27.0 million. This compares to a reduction in liquidity of $22.4 million from investing activities for the same period in 2017, explained in most part by purchases of property, plant and equipment of $20.7 million.

Financial Obligations

The following table details the maturities of the financial obligations as at June 30, 2018:

(in millions of dollars)	**Carrying Amount**	**Contractual Cash flow**	**Less than 1 year**	**1 – 3 years**	**4 – 5 years**	**After 5 years**
Accounts payable and accrued liabilities	165.8	165.8	165.8	-	-	-
Long-term debt obligations	581.2	689.6	28.8	58.3	384.6	217.9
Minimum payments under operating lease obligations	-	106.4	26.9	37.5	18.8	23.2
Non-compete agreements	4.3	4.7	1.8	2.9	-	-
Total	**751.3**	**966.5**	**223.3**	**98.7**	**403.4**	**241.1**

SHARE AND STOCK OPTION INFORMATION

As at June 30, 2018, the capital stock issued and outstanding consisted of 69,356,387 common shares (69,342,095 as at December 31, 2017). The following table presents the outstanding capital stock activity for the three- and six-month periods ended June 30, 2018:

Number of shares (in '000s)	Three-month Period Ended June 30, 2018	Six-month Period Ended June 30, 2018
Balance – Beginning of period	69,349	69,342
Employee share purchase plans	7	14
Balance – End of period	**69,356**	**69,356**

As at August 7, 2018, the capital stock issued and outstanding consisted of 69,356,387 common shares.

As at June 30, 2018, the number of outstanding options to acquire common shares issued under the Company's Stock Option Plan was 45,000 (December 31, 2017 – 45,000) of which 33,000 (December 31, 2017 – 33,000) were exercisable. As at August 7, 2018, the number of outstanding options was 45,000, of which 33,000 were exercisable.

DIVIDENDS

On August 7, 2018, the Board of Directors declared a quarterly dividend of $0.12 per common share payable on September 21, 2018 to shareholders of record at the close of business on September 3, 2018.

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 2017 Annual Report.

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 2017 Annual Report.

SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2 to the December 31, 2017 audited consolidated financial statements as well as in the impact of new accounting pronouncements MD&A section with regards to accounting policy changes for revenue recognition and financial instruments.

The Company prepares its consolidated financial statements in accordance with IFRS as issued by the IASB and CPA Canada Handbook Part I.

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, determination of the fair value of the assets acquired and liabilities assumed in the context of an acquisition 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.

Impact of new accounting pronouncements

IFRS 15 – *Revenue from Contracts with Customers*
In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, to specify how and when to recognize revenue as well as requiring the provision of more informative and relevant disclosures. IFRS 15 supersedes IAS 18, *Revenue*, IAS 11, *Construction Contracts*, and other revenue related interpretations. The adoption of this new standard had no significant impact on the Company's interim consolidated financial statements and the new accounting policy was defined as follows:

The Company sells treated wood products and wood products (the "Products"), as well as treating services. Revenue from the sale of Products is recognized when the Company satisfies a performance obligation by transferring a promised product to a customer. Products are transferred when the customer obtains control of the Products, being either at the Company's manufacturing site or at the customer's location. Control of the Products refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the Product.

The Company offers to treat wood products owned by third parties. Revenue from these treating services is recognized using the point in time criteria since there is a short timeframe to treat wood products.

Product sales can be subject to retrospective volume discounts based on aggregate sales over a twelve months period per certain contractual conditions. Revenue from these sales is recognized based on the price specified in a contract, net of the estimated volume discounts. Accumulated experience is used to estimate and provide for the discounts, using the expected value method, and revenue is only recognized to the extent that it is highly probable that the contractual conditions will be met. A contract liability is recognized for expected volume discounts payable to customers in relation to sales made until the end of the reporting period.

Products sales can also be subject to retrospective price discounts based on aggregate sales over a twelve months period per certain contractual conditions. Revenue from these sales is recognized based on the expected average sales price over the specified period. Accumulated experience is used to estimate and provide for the price discounts, using the expected value method, and revenue is only recognized to the extent that it is highly probable that the contractual conditions will be met. The customer is invoiced at the contract price and a liability is recognized to adjust to the average price.

A receivable is recognized when control of the Product is transferred because it is at this point in time that the consideration becomes unconditional since only the passage of time remains before payment is due.

IFRS 9 – *Financial Instruments*
The final version of IFRS 9, *Financial instruments*, was issued by the IASB in July 2014 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces a model for classification and measurement, a single, forward-looking expected loss impairment model and a substantially reformed approach to hedge accounting. The new single, principle-based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of an entity's own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. The adoption of this new standard had no significant impact on the Company's interim consolidated financial statements and the new accounting policy was defined as follows:

The Company recognizes a financial asset or a financial liability in its statement of financial position when it becomes party to the contractual provisions of the instrument. At initial recognition, the Company measures a financial asset or a financial liability at its fair value plus or minus, in the case of a financial asset or a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or the financial liability.

Financial assets
The Company will classify financial assets as subsequently measured at amortized cost, fair value through other comprehensive income or fair value through profit or loss, based on its business model for managing the financial asset and the financial asset's contractual cash flow characteristics. The three categories are defined as follows:

a) Amortized cost—a financial asset is measured at amortized cost if both of the following conditions are met:

    - the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
    - the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

b) Fair value through other comprehensive income—financial assets are classified and measured at fair value through other comprehensive income if they are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

c) Fair value through profit or loss—any financial assets that are not held in one of the two business models mentioned are measured at fair value through profit or loss.

When, and only when, the Company changes its business model for managing financial assets it must reclassify all affected financial assets.

The Company financial assets comprise of cash, cash equivalents, accounts receivable and derivative financial instruments. Cash, cash equivalents and accounts receivable are measured at amortized cost. Derivative financial instruments that are not designated as hedging instruments are measured at fair value through profit or loss. Derivative financial instruments that are designated as hedging instruments are measured at fair value through other comprehensive income.

Financial liabilities
The Company's liabilities include accounts payable and accrued liabilities, bank indebtedness, long-term debt and derivative financial instruments. Accounts payable and accrued liabilities, bank indebtedness and long-term debt are measured at amortized cost. Derivative financial instruments that are not designated as hedging instruments are measured at fair value through profit or loss. Derivative financial instruments that are designated as hedging instruments are measured fair value through other comprehensive income. After initial recognition, an entity cannot reclassify any financial liability.

Impairment
The Company assesses, on a forward looking basis the expected credit losses associated with its debt instruments carried at amortized cost and fair value through other comprehensive income. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, the Company applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognized from initial recognition of the receivables.

Hedging transactions
As part of its hedging strategy, the Company considers derivative financial instruments such as foreign exchange forward contracts to limit its exposure under contracted cash inflows of sales denominated in U.S. dollars from its

Canadian-based operations. The Company also considers interest rate swap agreements in order to reduce the impact of fluctuating interest rates on its short-term and long-term debt. These derivative financial instruments are treated as cash flow hedges for accounting purposes and are fair-valued through other comprehensive income.

The effective portion of changes in the fair value of derivative instruments that are designated and qualify as cash flow hedges is recognized in the cash flow hedge reserve within equity. The gain or loss relating to the ineffective portion is recognized immediately in profit or loss, within other income (expenses).

When forward contracts are used to hedge forecast transactions, the Company generally designates only the change in fair value of the forward contract related to the spot component as the hedging instrument. Gains or losses relating to the effective portion of the change in the spot component of the forward contracts are recognized in the cash flow hedge reserve within equity. The change in the forward element of the contract that relates to the hedged item ('aligned forward element') is recognized within other comprehensive income in the costs of hedging reserve within equity. In some cases, the entity may designate the full change in fair value of the forward contract (including forward points) as the hedging instrument. In such cases, the gains or losses relating to the effective portion of the change in fair value of the entire forward contract are recognized in the cash flow hedge reserve within equity. Amounts accumulated in equity are reclassified in the periods when the hedged item affects profit or loss.

When a hedging instrument expires, or is sold or terminated, or when a hedge no longer meets the criteria for hedge accounting, any cumulative deferred gain or loss and deferred costs of hedging in equity at that time remains in equity until the forecast transaction occurs, resulting in the recognition of a non-financial asset. When the forecast transaction is no longer expected to occur, the cumulative gain or loss and deferred costs of hedging that were reported in equity are immediately reclassified to profit or loss.

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 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 June 30, 2018 and have concluded that such DC&P were designed 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 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 effectively designed, as at June 30, 2018.

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 April 1, 2018 to June 30, 2018 that have materially affected or are reasonably likely to materially affect the Company's ICFR.

OUTLOOK

The Company's railway tie and utility pole product categories are essential components of the North American basic transportation and utility infrastructure. Such infrastructure needs to be regularly maintained which provides Stella-Jones with relatively steady demand for these 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 and assuming stable currencies, Management expects higher year-over-year overall sales for Stella-Jones driven by pricing as well as increased market reach for the residential lumber, utility pole and logs and lumber product categories. Operating margins are expected to improve in the second half of 2018 when compared to the first half of the year. However, the progression of operating margins in the second half of 2018 will be slowed down by increasing untreated railway tie costs until sales prices can be adjusted. The Company plans on spending between $30.0 million and $40.0 million on property, plant and equipment in 2018 and its overall effective tax rate is expected to be approximately 26.5%.

In the railway tie product category, North American railroads will continue to maintain their continental rail network, as operators constantly seek optimal line efficiency. Sales for the first half of 2018 were impacted by softer pricing and the transition of a Class 1 railroad customer from a "treating services only" program to a full service "black-tie" program. Pricing is expected to improve in the second half of 2018 but the related margin gains will be partially offset by rapidly increasing costs of untreated railway ties due to the tightening of supply. Management expects that this raw material cost increase will lead to continued upward selling price adjustments in the quarters ahead. These adjustments will have a positive effect on margins in 2019.

In the utility pole product category, demand for regular maintenance projects has historically been relatively steady. Sales for the first six months of 2018 benefited from both pricing adjustments and strong demand. Management expects that this trend will be maintained for the remainder of the year. The Company also expects a better sales mix within the product category for the upcoming quarters. However, these factors will be partially impacted by slight cost increases for certain wood species, and the timing of price adjustments. In addition, the Company continues to focus on reducing its operational costs in the U.S. Southeast, which will lead to improved margins in the second half of 2018.

In the residential lumber product category, the Company expects to further benefit from continued demand for new construction and outdoor renovation projects in the North American residential and commercial markets. Similar to the first half of 2018, sales for second half of 2018 are expected to increase year-over-year as the Company expands its market reach and benefits from increased pricing driven by higher wood cost. The effect of adjusting residential lumber selling prices as a result of higher wood costs will have a slight downward impact on operating margins as a percentage of sales for the year.

Sales for the logs and lumber product category, an activity used to optimize procurement, will continue to grow as a result of increased harvesting activities and the impact of persistently high cost of lumber. Since this business does not generate any margin, sales growth in this product category will further reduce overall margins as a percentage of sales.

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 market opportunities in all product categories. The Company will also remain focused on improving operating efficiencies throughout the organization.

In the short-term, the Company will focus on integrating the PFP and WP acquisitions as well as optimizing operating capacity and minimizing costs throughout the organization. Cash generation and maintaining a prudent use of leverage remain priorities for Management. The solid cash flows provided from 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, as Management believes that the fundamentals of each product category will remain strong. A solid financial position will allow Stella-Jones to continue to seek opportunities to further expand its presence in its core markets. These opportunities must meet its stringent investment requirements, provide synergies, and add value for shareholders.

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