Hardwoods Distribution Income Fund

First Annual Report to Unitholders

For the period
March 23 to December 31, 2004

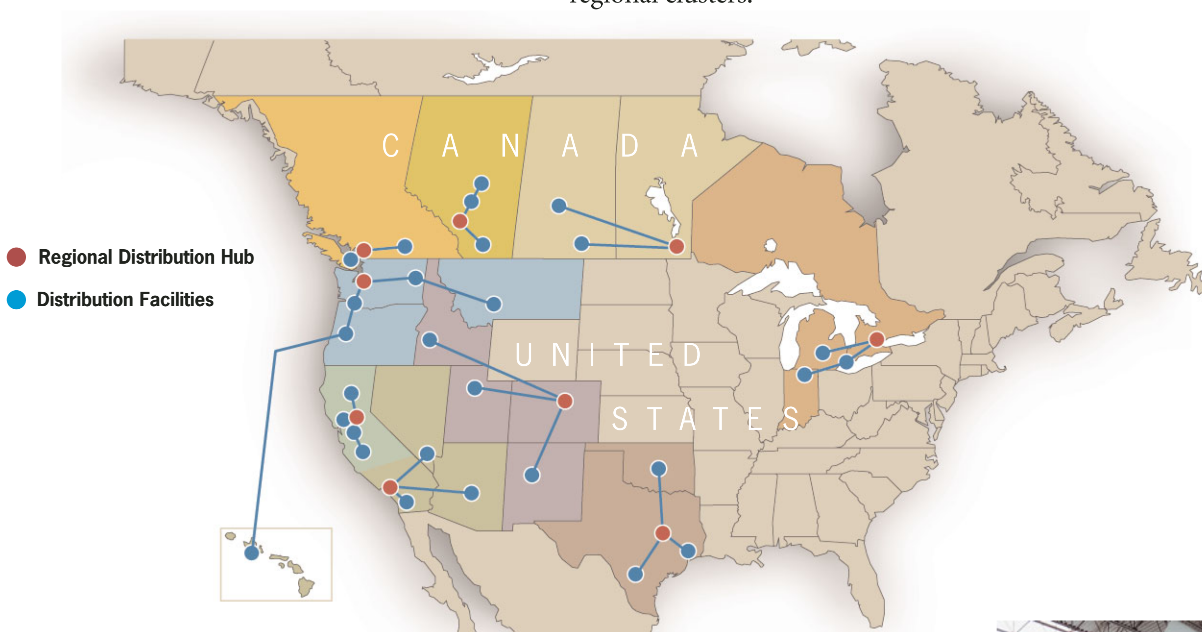
About the Fund

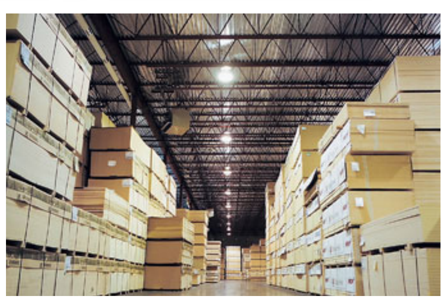
Hardwoods Distribution Income Fund is an unincorporated open-ended limited purpose trust. The Fund was launched on March 23, 2004 with the completion of an initial public offering (IPO) of 14.4 million trust units at $10 per unit. Net proceeds of the IPO were used to acquire an 80% interest in the hardwood lumber and sheet goods distribution business ("Hardwoods" or the "Business") from the previous owners.

Hardwoods Distribution Income Fund units trade on the Toronto Stock Exchange under the symbol HWD.UN. The Fund's performance depends on the performance of the Business.

About the Business

Hardwoods has been providing quality lumber, hardwood plywood and specialty products to customers for over 45 years. Today, we are the largest distributor of hardwood lumber and sheet goods in North America, operating a network of 37 distribution centres organized into nine regional clusters.





Report To Unitholders

FOR THE PERIOD
MARCH 23 - DECEMBER 31, 2004

It is a pleasure to issue the first Annual Report for Hardwoods Distribution Income Fund.

On March 23, 2004, the Fund completed a successful initial public offering of 14.4 million Trust Units at $10 per unit. Using the proceeds of this issue, we acquired an 80% interest in Hardwoods – North America's largest distributor of premium hardwood lumber and related sheet good products. Since then, Hardwoods' performance has been very strong. Drawing on robust demand and higher product prices, we set new records for sales volumes and revenue, and achieved significant gains in EBITDA and net earnings – all through our existing network.

This performance surpassed our IPO targets, which made it possible for the Fund to increase monthly distributions to Unitholders by 5%, effective in July 2004. As at December 31, 2004, distributable cash generated has exceeded distributions paid by $0.15 per Unit, enhancing our ability to maintain stable distributions going forward.

Full details of these results and the economic factors behind them can be found in our Management's Discussion and Analysis that follows on page 4. On a more general level, however, we believe our results reflect the attractiveness of our industry, and the unique capabilities of Hardwoods – a profitable company that has proven itself through 45 years of operation.

The Beauty of Hardwood

One of the keys to understanding Hardwoods' enduring success is to recognize that we operate in an industry very different from the softwood industry.

We do not sell commodities. We focus on appearance grade products that command premium pricing, and are free from duties and trade issues. This is true of both our lumber and our sheet good products. Over 70% of our sheet good sales are comprised of premium quality hardwood plywood. This is a wonderful product that combines the beauty of solid wood with the easy handling characteristics and economy of a panel product.

While demand for most of our products was unusually high in 2004, our products normally enjoy stable demand and pricing. In recent years, our strategy has been to distance ourselves even further from commodity markets by focusing on products at the higher end of the quality scale. We no longer carry hardwood flooring materials, for example, and we partner with suppliers to provide products that meet specific quality and margin objectives. In 2004, we introduced Dragon Ply™, a high-quality hardwood plywood panel custom manufactured for us in China. This product delivers exceptional quality and became a strong performer for us during the year.

The Essential Link

Our success has been further supported by the essential role we play within our industry. The hardwood industry is highly diverse, with hundreds of small mills producing products for thousands of different customers. We provide the essential link between the two.

Our customers are predominantly small industrial manufacturers who use a variety of hardwood species and panels to make products such as furniture and kitchen cabinets. Few of our customers have the space or the working capital to stock the different materials they need in large quantities, and they depend on distributors like us to provide quick access to inventory. We respond by keeping inventory on the ground, close to customers through our network of 37 distribution centres. We also perform an important financing role by extending credit on purchases in an industry where working capital is scarce.

For suppliers, we serve as a welcome third party sales force. Small mills rarely have the capacity to respond to customers who want to order frequently and in small volumes. We handle the sales and service for them, buying in volume and providing prompt payment, so they can focus on their own business of harvesting trees and producing hardwood lumber and panel products.

Within this chain, we enjoy a strong position. We are larger than any of our direct competitors, virtually all of our customers and most of our suppliers. And we continue to strengthen our position by pursuing successful growth and expansion.

A Growing, Flexible Distribution Model

Hardwoods has been growing at a pace of about one new distribution centre each year for the past twenty years in order to grow our business and enhance our industry position. The 37 distribution centres we currently operate are organized into nine regional clusters. Each cluster is anchored by one larger centre that serves as a supply depot to a number of smaller satellite centres positioned close to customers. This approach ensures we can provide excellent service, without sacrificing inventory efficiency.

That efficiency was clearly evident in the months following our IPO, when we achieved a 14.3% increase in sales, compared to the same period in 2003 – without adding any new facilities or employees. This, in turn, contributed to EBITDA and earnings growth that outstripped our volume growth by a substantial margin.

While this achievement strongly underscores the strength and flexibility of our distribution network, it does not signal a change in our growth strategy. During 2005, we plan to continue pursuing expansion. In the short term, we will focus on adding or expanding our centres in California and the US Midwest, where we see significant opportunities, but currently have limited operations.

On a longer-term basis, we plan to further increase our presence in the Midwest and establish operations in the Eastern United States. These regions are home to a diverse group of large and small cabinetry, mill-work and furniture manufacturers, and provide access to the right mix of suppliers and customers.

Our network is well designed to accommodate this growth. Because our facilities are leased and new operations are initially linked to an existing hub for inventory supply and management, we can establish new centres quickly. Most are profitable within a matter of months.

We also have opportunities to grow our network through acquisitions. Our industry is highly fragmented, and many consolidation opportunities exist to continue building our leadership position as North America's largest distributor of hardwood lumber and sheet goods.

Looking Ahead

Our sought-after products, our essential role in linking a fragmented supplier and user base, and our flexible distribution network combined to help us achieve record results in 2004. These strengths will continue to support our business going forward.

Although we expect our rate of sales growth will moderate to more normal levels in 2005, our outlook remains positive. Our focus will be on profitably growing our business, while closely managing selling and administrative costs, and continuing to improve inventory turnover and collection of accounts receivable. Both domestically and as part of our growing import program, we will also continue to seek out high-value products that deliver strong margins.

At the close of our first year as an income trust, we want to congratulate our employees for the record performance achieved in 2004, and to thank our new Unitholders for your investment in the Fund. We are pleased with our initial results, and look forward to reporting further positive performance in the months ahead.

Sincerely,

Maurice E. Paquette
President and Chief Executive Officer

Terry M. Holland
Chairman of the Board of Trustees

HARDWOODS

Management's Discussion & Analysis of Financial Condition and Results

MARCH 3, 2005

This management's discussion and analysis ("MD&A") should be read in conjunction with the audited consolidated financial statements and accompanying notes ("Audited Financial Statements") of Hardwoods Distribution Income Fund for the period from March 23, 2004 to December 31, 2004. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with Canadian generally accepted accounting principles.

The Fund was created on March 23, 2004. As such, no prior year comparative information is provided in the consolidated Audited Financial Statements. In order to enhance the usefulness of this MD&A, certain financial and operating results are compared to the unaudited pro forma results of the predecessor companies. All results of the predecessor companies are prepared on a pro forma basis reflecting the new financial structure of the Fund. This information is for reference purposes only, and is not intended to represent a comprehensive comparison of the consolidated financial results.

About the Fund

The Fund is an unincorporated open-ended limited purpose trust formed under the laws of the Province of British Columbia by a declaration of trust dated January 30, 2004. The Fund was launched on March 23, 2004 with the completion of an initial public offering ("IPO") of 14,410,000 trust Voting Units ("Units") at $10.00 per unit. Net IPO proceeds of $133.5 million, together with drawings on credit facilities totaling $31.6 million, were used to acquire an 80% interest in the hardwood lumber and sheet goods distribution business ("Hardwoods" or the "Business") from the previous owners.

The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund's operating subsidiaries, which together are exchangeable into Units provided that the Fund achieves certain objectives. Distributions by the operating subsidiaries to the previous owners are subject to subordination arrangements until at least March 31, 2006. As at December 31, 2004, the following units of the Fund were issued and outstanding:

Units	14,410,000
Special Voting Units	3,602,500

Hardwoods Distribution Income Fund units trade on the Toronto Stock Exchange under the symbol **HWD.UN**. The Fund's performance depends on the performance of the Business.

About our Business and Industry

Hardwoods is North America's largest distributor of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. We operate from 37 distribution facilities organized into nine geographic regions throughout North America. In a highly fragmented but stable industry, we match products supplied from hundreds of mills to over 2,500 manufacturing customers.

Our product mix includes higher grades of hardwood lumber, as well as sheet goods, consisting primarily of hardwood plywood, as well as non-structural sheet goods such as medium density fiberboard, particleboard and melamine-coated stock. Our sheet goods are a key complementary product line as they are used by many purchasers of hardwood lumber in the manufacture of their end products.

Approximately 95% of the hardwood lumber distributed in North America is harvested from North American hardwood forests, located principally in the Eastern United States. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. Sheet goods are generally produced in North America by large manufacturers using domestic hardwoods and other materials, although imported hardwood plywood volumes have been increasing. Both domestic and imported hardwood lumber and plywood are distributed principally by third parties such as us. Historically, balanced supply and demand conditions have resulted in a stable pricing environment for hardwood lumber and hardwood plywood, which have generally kept pace with inflation over the long-term.

The hardwood distribution industry is highly fragmented. While there are a number of hardwood distributors that operate from multiple locations, most are small, privately held companies serving discrete local markets. The competitive environment faced by small distributors, together with the desire of many owners for liquidity, provides an opportunity for industry consolidation.

Overview and Outlook

During 2004, we experienced strong demand for our lumber and panel products. Demand was driven by strong economic conditions across North America, and resulted in increased sales volumes across our entire North American network. Prices for hardwood lumber were also higher than normal in 2004 as a result of a tight supply situation. The supply constraints reflect two consecutive years of bad weather in the Eastern United States which have reduced harvests. Higher volumes, combined with higher selling prices, contributed to sales growth of 14.3% during the March 23 to December 31, 2004 period, when compared to the operating results of the predecessor companies for the nine-month period ended December 31, 2003.

Our 2004 results were further strengthened by the success of products introduced through our import program during the year, including our new line of Dragon Ply™ hardwood plywood. Custom manufactured for us in China, this high-quality product has been well received by customers, and sales have increased rapidly.

Our increased sales were partially offset by the strengthening value of the Canadian dollar relative to the US dollar. Approximately two-thirds of our sales are generated in the United States in US dollars. Accordingly, a higher Canadian dollar has a negative top line impact when we translate US sales to Canadian dollars for reporting purposes. The bottom line impact is significantly less, due to our natural hedges and foreign exchange contracts. While the majority of our sales are in US dollars, most of the products we purchase and many of our operating costs are also in US dollars. In addition, we maintain an active program to mitigate the potential impact of foreign exchange fluctuations on Canadian dollar distributions by the Fund by entering into monthly forward foreign exchange contracts. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 12 of this report.

Looking ahead, we expect our operations will continue to perform well in 2005, although we expect our rate of sales growth to moderate. The rapid sales growth experienced since our IPO has been driven by volume and product price increases that are unusually strong by historical standards. In 2005, we expect our sales to return to a more historical rate of growth, which traditionally mirrors general inflation rates, as measured by the consumer price index in the United States.

The first quarter, like the fourth quarter, is a seasonally slower period for our business. We expect demand levels in the first quarter of 2005 to be below second and third quarter levels, and cash distributions may exceed distributable cash generated during this period. Over the course of the full year, we expect to meet our current rate of cash distributions of $1.08 per Unit.

Our focus for 2005 remains on profitably growing our business, while closely managing selling and administrative costs, and continuing to improve inventory turnover and collection of accounts receivable.

Import products will continue to be a focus for us in 2005. We expect to increase sales of our existing import products, while adding new ones to our product line.

Our growth plans for 2005 include increasing our market presence in the Midwest of the United States and California through the expansion of existing branches, or the opening of new branches.

Given the fragmented nature of the industry, we will also consider acquisition opportunities with the potential to broaden and strengthen our market position.

In summary, we anticipate continued positive performance in 2005, and we expect to meet current cash distribution levels.

Results of Operations - March 23, 2004 to December 31, 2004

Selected Unaudited Consolidated Financial Information
(Expressed in thousands of Canadian dollars)

	For the period from March 23, 2004 to December 31, 2004	For the nine months ended December 31, 2003
		(predecessor companies - pro forma[1])
Total sales	$ 289,895	$ 253,685
Gross profit	53,855	47,094
Gross margin %	*18.6%*	*18.6%*
Selling and administrative expenses	32,122	30,697
Net earnings for the period	14,603	8,987
Add (Deduct):		
Income taxes	2,331	1,500
Interest	1,252	1,200
Amortization	1,825	2,080
Gain on foreign currency contracts	(2,511)	—
Non-controlling interest	4,233	2,623
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 21,733	$ 16,390
Deduct:		
Interest	(1,252)	
Capital expenditures	(1,006)	
Distributable Cash available to non-controlling interest (2)	(3,895)	
Current income taxes	(1,546)	
Distributable Cash available to Unitholders	$ 14,034	
Cash distributions to Unitholders	$ 11,802	
Total assets	$ 209,513	
Foreign currency contracts asset	$ 2,511	
Per Unit information:		
Basic and fully diluted earnings per Unit	$ 1.013	
Distributable Cash available to Unitholders per unit	$ 0.974	
Cash distributions per Unit	$ 0.819	
Average Canadian dollar / U.S. dollar exchange rate	1.2966	1.3657

1 The results of operations of the predecessor companies have been adjusted on a pro forma basis to reflect the Fund's capital structure and the acquisition of the Hardwoods Group of Companies by the Fund. Significant pro forma adjustments relate to changes in amortization, interest, non-controlling interest and income tax expenses.

2 The non-controlling interest will be distributed to the previous owners who continue to own a 20% interest in the business of the Fund only to the extent the terms of the subordination agreement between the Fund and the previous owners are satisfied.

Results of Operations - March 23, 2004 to December 31, 2004

Non-GAAP Measures - EBITDA and Distributable Cash

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization, gains or losses on foreign currency contracts and the non-controlling interest in earnings. We believe that, in addition to net income or loss, EBITDA is a useful supplemental measure of performance and of cash available for distribution, prior to debt service, changes in working capital, capital expenditures and income taxes. Specifically, we believe that EBITDA is the appropriate measure from which to make adjustments to determine the Distributable Cash of the Fund.

EBITDA is not an earnings measure recognized by generally accepted accounting principles in Canada ("GAAP") and does not have a standardized meaning prescribed by GAAP. Investors are cautioned that EBITDA should not replace net income or loss (as determined in accordance with GAAP) as an indicator of our performance, or to cash flows from operating, investing and financing activities, or as a measure of our liquidity and cash flows. Our method of calculating EBITDA may differ from the methods used by other issuers. Therefore, our EBITDA may not be comparable to similar measures presented by other issuers.

Distributable Cash of the Fund is a non-GAAP measure generally used by Canadian open-ended income funds as an indicator of financial performance. We define Distributable Cash as net earnings before depreciation, amortization, future income taxes, non-controlling interest and unrealized mark-to-market adjustments on foreign exchange hedge contracts, and after capital expenditures and contributions to any reserves that the Board of Trustees deem to be reasonable and necessary for the operation of the Fund.

Our Distributable Cash may differ from similar computations as reported by other entities and, accordingly, may not be comparable to distributable cash as reported by such entities. We believe that our Distributable Cash is a useful supplemental measure that may assist prospective investors in assessing the return on their investment in Units.

Sales

For the period from March 23, 2004 to December 31, 2004, our sales increased to $289.9 million, up 14.3% from $253.7 million for the combined predecessor companies during the nine-month period ended December 31, 2003. This reflects a 19.2% increase in US sales (in US dollars), and a 16.7% increase in Canadian sales (in Canadian dollars).

As no new operating locations were added during these periods, the sales increase was achieved entirely within our existing facility network. The increase reflects a combination of higher product prices and increased sales volumes. Sales growth was generally achieved across all geographic regions, with the strongest increases occurring in the United States.

The increase in sales was partially offset by the strengthening value of the Canadian dollar. During the last nine months of 2004, the average exchange rate for the Canadian dollar was 5.1% stronger than during the same period in 2003. Had exchange rates remained consistent with 2003 levels, revenue for the 2004 period would have increased an additional $10.6 million to $300.5 million.

Gross Profit

For the period March 23, 2004 to December 31, 2004, we reported gross profit of $53.9 million. This was 14.4% higher than the gross profit of $47.1 million achieved by the combined predecessor companies during the nine-month period ended December 31, 2003. Our gross margins remained steady at 18.6% of sales. Accordingly, the 14.4% growth in gross profit is consistent with our 14.3% increase in sales.

Selling and Administrative Expenses

For the period March 23, 2004 to December 31, 2004, selling and administrative expenses increased $1.4 million, or 4.6%, to $32.1 million, compared to $30.7 million for the combined predecessor companies during the nine-month period ended December 31, 2003. This increase is due primarily to new costs as a public company and an increase in profit sharing associated with the growth in operating profits, partially offset by the strengthening value of the Canadian dollar.

As a percentage of sales, our selling and administrative expenses have declined to 11.1%, from 12.1% for the combined predecessor companies during the nine-month period ended December 31, 2003. The decrease reflects greater efficiencies resulting from moving higher volumes through the same network.

Other Income

The mark-to-market valuation of our outstanding foreign currency contracts resulted in an income gain of $2.5 million for the period from March 23, 2004 to December 31, 2004. We continue to monitor our foreign currency contract policy as part of our efforts to mitigate the impact of foreign exchange fluctuations on Canadian dollar distributions generated by our U.S. operations. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 12 of this report.

EBITDA

For the period March 23, 2004 to December 31, 2004, EBITDA increased 32.6% to $21.7 million, from $16.4 million for the combined predecessor companies during the nine-month period ended December 31, 2003. The increase is primarily due to sales growth between the two periods, combined with our continued focus on controlling operating costs.

Net Earnings

For the period March 23, 2004 to December 31, 2004, net earnings climbed 62.4% to $14.6 million, from $9.0 million for the combined predecessor companies for the nine-month period ended December 31, 2003. The increase in net earnings primarily reflects the growth in EBITDA and a $2.5 million mark-to-market gain on foreign currency contracts which helped offset the impact of a stronger Canadian dollar.

Results of Operations – Three Months Ended December 31, 2004

Sales

For the three months ended December 31, 2004, sales increased 13.0% to $93.7 million, from $82.9 million for the combined predecessor companies during the fourth quarter of 2003. The increase includes an 18.5% increase in US sales (in US dollars), and an 18.7% increase in Canadian sales (in Canadian dollars).

The growth in sales reflects increased volumes and higher product pricing, partially offset by the impact of the strengthening Canadian dollar. The exchange between the Canadian and U.S. dollar averaged $1.2235 for the three-month period ended December 31, 2004, compared to $1.3157 during the corresponding period in 2003. Had exchange rates remained consistent with 2003 levels, revenue for the fourth quarter of 2004 would have increased an additional $4.8 million to $98.5 million.

Gross Profit

Gross profit for the three-month period ended December 31, 2004 was $17.0 million, an increase of $1.9 million, or 12.3%, from $15.1 million for the combined predecessor companies in the fourth quarter of 2003. As a percentage of sales, gross profit was 18.1%, compared to 18.3% for the predecessor companies during the same period in 2003. Accordingly, the increase in gross profit was due primarily to growth in sales.

Selling and Administrative Expenses

Fourth quarter 2004 selling and administrative expenses decreased $0.1 million, or 1.2%, to $10.6 million, from $10.7 million in the prior year period. The decrease is due primarily to the impact of the strengthening Canadian dollar, more than offsetting modest increases in operating costs in the period.

Other Income

For the three months ended December 31, 2004, the mark-to-market valuation of our outstanding foreign currency contracts provided an income gain of $1.7 million. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 12 of this report.

Results of Operations - Three Months Ended December 31, 2004

Selected Unaudited Consolidated Financial Information
(Expressed in thousands of Canadian dollars)

	For the three months ended December 31 2004	For the three months ended December 31, 2003 (predecessor companies - pro forma[1])
Total sales	$ 93,730	$ 82,923
Gross profit	17,003	15,140
Gross margin %	*18.1%*	*18.3%*
Selling and administrative expenses	10,581	10,710
Net earnings for the period	5,568	2,217
Add (Deduct):		
Income taxes	20	500
Interest	499	400
Amortization	598	633
Gain on foreign currency contracts	(1,660)	—
Non-controlling interest	1,397	679
Earnings before interest, taxes, depreciation and amortization and non-controlling interest (“EBITDA”)	$ 6,422	$ 4,429
Deduct:		
Interest	(499)	
Capital expenditures	(197)	
Distributable Cash available to non-controlling interest [2]	(1,145)	
Current income taxes	(80)	
Distributable Cash available to Unitholders	$ 4,501	
Cash distributions to Unitholders	$ 3,891	
Total assets	$ 209,513	
Foreign currency contracts asset	$ 2,511	
Per Unit information:		
Basic and fully diluted earnings per Unit	$ 0.386	
Distributable Cash available to Unitholders per unit	$ 0.312	
Cash distributions per Unit	$ 0.270	
Average Canadian dollar / U.S. dollar exchange rate	1.2235	1.3157

1 The results of operations of the predecessor companies have been adjusted on a pro forma basis to reflect the Fund’s capital structure and the acquisition of the Hardwoods Group of Companies by the Fund. Significant pro forma adjustments relate to changes in amortization, interest, non-controlling interest and income tax expenses.

2 The non-controlling interest will be distributed to the previous owners who continue to own a 20% interest in the business of the Fund only to the extent the terms of the subordination agreement between the Fund and the previous owners are satisfied.

EBITDA

EBITDA increased to $6.4 million in the fourth quarter of 2004, up 45.0% from $4.4 million for the combined predecessor companies during the same period in 2003. The increase in EBITDA reflects higher sales.

Net Earnings

Fourth quarter net earnings increased 151.2% to $5.6 million, from $2.2 million for the combined predecessor companies during the three-month period ended December 31, 2003. The increase in net earnings primarily reflects the increase in EBITDA, a $1.7 million gain on outstanding currency contracts during the fourth quarter of 2004, and lower income tax expense in the quarter.

Quarterly Financial Information

The table below provides selected quarterly financial information for the three most recent fiscal quarters to December 31, 2004. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in our opinion, necessary to present a fair statement of the results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as indication of future performance.

Liquidity

Distributable Cash and Distributions

Our policy is to make stable monthly distributions to our Unitholders based on our estimate of distributable cash for the year. We pay distributions at the end of the month that follows the month when the cash was earned. In the period from March 23, 2004 to December 31, 2004, we made eight consecutive monthly distributions totaling $11.8 million to Unitholders. Distributions for the period March 23, 2004 to April 30, 2004 were $0.1082 per unit, and for each of the months of May and June were $0.0854 per unit, consistent with monthly distributions anticipated at the time of our IPO. We increased distributions by 5.4% to $0.09 per unit effective in July 2004, based on successful year-to-date results and a continued positive outlook for the Fund.

Quarterly distributions to Hardwoods' previous owners were made as follows: $1.0 million on July 30, 2004, $1.3 million on October 29, 2004, and $1.0 million on January 28, 2005. On an after-tax per unit basis, such cash distributions are equivalent to the respective quarterly distributions to public Unitholders pursuant to the terms of a subordination agreement as outlined in the Fund's prospectus dated March 12, 2004. For the period March 23, 2004 to December 31, 2004, the ratio of total cash distributions paid to

Quarterly Financial Information

(Expressed in thousands of Canadian dollars)

	For the three months ended December 31 2004	For the three months ended September 30 2004	For the period from March 23 to June 30 2004
Total sales	$ 93,730	$ 97,040	$ 99,125
Net earnings	$ 5,568	$ 4,351	$ 4,684
Basic and fully diluted earnings per Unit	$ 0.386	$ 0.302	$ 0.325
Distributable cash per Unit	$ 0.312	$ 0.279	$ 0.383
Cash distributions per Unit	$ 0.270	$ 0.270	$ 0.279

Unitholders, as compared to cash available for distribution to Unitholders, was 84.1%.

Capital Expenditures

For the period from March 23, 2004 to December 31, 2004, capital expenditures were $1.0 million. This compares to annual maintenance capital expenditures anticipated at the time of the IPO of $0.8 million. Our capital expenditures have been higher than expected, primarily due to earlier replacement of forklifts and phone systems, as well as leasehold improvements to our head office in Langley, British Columbia.

Revolving Credit Facilities

At the time of the IPO, we established independent credit facilities comprising a three-year operating line in each of Canada and the U.S. In Canada, our initial operating line comprised a maximum facility of $20.0 million. In response to growth in the business since the IPO, the maximum facility in Canada was increased to $22.0 million on December 17, 2004, of which the balance outstanding was $14.0 million as at December 31, 2004. In the U.S., our initial operating line comprised a maximum facility of $32.5 million (US $27.0 million), which was increased on December 30, 2004 to $36.0 million (US $30.0 million). As at December 31, 2004, the balance outstanding on the US operating line was $23.9 million (US $19.9 million).

Our credit facilities have increased from balances at the time of the IPO of $12.0 million and $19.8 million (US $15.0 million) in Canada and the U.S. respectively. These increases are due primarily to an increase in net non-cash working capital as a result of the growth in our business, and the related post-closing working capital adjustment paid to the previous owners pursuant to the IPO.

We believe that our operating loans in both Canada and the U.S. are sufficient to meet our working capital requirements.

Contractual Obligations

The table below sets forth other contractual obligations of the Fund as at December 31, 2004 due in the years indicated. These relate to various premises operating leases:

(Expressed in thousands of Canadian dollars)

2005	$ 5,610
2006	5,175
2007	4,816
2008	4,417
2009	3,234
2010 and thereafter	$ 2,520
	$ 25,772

Off-Balance Sheet Arrangements

The Fund has no off-balance sheet arrangements with the exception of the foreign currency contracts discussed below in Financial Instruments.

Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that we make estimates and assumptions that can have a material impact on our results of operations as reported on a periodic basis. We base our estimates and assumptions on past experience and other factors that are deemed reasonable under the circumstances. Actual results could differ from these estimates.
The critical estimates used in preparing our financial statements are:

Accounts Receivable Provision: Due to the nature of our business and the credit terms we provide to our customers, we anticipate that a certain portion of required customer payments will not be made, and we maintain an allowance for these doubtful accounts. The allowance is based on our estimation of the potential of recovering our accounts receivable, and incorporates current and expected collection trends.

Valuation of Inventories: The net realizable value of our inventory could be affected by market shifts or damage to our products. Our inventory is valued at the lower of cost and net realizable value.

Allocation of Purchase Price: The allocation of the purchase price for the business acquired at the time of our IPO requires judgement, specifically regarding the allocation between goodwill and other intangible assets, and the amortization period of the intangible assets, which we have determined to be 15 years using the straight-line method.

All significant accounting policies have been included in note 2 to the financial statements.

Related Party Transactions

For the period from March 23, 2004 to December 31, 2004, sales of $1.2 million were made to affiliates of the previous owners, and we incurred purchases of $0.4 million from affiliates of the previous owners. These sales and purchases took place at prevailing market prices. During the period from March 23, 2004 to December 31, 2004, subsidiaries of the Fund made cash distributions of $2.3 million to Hardwoods' previous owners, pursuant to the terms of a subordination agreement as outlined in the Fund's prospectus dated March 12, 2004. In addition, the Fund has recorded a distribution payable to the previous owners of $1.0 million which was paid on January 28, 2005. During the period from March 23, 2004 to December 31, 2004, we paid $0.1 million to affiliates of the previous owners under the terms of an agreement to provide transitional services for management information systems.

Financial Instruments

The Fund uses currency derivatives to manage exposure to fluctuations in exchange rates between the Canadian dollar and the United States dollar. The foreign currency contracts are recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of operations. At December 31, 2004, the Fund had 28 monthly foreign currency contracts to exchange US$675,000 into approximately $903,000, reflecting an exchange rate of Cdn$1.3385 to US$1.00, each month until April 2007. The fair value of the remaining 28 monthly contracts has been reflected in the financial statements.

On February 15, 2005, the Fund modified and extended its existing foreign currency hedging arrangement to exchange US dollars for Canadian dollars described above. Under the new arrangement, the maturity of the Fund's cash distribution foreign currency contract agreements were extended from April 2007 to April 2008. The modified and extended foreign currency contracts allow the Fund to exchange, beginning in February 2005, US$675,000 into approximately $878,000 each month until April 2008. This reflects an exchange rate of $1.30 and extends our foreign currency contract arrangement by an additional 12 months. This is consistent with our intent to maintain an active foreign currency contract program to mitigate the potential impact of foreign exchange fluctuations on Canadian dollar distributions by the Fund.

Forward-looking Statements

This MD&A may contain forward-looking statements, which reflect our expectations regarding the future growth, results of operations, performance and business prospects, and opportunities of the Fund. Forward-looking statements contain such words as "anticipate", "believe", "continue", "could", "expects", "intend", "may", "plans" or similar expressions suggesting future conditions or events. Such forward-looking statements reflect our current beliefs and are based on information currently available to us. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from results discussed in the forward-looking statements. These include the effects of, as well as changes in: national and local business conditions; political or economic instability in local markets; competition; consumer preferences, spending patterns and demographic trends; legislation and governmental regulation. Although the forward-looking statements contained in this MD&A are based on what we believe to be reasonable assumptions, we cannot assure readers that actual results will be consistent with these forward-looking statements.

Additional Information

Additional information relating to the Fund, including all public filings, are available on SEDAR (www.sedar.com) and our website (www.hardwoods-inc.com).

Management's Statement of Responsibilities

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Boards of Directors and the Trustees. The consolidated financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements.

The Fund maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements.

The Boards of Directors and the Trustees ensure that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee. This committee reviews the consolidated financial statements and is comprised of independent Trustees. The auditors have full and direct access to the Audit Committee.

The consolidated financial statements have been independently audited by KPMG LLP, in accordance with Canadian generally accepted auditing standards. Their report below expresses their opinion on the consolidated financial statements of the Fund.

Maurice Paquette

Maurice E. Paquette
President and Chief Executive Officer

Auditors' Report to the Unitholders

We have audited the consolidated balance sheet of Hardwoods Distribution Income Fund (the "Fund") as at December 31, 2004 and the consolidated statements of operations and retained earnings and cash flows for the period from March 23, 2004 to December 31, 2004. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2004 and the results of its operations and its cash flows for the period from March 23, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Vancouver, Canada
February 15, 2005

Consolidated Balance Sheet

(Expressed in thousands of Canadian dollars)

		December 31, 2004
Assets		
Current assets:		
Accounts receivable	$	45,283
Income tax receivable		401
Inventory		42,499
Prepaid expenses		627
		88,810
Long-term receivables		1,787
Property, plant and equipment *(note 3)*		4,687
Deferred financing costs, net		142
Other intangible assets (net of accumulated amortization of $700)		13,293
Foreign currency contracts *(note 4)*		2,511
Goodwill		98,283
	$	209,513
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness *(note 5)*	$	39,058
Accounts payable and accrued liabilities		7,897
Distributions payable to Unitholders		1,297
Distributions payable to non-controlling interests		981
		49,233
Future income taxes *(note 8)*		545
Non-controlling interests *(note 6)*		32,123
Unitholders' equity:		
Fund Units *(note 7)*		133,454
Retained earnings		2,801
Cumulative foreign currency translation account		(8,643)
		127,612
	$	209,513

Subsequent event *(note 4)*

Commitments *(note 10)*

See accompanying notes to consolidated financial statements.

Approved on behalf of the Trustees:

Lawrence I. Bell
Trustee

Terry M. Holland
Trustee

Consolidated Statement of Operations and Retained Earnings

(Expressed in thousands of Canadian dollars)

	Period from March 23, 2004 to December 31, 2004
Sales	$ 289,895
Cost of sales	236,040
Gross profit	53,855
Expenses (income):	
Selling and administrative	32,122
Amortization:	
Plant and equipment	1,040
Deferred financing costs	50
Other intangible assets	735
Interest	1,252
Mark-to-market gain on foreign currency contracts *(note 4)*	(2,511)
	32,688
Earnings before non-controlling interests and income taxes	21,167
Non-controlling interests *(note 6)*	4,233
Earnings before income taxes	16,934
Income taxes *(note 8)*	2,331
Net earnings for the period	14,603
Retained earnings, beginning of period	-
Distributions to Unitholders	(11,802)
Retained earnings, end of period	$ 2,801
Basic and diluted earnings per Unit	$ 1.01
Weighted average number of Units outstanding	14,410,000

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

(Expressed in thousands of Canadian dollars)

	Period from March 23, 2004 to December 31, 2004
Cash flows provided by (used in) operating activities:	
Net earnings for the period	$ 14,603
Items not involving cash:	
Amortization	1,825
Gain on sale of property, plant and equipment	(22)
Mark-to-market gain on foreign currency contracts	(2,511)
Non-controlling interests	4,233
Future income taxes	785
	18,913
Change in non-cash operating working capital *(note 9)*	(15,059)
Net cash provided by operating activities	3,854
Cash flows provided by (used in) investing activities:	
Business acquisition *(note 1)*	(165,137)
Additions to property, plant and equipment	(1,006)
Proceeds on disposal of property, plant and equipment	53
Long-term receivables	200
Net cash used in investing activities	(165,890)
Cash flows provided by (used in) financing activities:	
Net proceeds from the issuance of Units	133,454
Increase in bank indebtedness	41,515
Increase in deferred financing fees	(204)
Distributions paid to Unitholders	(10,505)
Distributions paid to non-controlling interests	(2,224)
Net cash provided by financing activities	162,036
Increase in cash	—
Cash, beginning of period	—
Cash, end of period	$ —
Supplementary information (cash amounts):	
Interest paid	$ 1,252
Income taxes paid	2,100

See accompanying notes to consolidated financial statements.

Notes to the Consolidated Financial Statements

PERIOD FROM MARCH 23, 2004 TO DECEMBER 31, 2004
(Tabular amounts expressed in thousands of Canadian dollars)

1. Nature of operations and business acquisition:

Hardwoods Distribution Income Fund (the "Fund") is an unincorporated, open ended, limited purpose trust established under the laws of the Province of British Columbia on January 30, 2004 by a Declaration of Trust. The Fund commenced operations on March 23, 2004 when it completed an initial public offering (the "Offering") of Units and acquired (the "Acquisition") an 80% interest in a hardwood lumber and sheet goods distribution business in North America (the "Business") from affiliates of Sauder Industries Limited ("SIL"). The Fund holds, indirectly, 80% of the outstanding limited partnership units of Hardwoods Specialty Products LP ("Hardwoods LP") and Hardwoods Specialty Products US LP ("Hardwoods USLP"), limited partnerships established under the laws of the Province of Manitoba and the state of Delaware, respectively.

On March 23, 2004, the Fund issued 14,410,000 Units at $10 per Unit pursuant to the Offering. Net proceeds from the Offering were $133,454,000, after deducting expenses of the Offering of $10,646,000.

Also on March 23, 2004, the Fund used the net proceeds from the Offering, together with funds from two new credit facilities (note 5), to acquire an 80% interest in Hardwoods LP and Hardwoods USLP for total consideration of approximately $165,137,000. The acquisition of the Fund's interest in Hardwoods LP and Hardwoods USLP was completed through a series of transactions and has been accounted for using the purchase method.

The fair value of the net assets acquired is as follows:

Net working capital	$ 73,658
Property, plant and equipment	5,094
Goodwill	104,580
Other intangible assets	15,000
Future income taxes	267
Non-controlling interests	(33,462)
Consideration, being cash from the Offering and new credit facilities	$ 165,137

The results of operations of Hardwoods LP and Hardwoods USLP have been included in the Fund's consolidated financial statements from March 23, 2004, being the date of acquisition.

2. Significant accounting policies:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Fund and its 80% owned subsidiaries Hardwoods LP and Hardwoods USLP and other wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

(b) *Cash and cash equivalents:*

The Fund considers deposits in banks, certificates of deposits and short-term investments with original maturities of three months or less when acquired as cash and cash equivalents.

(c) *Accounts receivable:*

Accounts receivable includes trade accounts receivable net of allowances for doubtful accounts plus the current portion of housing loans receivable from employees related to their relocation.

(d) *Inventory:*

Inventory is valued at the lower of weighted average cost and net realizable value.

(e) *Long-term receivables:*

Long-term receivables are housing loans receivable from employees related to their relocation. Housing loans in Canada are interest bearing and in the United States are not. The housing loans are secured by a deed of trust or mortgage depending upon the jurisdiction.

(f) *Property, plant and equipment:*

Property, plant and equipment are stated at cost. Amortization is provided at straight-line rates sufficient to amortize the cost of the assets over their estimated useful lives as follows:

Assets	**Estimated useful life**
Buildings	20 years
Machinery and equipment	5 to 10 years
Automobiles	3 years
Mobile equipment	7 to 10 years
Leasehold improvements	Over the term of the lease

(g) *Deferred financing costs:*

Financing costs incurred to obtain credit facilities are deferred and amortized on a straight-line basis over the term of the related debt.

(h) *Other intangible assets:*

Other intangible assets represent customer relationships acquired in the business combination and are recorded at cost less accumulated amortization. Amortization is provided for on a straight-line basis over 15 years.

(i) *Goodwill:*

Goodwill is recorded at cost and is not amortized. Management reviews the carrying value of goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Any excess of carrying value over fair value will be charged to income in the period in which the impairment is determined. To December 31, 2004, no impairment in goodwill has been determined to have occurred.

(j) *Impairment of long-lived assets:*

Long-lived assets, including property, plant and equipment and other intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recorded when it is determined that the carrying amount of these assets is not recoverable and exceeds their fair value.

(k) Income taxes:

Incorporated subsidiaries of the Fund use the asset and liability method of accounting for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the substantive enactment date. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

As the Fund distributes all of its net earnings to Unitholders and deducts these amounts in computing its taxable income, Unitholders, rather than the Fund, will generally be liable for any income tax obligations. Accordingly, no provision for income taxes has been made in respect of the Fund itself.

(l) Revenue recognition:

Revenue from the sale of hardwood lumber and sheet goods is recognized at the time of delivery, which is when title and the risks and rewards of ownership transfers to the customer.

(m) Translation of foreign currencies:

The accounts of the Fund's self-sustaining foreign operations are translated into Canadian dollars using the current rate method. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenue and expenses are translated at average exchange rates for the period. Gains or losses arising from the translation of the financial statements of the self-sustaining foreign operations are deferred in the cumulative foreign currency translation account in Unitholders' equity.

Foreign monetary assets and liabilities of the Canadian operations have been translated into Canadian dollars using the rate of exchange in effect at the balance sheet date. Revenue and expenses of the Canadian operations denominated in foreign currencies are translated at the average exchange rates for the period. Exchange gains or losses arising from translation of these foreign monetary balances and transactions are reflected in earnings.

(n) Foreign currency contracts:

The Fund uses currency derivatives to manage its exposure to fluctuations in exchange rates between the Canadian and the United States dollar. The foreign currency contracts are recognized in the balance sheet and measured at fair value, with changes in fair value recognized currently in the statement of operations.

(o) Earnings per Unit:

Basic earnings per Unit is calculated by dividing net earnings by the weighted average number of Units outstanding during the reporting period which commenced March 23, 2004. Diluted earnings per Unit is calculated by application of the if-converted method for convertible securities (being exchangeable Units held by the non-controlling interest). As the conversion of convertible securities would not have a dilutive effect on earnings per Unit, diluted and basic earnings per Unit are the same amount.

(p) Use of estimates:

The preparation of financial statements 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. Areas requiring significant management estimates include the valuation of goodwill, other intangible assets, allowance for doubtful accounts, future income taxes and amounts of accrued liabilities. Actual amounts may differ from the estimates applied in the preparation of these financial statements.

3. Property, plant and equipment:

	Cost	Accumulated Amortization	Net book Value
Buildings	$ 491	$ 34	$ 457
Machinery and equipment	1,283	344	939
Automobiles	11	9	2
Mobile equipment	2,454	463	1,991
Leasehold improvements	669	140	529
	4,908	990	3,918
Land	769	—	769
	$ 5,677	$ 990	$ 4,687

4. Foreign currency contracts:

In order to manage the Fund's exposure to exchange rate fluctuations on United States dollar denominated distributable cash, a subsidiary of the Fund has entered into foreign currency contracts to exchange US$675,000 each month for approximately $903,000, for thirty-six consecutive months from April 2004 to April 2007. The remaining 28 monthly foreign currency contracts at December 31, 2004 are recognized in the balance sheet and measured at fair value, which at December 31, 2004 represented an asset of $2,511,496.

On February 15, 2005, the Fund modified and extended its existing foreign currency arrangement to exchange US dollars for Canadian dollars described above. Under the new arrangement, the maturity of the Fund's foreign exchange contracts were extended from April 2007 to April 2008. The modified and extended foreign currency contracts allow the Fund to exchange, beginning in February 2005, US$675,000 into approximately $878,000 each month until April 2008, reflecting an exchange rate of $1.30.

5. Bank indebtedness:

Checks issued in excess of funds on deposit	$ 1,186
Credit facility, Hardwoods LP	14,000
Credit facility, Hardwoods USLP (US$19,860)	23,872
	$ 39,058

Bank indebtedness consists of checks issued in excess of funds on deposit and advances under operating lines of credit available to Hardwoods LP and Hardwoods USLP. Hardwoods LP has a revolving credit facility of up to an aggregate amount of $22,000,000 and Hardwoods USLP has a revolving credit facility of up to an aggregate amount of $36,060,000 (US$30,000,000) (less the net exposure under the foreign currency contracts facility as described in note 4, as determined by the lender from time to time).

The Hardwoods LP credit facility is secured by a first security interest in all of the present and after acquired property of Hardwoods LP and its operating subsidiaries, and by the Hardwoods LP Units held indirectly by the Fund. The Hardwoods USLP credit facility, and the foreign currency contract arrangements, are secured by a first security interest in all of the present and after acquired property of Hardwoods USLP and by the Hardwoods USLP Units held indirectly by the Fund.

Each facility is a demand loan with a revolving three-year term expiring on March 23, 2007. The credit facilities are repayable without any prepayment penalties and bear interest at a floating rate based on the Canadian dollar or US dollar prime rate (as the case may be), LIBOR or bankers acceptance rates plus, in each case, an applicable margin. Letters of credit are also available under the credit facilities. The rates vary with the ratio of total debt for borrowed money, capital leases and letters of credit (as adjusted for certain items) to earnings before interest, taxes, depreciation and amortization, as defined in the credit agreements. Commitment fees and standby charges are payable.

The average annual interest rates payable for the period from March 23, 2004 to December 31, 2004 were 5.2% and 3.6% for the Hardwoods LP and Hardwoods USLP credit facilities, respectively.

6. Non-controlling interests:

Retained interest in Hardwoods LP and Hardwoods USLP	$ 33,462
Interest in post-acquisition earnings	4,233
Distributions paid to non-controlling interests	(2,224)
Distributions payable to non-controlling interests	(981)
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	(2,367)
	$ 32,123

The previous owners of the Business (note 1) have retained a 20% interest in Hardwoods LP and Hardwoods USLP through ownership of Class B Hardwoods LP units ("Class B LP Units") and Class B Hardwoods USLP units ("Class B USLP Units"), respectively. The Fund owns an indirect 80% interest in Hardwoods LP and Hardwoods USLP through ownership of all Class A Hardwoods LP units ("Class A LP Units") and Class A Hardwoods USLP units ("Class A USLP Units"), respectively.

The Class A LP Units and Class B LP Units and the Class A USLP Units and Class B USLP Units, respectively, have economic and voting rights that are equivalent in all material respects except distributions on the Class B LP Units and Class B USLP Units are subject to the subordination arrangements described below until the date (the "Subordination End Date") on which:

- the consolidated Adjusted EBITDA, as defined in the Subordination Agreement dated March 23, 2004, of the Fund for the 12 month period ending on the last day of the month immediately preceding such date is at least $21,300,000; and
- cash distributions of at least $29,540,000 ($2.05 per Unit) have been paid on the Units and a combined amount of cash advances or distributions of at least $7,385,000 has been paid on the Class B LP Units and Class B USLP Units, being $2.05 per combined Class B LP and Class B USLP Units (as adjusted for issuances, redemptions and repurchases of Units, LP Units and USLP Units subsequently and by converting the cash distributions or advances by Hardwoods USLP on the USLP Units at the rate of exchange used by the Fund to convert funds received by it in US dollars into Canadian dollars) for the 24 month period ending on the last day of the month immediately preceding such date.

The Subordinated End Date had not occurred at December 31, 2004.

Distributions are to be made monthly on the Class A LP Units and Class A USLP Units equal to at least $0.0854 per Unit to the extent cash is available to make cash distributions and as determined by the board of directors of the general partners. Distributions on the Class B LP Units and Class B USLP Units will be subordinated and will be made quarterly in a combined amount for one Class B LP Unit and one Class B USLP Unit equal, on a pro rated basis, to the combined amount distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter, only after the distributions have been made on the Class A LP Units and Class A USLP Units and to the extent cash is available to make such distributions.

After the Subordination End Date, the holders of the Class B LP Units and Class B USLP Units will generally be entitled to effectively exchange all or a portion of their Class B LP Units and Class B USLP Units together for up to 3,602,500 Units of the Fund, representing 20% of the issued and outstanding Units of the Fund on a fully diluted basis. In the event the Fund enters into an agreement in respect of an acquisition or a take-over bid of the Fund, the holders of the Class B LP Units and Class B USLP Units will be entitled to exchange such units for Units of the Fund.

7. Fund Units:

An unlimited number of Units and Special Voting Units may be created and issued pursuant to the Declaration of Trust. Each Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. The Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund or in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Unit, or Special Voting Unit, entitles the holder thereof to one vote at all meetings of voting Unitholders.

On March 23, 2004, the Fund issued 14,410,000 Units at a price of $10 per Unit pursuant to the Offering. Net proceeds from the Offering were $133,454,000 after deducting expenses of the Offering of $10,646,000. The holders of the Class B Units of Hardwoods LP and Hardwoods USLP were issued 3,602,500 Special Voting Units of the Fund, the value of which is included in non-controlling interests (note 6). Such Special Voting Units are to be cancelled on the exchange of Class B Units of Hardwoods LP and Hardwoods USLP for Units of the Fund.

8. Income taxes:

Current	$ 1,546
Future	785
	$ 2,331

Income tax expense differs from that calculated by applying U.S. federal and state statutory income tax rates in effect in the jurisdiction in which a subsidiary of the Fund is subject to tax of 39% to earnings before income taxes for the following reasons:

Earnings before income tax	$ 16,934
Computed tax expenses at statutory rate	$ 6,604
Income of Fund distributed directly to Unitholders	(3,232)
Income and deductions not subject to tax	(783)
Deductible state taxes	(94)
Other	(164)
Income tax expense	$ 2,331

The tax effect of temporary differences that give rise to significant portions of the future income tax assets and liabilities at December 31, 2004 is as follows:

Future income tax assets:	
Accrued liabilities	$ 103
Inventory	451
	554
Future income tax liabilities:	
Property, plant and equipment	(3)
Goodwill	(1,096)
	(1,099)
Net future income tax liability	$ (545)

9. Changes in non-cash operating working capital:

Accounts receivable	$ 759
Income taxes receivable	(401)
Inventory	(6,902)
Prepaid expenses	(392)
Accounts payable and accrued liabilities	(8,123)
	$ (15,059)

10. Commitments:

(a) The Fund's subsidiaries are obligated under various operating leases that require minimum rental payments in each of the next five years as follows:

2005	$ 5,610
2006	5,175
2007	4,816
2008	4,417
2009	3,234
	23,252
Thereafter	2,520
	$ 25,772

(b) At December 31, 2004, the Fund's subsidiaries were committed in the amount of $172,080 (US$143,161) under letters of credit.

11. Segment disclosure:

Information about geographic areas is as follows:

Revenue from external customers:	
Canada	$ 91,337
United States	198,558
	$ 289,895
Property, plant and equipment:	
Canada	$ 1,635
United States	3,052
	$ 4,687
Goodwill	
Canada	$ 42,043
United States	56,240
	$ 98,283

12. Financial instruments:

(a) Fair values of financial instruments:

The carrying value of cash and cash equivalents, trade accounts receivable, accounts payable and accrued liabilities and distributions payable approximate their fair value due to the relatively short period to maturity of the instruments. The fair value of long-term receivables is not expected to differ materially from the carrying value. The carrying value of the credit facilities approximate their fair values due to the existence of floating market based interest rates. The foreign currency contracts are carried at market values.

(b) Credit risk:

The Fund is exposed to credit risk in the event they are unable to collect in full amounts receivable from its customers. The Fund employs established credit approval practices and employs a full-time credit attorney to mitigate the credit risk. It is the Fund's policy to secure credit terms with customers whenever possible by registering security interests in the assets of the customer and by obtaining personal guarantees. No single customer represents a concentration of credit risk to the Fund.

(c) Counterparty risk:

Changes in the exchange rates and interest rates will result in market gains and losses on the foreign currency contracts entered into by the Fund. Furthermore, the Fund may be exposed to losses should the counterparty to its foreign currency contracts fail to fulfill its obligations. The Fund has sought to minimize potential counter party losses by transacting with high credit quality institutions.

13. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP Plan") along with an affiliate of the previous owners in the form of a Multi Employer Plan. The assets of the USLP Plan are held and related investment transactions are executed by the Plan's Trustee, ING National Trust, and, accordingly, are not reflected in these consolidated financial statements. During the period from March 23, 2004 to December 31, 2004, Hardwoods USLP contributed and expensed $243,766 (US$188,004) in relation to the USLP Plan.

Hardwoods LP does not maintain a pension plan. Hardwoods LP does, however, administer a group registered retirement savings plan ("LP Plan") that has a matching component whereby Hardwoods LP makes contributions to the LP Plan which match contributions made by employees up to a certain level. The assets of the LP Plan are held and related investment transactions are executed by LP Plan's Trustee, Sun Life Financial Trust Inc., and, accordingly, are not reflected in these consolidated financial statements. During the period from March 23, 2004 to December 31, 2004, Hardwoods LP contributed and expensed $144,015 in relation to the LP Plan.

14. Related party transactions:

For the period from March 23, 2004 to December 31, 2004, sales of $1,158,593 were made to affiliates of SIL, and the Fund made purchases of $439,033 from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the period from March 23, 2004 to December 31, 2004, the Fund paid $64,544 to affiliates of SIL under the terms of an agreement to provide transitional services for management information systems. This cost is included in the selling and administrative expense in the statement of operations.

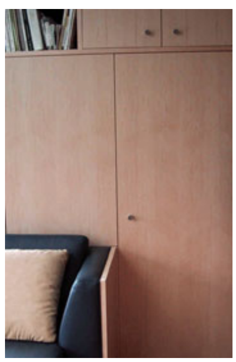
The Beauty of Hardwood

People love hardwood and find many different ways to bring it into their lives. Whether in furniture, kitchen cabinets, doors or mouldings, people place a higher value on products crafted from real wood. It's a preference that doesn't change with the whims of fashion.

Demand for hardwood has remained remarkably stable decade after decade, in part because hardwood has no real substitute. There's a warmth to the look and touch of hardwood that no other material can match. The stability of the hardwood market is further enhanced by balanced supply and demand characteristics.

Enjoying steady demand and stable pricing, the hardwood industry is ideally suited to the income trust structure.

Custom furnishings and millwork



Millwork, cabinetry and mouldings

Artisan crafted furnishings and millwork

Exotic woods for luxury yacht interiors

Unitholder Information

Trustees

Lawrence I. Bell
Chair, British Columbia Hydro & Power Authority

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

Lawrence I. Bell
Chair, British Columbia Hydro & Power Authority

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Vice Chair, Sauder Industries Limited

Richard N. McKerracher
President, Sauder Industries Limited

Officers

Maurice E. Paquette
President and Chief Executive Officer

Robert J. Brown
Chief Financial Officer

Daniel A. Besen
Vice President and Group Manager, California Region

Bryan R. Hoyt
Vice President and Group Manger, Pacific Mountain Region

Garry W. Warner
Vice President and Group Manager, Western Canada Region

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Listings

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Trading under **HWD.UN**

Transfer Agent

Computershare Trust Company of Canada

Investor Relations

Rob Brown
Chief Financial Officer

Telephone: 604-607-3867

Email: robbrown@hardwoods-inc.com

Annual General Meeting

The Annual General Meeting of Hardwoods Distribution Income Fund will be held at
The Fairmont Waterfront Hotel,
900 Canada Place Way,
Vancouver, BC
at 1:30pm
Thursday, May 5, 2005.