PERFORMING UNDER PRESSURE

HARDWOODS

Hardwoods Distribution Income Fund

2007

Annual Report

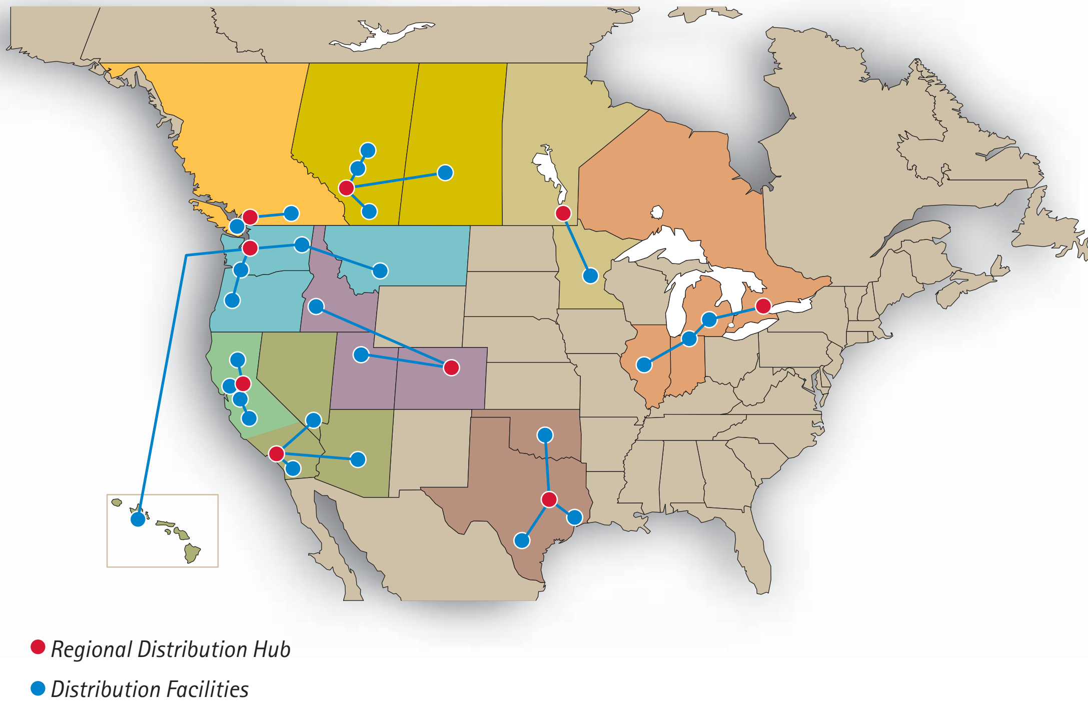
To Unitholders

About the Fund

Hardwoods Distribution Income Fund (the "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 ("Class A Units). Net proceeds of the IPO were used to acquire an 80% interest in a hardwoods 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 ("Class B Units"), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. 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 one of the largest distributors of hardwood lumber and sheet goods in North America, operating a network of 36 distribution centers organized into nine regional clusters at December 31, 2007.



● *Regional Distribution Hub*

● *Distribution Facilities*

Contents:

Report to Unitholders - 1 | Management's Discussion and Analysis - 3 | Consolidated Financial Statements - 22
Notes to the Statements - 27 | Unitholder Information - back cover

To Our Unitholders:

Hardwoods met its objective of generating more Distributable Cash in 2007, increasing Distributable Cash by 3.1% to $17.3 million, or $0.959 per unit, from $0.930 per unit in 2006. In a typical year, such an increase might be viewed as a welcome, but modest, result. In 2007, it was a considerable achievement.

2007 brought what many consider the worst industry market conditions in memory. Residential housing starts, which underpin roughly half of our sales, fell by a dramatic 38% in the US, furthering the decline begun in 2006. The malaise in the housing market spread to the broader US economy, creating a weak foundation for other segments that support hardwood sales such as furniture manufacturing, home renovations, RV manufacturing, and more.

The impact on our industry was significant. On the supply side, prices for hardwood lumber declined by 8%, hard on the heels of a 10% price decline just one year earlier. With fewer orders and lower prices, a number of mills opted to close or consolidate and hardwood lumber production declined by an estimated 20%.

On the customer side, results were not much better. According to the Kitchen Cabinet Manufacturers Association, US kitchen cabinet sales declined 13% in 2007 and by year-end a number of major cabinet manufacturers were laying off workers or closing plants. Furniture manufacturers followed suit. Closer to home, Canadian manufacturing customers enjoyed stronger domestic markets, but faced serious challenges of their own – specifically, a stronger Canadian dollar and its impact on their ability to compete in US markets.

In this environment, Hardwoods' 2007 results were highly encouraging. While our total sales declined by 8.5%, this was partially due to the higher Canadian dollar. Our underlying sales were down by just 5.7% in the US and 3.5% in Canada, as we applied innovative customer and product solutions to help offset market weakness.

Simultaneously, we increased margins to 18.9% from 18.2% by becoming even more disciplined about product pricing and continuing to expand our import program with an enhanced mix of higher-margin import products. While we were at it, we reduced our sales and administrative expenses by $2.2 million and ended the year with $13.4 million less bank indebtedness (net of cash) than compared to the prior year.

These were impressive achievements in the midst of extremely challenging market conditions and we were rewarded for our efforts. Despite lower sales, our 2007 EBITDA remained relatively stable, distributable cash improved, and net income increased compared to 2006.

With our results strengthening, our debt falling and our payout ratio still at a conservative level, our Board of Trustees chose to flow through some of our gains directly to investors. In April, unitholders began receiving a 5% increase in monthly cash distributions, followed by another 5% increase in October 2007. I am pleased to report that we were able to make these increases and still maintain a prudent payout ratio. At year-end, our 2007 payout ratio was 71.5%, down from 79.2% in 2006.

While we are proud of these achievements, we recognize there are more challenges to come in 2008. As evidenced by

our weaker fourth quarter 2007 results, our sales are being hit harder still by the stronger Canadian dollar and a slowing US economy. Moving into 2008, we are taking the necessary steps to align our business with market conditions, including closing two of our US branches in the first quarter of 2008. We will continue to maintain extremely tight control of our costs.

Our strategy will not be entirely defensive, however. We will continue to emphasize margin performance in 2008 with continued growth in our import program and the introduction of new products that support the growing trend toward "green" building practices. For example, to start 2008 we launched a new line of proprietary hardwood veneer products that use fast-growing, plantation hardwood species like poplar to realistically mimic the look of oak, cherry and other more exotic species. To provide added support for our "green" initiatives, we have also certified our entire distribution network to handle environmentally friendly, FSC-certified wood products.

Our strategy for 2008 will also focus on expanding our market share. While market downturns can be difficult, they also provide opportunities to introduce new products and services to customers in need of solutions. Our sales teams are actively targeting new accounts as we work to build awareness and sales for our innovative line of products. Overall, we believe Hardwoods is well positioned to not simply weather this downturn, but to strengthen our market position as we work through it.

In closing, I want to thank our employees for their commitment to the success of Hardwoods and for their support in seeing us through a very challenging year. I also thank our investors for their continued confidence in Hardwoods. In 2007 we demonstrated that we are more than capable of performing under pressure. We look forward to enhancing this reputation in 2008.

Maurice E. Paquette
President and Chief Executive Officer

Management's Discussion and Analysis

March 12, 2008

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 years ended December 31, 2007 and 2006. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). This MD&A also provides additional information regarding our distributable cash and cash distributions in accordance with the interpretative release issued in 2007 by the Canadian Institute of Chartered Accountants (the "CICA") with respect to "Standardized Distributable Cash in Income Trusts and Other Flow Through Entities" and National Policy 41-201 of the Canadian Securities Administrators "Income Trusts and Other Indirect Offerings" (collectively, the "Interpretative Guidance"). For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

This MD&A includes the following sections:

1.0 Background
- 1.1 About the Fund
- 1.2 About Our Business and Industry

2.0 Overview and Outlook

3.0 Results of Operations
- 3.1 Years Ended December 31, 2007 and December 31, 2006
- 3.2 Three Month Periods Ended December 31, 2007 and December 31, 2006

4.0 Liquidity and Capital Resources
- 4.1 Distributable Cash and Cash Distributions
- 4.2 Standardized Distributable Cash and Cash Distributions
- 4.3 Working Capital
- 4.4 Capital Expenditures and Productive Capacity
- 4.5 Utilization of Distributable Cash
- 4.6 Revolving Credit Facilities and Debt Management Strategy
- 4.7 Contractual Obligations
- 4.8 Off Balance Sheet Arrangements

5.0 Financial Instruments

6.0 Related Party Transactions

7.0 Critical Accounting Estimates

8.0 Risks and Uncertainties

9.0 Disclosure Controls and Procedures and Internal Control Over Financial Reporting

10.0 Selected Financial Information
- 10.1 Quarterly Financial Information
- 10.2 Annual Financial Information

Certain statements in this MD&A contain forward-looking information within the meaning of applicable securities laws in Canada ("forward-looking information"). The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words.

The forward-looking information in this MD&A includes, but is not limited to: our expectation that, moving into 2008, our sales will continue to come under pressure from the weak US housing market and the broader economic downturn; our plan to continue to manage our business closely in 2008 and take aggressive action on costs; our plan to continue to monitor our distribution network to ensure expenditures are matched to sales potential in each market; our intention to continue expansion of our high-margin import business, with the planned introduction of a new line of "green" products in 2008, that is expected to have a positive impact in this regard; our expectation that the proposed trust tax will have substantially less impact on the Fund than on other trusts that operate principally or exclusively in Canada; our belief that we will be able to re-organize our tax structure prior to 2011 so as not to expose our US-sourced income to additional taxes associated with the proposed new Canadian trust tax; and, our belief that we are well positioned to withstand the current economic downturn and to continue to strengthen our underlying business.

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: there are no material exchange rate fluctuations between the Canadian and US dollar that affect the amount of cash we have available to distribute to our unitholders in Canadian dollars; we do not lose any key personnel; there are no decreases in the supply of, demand

for, or market values of hardwood lumber or sheet goods that harm our business; we do not incur material losses related to credit provided to our customers; our products are not subjected to negative trade outcomes; we are able to sustain our level of sales and EBITDA margins; we are able to grow our business and to manage our growth; there is no new competition in our markets that leads to reduced revenues and profitability; we do not become subject to more stringent regulations; importation of products manufactured with hardwood lumber or sheet goods does not increase and replace products manufactured in North America; the downturn in the general state of the economy does not worsen and impact upon our results; our management information systems upon which we are dependent are not impaired; our insurance is sufficient to cover losses that may occur as a result of our operations; and, the financial condition and results of operations of our business upon which we are dependent is not impaired.

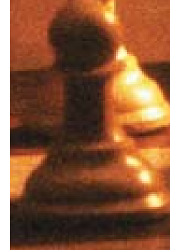
The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results to differ from current expectations include, but are not limited to: exchange rate fluctuations between the Canadian and US dollar could affect the amount of cash we have available to distribute to our unitholders in Canadian dollars; we depend on key personnel, the loss of which could harm our business; decreases in the supply of, demand for, or market values of hardwood lumber or sheet goods could harm our business; we may incur losses related to credit provided to our customers; our products may be subject to negative trade outcomes; we may not be able to sustain our level of sales or EBITDA margins; we may be unable to grow our business or to manage any growth; competition in our markets may lead to reduced revenues and profitability; we may become subject to more stringent regulations; importation of products manufactured with hardwood lumber or sheet goods may increase, and replace products manufactured in North America; our results are dependent upon the general state of the economy; we are dependent upon our management information systems; our insurance may be insufficient to cover losses that may occur as a result of our operations; our credit facilities contain restrictions on our ability to borrow funds and restrictions on distributions that can be made; there are tax risks associated with an investment in our units; our future growth may be restricted by the payout of substantially all of our operating cash flow; and, other risks described in our Annual Information Form and our other continuous disclosure documents.

All forward-looking information in this MD&A is qualified in its entirety by this cautionary statement and, except as may be required by law, we undertake no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

In this MD&A, references to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustments on foreign currency contracts, goodwill and other intangible assets impairments, and the non-controlling interest in earnings. In addition to net income or loss, EBITDA is a useful supplemental measure of performance and cash available for distribution prior to debt service, changes in working capital, capital expenditures and income taxes.

References to "Distributable Cash" are to net cash provided by operating activities, before changes in non-cash operating working capital, less capital expenditures and contributions to any reserves that the Boards of Directors of our operating entities determine to be reasonable and necessary for the operation of the businesses owned by these entities.

We believe that, in addition to net income or loss, our EBITDA and our Distributable Cash are each a useful supplemental measure of operating performance that may assist investors in assessing their investment in Class A Units. Neither EBITDA nor Distributable Cash are earnings measures recognized by GAAP and they do 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, nor should Distributable Cash replace cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA and Distributable Cash may differ from the methods used by other issuers. Therefore, our EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. For reconciliation between EBITDA and net income or loss as determined in accordance with GAAP, please refer to the discussion of Results of Operations described in section 3.0 of this report. For reconciliation between Distributable Cash and net cash provided by operating activities as determined in accordance with GAAP, please refer to the discussion of



Distributable Cash and Cash Distributions described in section 4.1 of this report.

We believe that this MD&A has been prepared in all material respects in accordance with recommendations issued in 2007 in the Interpretive Guidance. The Interpretive Guidance provides guidance on standardized preparation and disclosure of distributable cash for income trusts ("Standardized Distributable Cash"). The CICA calculation of Standardized Distributable Cash, which is also a non-GAAP measure, is defined, for the purposes of the Fund, as the periodic cash provided by operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital, less total capital expenditures. For a summary of our Standardized Distributable Cash, please refer to section 4.2 of this report. For reconciliation between Standardized Distributable Cash and our Distributable Cash, please see section 4.2.

1.0 BACKGROUND

1.1 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 ("Class A Units"). Net IPO proceeds of $133.5 million, together with drawings on credit facilities totalling $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 ("Class B Units"), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. Distributions by the Fund's operating subsidiaries to the previous owners are subject to subordination arrangements until certain financial tests established at the time of the IPO and described in the Audited Financial Statements are met. As at December 31, 2007, 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.

1.2 About our Business and Industry

Hardwoods is one of North America's largest distributors of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. At December 31, 2007 we operated 36 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.

Approximately half of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods, consisting primarily of hardwood plywood, and including 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.

Our customer base manufactures a range of end-use products, such as cabinetry, furniture and custom millwork. These products in turn are sold into multiple sectors of the economy, including new home construction, renovation, non-residential construction and institutional markets. As a result of this diversity, it is difficult to determine with certainty what proportion of our products ends up in each sector of the economy. We estimate that approximately 40% to 50% of our products are used in new residential construction, in the form of cabinets, mouldings, custom finishing, and home furniture. We believe the balance of our products end up in other sectors of the economy not associated with new residential construction, such as home renovations, finishing millwork for office buildings, restaurant and bar interiors, hotel lobbies, retail point-of-purchase displays, schools, hospitals, custom motor coaches, yacht interiors and other specialty areas.

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. Prices have generally kept pace with inflation over the long term, although more recently we have experienced a more pronounced downward trend in hardwood pricing reflecting weaker market conditions.

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.

2.0 OVERVIEW AND OUTLOOK

Market conditions continued to worsen in 2007. Housing starts in the United States fell 38% year-over-year, exacerbating the 13% decline experienced in 2006. Mortgage defaults associated with the subprime mortgage segment reached record highs and cast a further pall over the broader US economy. The hardwoods industry, which is affected by changes in both the residential construction market and the general economy, was negatively affected by the downturn. The hardwood lumber price index (representing the average published prices of 14 key hardwood items) declined 8% in 2007 after falling 10% in 2006. Sales in the US cabinet industry were also down 13% year-over-year according to the Kitchen Cabinet Manufacturers Association, and a number of major US cabinet and furniture manufacturers curtailed production as the year progressed.

While Canadian housing starts and economic conditions fared better in 2007, our domestic operations faced the challenges of a rising Canadian dollar. Increases in the value of the Canadian dollar relative to the US currency affect us in two ways: First, a stronger Canadian dollar reduces the purchase price we pay for products sourced from mills in the United States. When these products are resold to our Canadian customers it is also at a lower Canadian dollar equivalent selling price, which effectively reduces our revenue in Canada. Second, a stronger Canadian dollar can affect the competitiveness of our Canadian customers who sell their products to customers in the US.

In light of these challenges, our 2007 sales results showed resiliency. Underlying sales decreased by just 5%, with foreign exchange factors increasing the negative impact to 8.5%. Simultaneously, we increased our average gross profit margin to 18.9% from 18.2% – a significant achievement accomplished with disciplined selling and the expansion of our import program. Hardwoods began increasing its' emphasis on import products in 2004. Our focus on high-quality, high-margin products has been providing benefits for customers and for Hardwoods ever since. During 2007, sales from this program climbed 33% to $40 million, adding more high-margin sales to the mix.

We also took aggressive action on costs during 2007, reducing our employee base by 6%, eliminating excess trucking contracts, curtailing employee relocation expenses and subletting underutilized warehouse. These initiatives, together with the positive impact of a stronger Canadian dollar on US operations' costs, helped reduce our sales and administrative expenses by $2.2 million in 2007.

The combination of higher margins and lower costs resulted in relatively stable EBITDA, higher Distributable Cash and improved net earnings, all of which supported the Board's decision to increase monthly cash distributions twice in 2007. By year-end, monthly cash distributions had climbed 10% to $0.075 per unit, or $0.90 per unit on an annualized basis. Significantly, our payout ratio also remained at a conservative at 71.5% and we continued to pay down debt. As at December 31, 2007, our bank indebtedness (net of cash) was reduced $13.4 million compared to the prior year, and our debt-to-EBITDA ratio had decreased to 1.19 compared to 1.77 at the end of 2006.

Moving into 2008, we expect our sales will continue to come under pressure from the weak US housing market and the broader economic downturn, which is now affecting the US market as a whole. While economic conditions are currently stronger in Canada, the domestic market continues to be negatively affected by foreign exchange impacts.

With approximately 70% of our operations in the United States, our overall sales results are also influenced by changes in the value of the Canadian dollar relative to the US dollar. To date our Distributable Cash results have been partially cushioned by currency hedges that fix the exchange rate at $1.30 on a portion of our Distributable Cash. These hedges will remain in effect until April 2008, after which for the balance of 2008 they will be replaced with currency hedges at $1.12 Canadian. In 2008, realized gains on foreign

currency contracts under the new hedges at $1.12 Canadian will be $0.9 million less than would otherwise be realized under the previous hedges at $1.30 Canadian.

In light of these factors, we will continue to manage our business closely in 2008 and take aggressive action on costs. Two distribution centres with limited sales growth potential are scheduled to close in the first quarter of 2008: Bozeman, Montana and Oklahoma City, Oklahoma. Going forward, we will continue to monitor our distribution network to ensure expenditures are matched to sales potential in each market.

Maintaining strong gross profit margin performance will be another key priority in 2008. The continued expansion of our high-margin import business, with the planned introduction of a new line of "green" products in 2008, should have a positive impact in this regard. In addition, we are working to expand market share by targeting new customers with innovative product and service solutions that help them respond to the challenging conditions.

We will continue to monitor and plan for the impact of the federal government's decision to tax income trusts. The government's legislation was substantively enacted on June 12, 2007, and these changes will begin to take effect in 2011. Overall, it is anticipated that the proposed trust tax will have substantially less impact on the Fund than on other trusts that operate principally or exclusively in Canada. The 70% of Hardwoods' business that is conducted in the U.S. is already subject to US taxation. The Fund believes that it will be able to re-organize its tax structure prior to 2011 such that it will not expose its US-sourced income to additional taxes associated with the proposed new Canadian trust tax.

Overall, with a strong balance sheet, a conservative payout ratio and a clear and appropriate strategy for maintaining solid results, we believe Hardwoods is well positioned to withstand the current economic downturn and to continue to strengthen our underlying business.

3.0 RESULTS OF OPERATIONS

3.1 Years Ended December 31, 2007 and December 31, 2006

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

	Year ended December 31 2007	Year ended December 31 2006
Total sales	$ 331,765	$ 362,528
Sales in the US (US$)	*210,785*	*223,509*
Sales in Canada	*105,171*	*109,024*
Gross profit	62,737	66,042
Gross profit %	*18.9%*	*18.2%*
Selling and administrative expenses	(43,360)	(45,559)
Realized gain on foreign currency contracts	1,883	1,338
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 21,260	$ 21,821
Add (deduct):		
Amortization	(1,866)	(2,100)
Interest	(2,402)	(3,127)
Mark-to-market adjustment on foreign currency contracts	641	(1,280)
Intangibles impairment	–	(326)
Goodwill impairment	–	(7,566)
Non-controlling interest	(109)	(1,484)
Income taxes	(1,905)	(2,301)
Net earnings for the period	$ 15,619	$ 3,637
Basic and fully diluted earnings per Class A Unit	$ 1.084	$ 0.252
Average Canadian dollar/US dollar exchange rate	1.0750	1.1342

Sales

For the year ended December 31, 2007, total sales were $331.8 million, down 8.5% from $362.5 million in 2006. The decrease in total sales reflects a 5.0% decrease in underlying sales activity, and a 3.5% decrease in sales due to the negative impact of a stronger Canadian dollar.

Sales in the United States, as measured in US dollars, decreased 5.7% to $210.8 million, compared to $223.5 million in 2006. The majority of the sales decrease occurred in our California locations. The widely reported slowdown in the US housing starts has been particularly severe in California, significantly reducing demand in one of our key markets.

Sales in Canada, as measured in Canadian dollars, were $105.2 million, down 3.5% from $109.0 million in 2006. Approximately half of the $3.8 million sales decrease was due to reduced sales contribution from our Windsor, Ontario branch, which was closed at the end of 2006. Demand for our products in Canada was generally stable in 2007, although the continued strengthening of the Canadian dollar in 2007 represented an ongoing challenge.

Gross Profit

Gross profit for the year ended December 31, 2007 was $62.7 million, compared to $66.0 million in 2006. Although our sales decreased by 8.5% in 2007, gross profits fell by a lesser amount of 5.0% due to our efforts to improve our gross profit percentage. Gross profit percentage increased to 18.9% in 2007, compared to 18.2% in 2006. This improvement reflects the discontinuation of lower-margin business with some customers, advantageous inventory purchases, disciplined setting of our selling prices, and continued growth of import products into our sales mix.

Selling and Administrative Expenses

Selling and Administrative (S&A) expenses were $43.4 million in 2007, a decrease of $2.2 million or 4.8% from $45.6 million in 2006. Recognizing the more challenging sales environment facing our business, we took steps to control costs as discussed in section 2.0 Overview and Outlook. The benefit of the stronger Canadian dollar on the conversion of S&A expenses at our US operations also reduced costs by $1.5 million, compared to the same period in the prior year. As a percentage of sales, S&A expenses were 13.1% of sales in 2007, compared to 12.6% in 2006, reflecting lower sales.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of $1.9 million on foreign currency contracts which matured in 2007, an increase of $0.6 million compared to realized gains of $1.3 million in 2006. This improvement was driven by the strengthening of the Canadian dollar in 2007. The terms of our foreign currency contracts and the Fund's use of currency derivatives to mitigate the economic impact of fluctuations between the Canadian and US dollar are described in section 5.0 of this report.

EBITDA

Full-year EBITDA was $21.3 million, compared to $21.8 million in 2006. The $0.5 million decrease in EBITDA reflects lower gross profit, partially offset by the $2.2 million reduction in S&A and the $0.6 million increase in realized gains on foreign currency contracts.

Interest Expense

Interest expense was $2.4 million in 2007, compared to $3.1 million in 2006. The reduced interest charges reflect reduced bank indebtedness, described more fully in section 4.6 of this report.

Mark-To-Market Adjustment on Foreign Currency Contracts

For the year ended December 31, 2007, the mark-to-market valuation of our outstanding foreign currency contracts created an adjustment gain of $0.6 million, compared to an adjustment loss of $1.3 million in 2006. Further discussion of our foreign currency contracts can be found under Financial Instruments in section 5.0 of this report.

Goodwill and Intangibles Impairment

Under Canadian GAAP, goodwill and intangible assets are subject to an annual impairment test. The Fund completed its annual impairment test for 2007 and determined that the fair value of goodwill and other intangibles exceeded their respective carrying values as recorded in the Audited Financial Statements; accordingly, no impairment was identified. Comparatively, when the Fund completed its annual impairment test in 2006, it was determined that the carrying value of goodwill exceeded the fair value of goodwill by $7.6 million, while the carrying value of other intangibles

exceeded the fair value of other intangibles by $0.3 million. As a result, the excess of carrying value over fair value was charged to income in 2006 when the impairment was identified. The 2006 write-down of goodwill and intangibles related solely to Hardwoods' Canadian operations, and approximately two-thirds of the $7.9 million in impairment charges reflected the anticipated reduction to cash flows resulting from the federal government's decision to tax Canadian income trusts commencing in 2011.

Non-controlling Interest

Non-controlling interest in earnings was $0.1 million for 2007, compared to $1.5 million in 2006. The reduction in non-controlling interest is due to an adjustment related to the subordinated status of the non-controlling interest. In 2007, the non-controlling interest in earnings was reduced to reflect the value of subordinated distributions that were not made to the Class B Units, and that can no longer be recovered by the Class B Units under the terms of the Fund's subordination feature. The Fund's subordination feature is further described in section 4.0 of this report and in the Audited Financial Statements.

Net Earnings

Net earnings for 2007 were $15.6 million, compared to $3.6 million in 2006. The $12.0 million increase primarily reflects the $7.9 million reduction in impairment in goodwill and other intangible assets, a $1.9 million increase in mark-to-market adjustment gains on foreign currency contracts, a $1.4 million decrease in non-controlling interest, a $0.4 million decrease in income taxes, a $0.7 million decrease in interest expense, and a $0.2 million reduction in amortization expense. These gains were partially offset by the $0.5 million decrease in EBITDA.

3.2 Three Months Ended December 31, 2007 and December 31, 2006

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

	3 months ended December 31 2007	3 months ended December 31 2006
Total sales	$ 68,767	$ 83,120
Sales in the US (US$)	*46,643*	*51,502*
Sales in Canada	*23,665*	*24,466*
Gross profit	12,488	15,116
Gross profit %	*18.2%*	*18.2%*
Selling and administrative expenses	(10,024)	(11,354)
Realized gain on foreign currency contracts	648	326
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 3,112	$ 4,088
Add (deduct):		
Amortization	(437)	(527)
Interest	(487)	(664)
Mark-to-market adjustment on foreign currency contracts	(634)	(1,212)
Intangibles impairment	–	(326)
Goodwill impairment	–	(7,566)
Non-controlling interest	277	1,242
Income taxes	284	139
Net earnings (loss) for the period	$ 2,115	$ (4,826)
Basic and fully diluted earnings (loss) per Class A Unit	$ 0.147	$ (0.335)
Average Canadian dollar/US dollar exchange rate	0.9812	1.1384

Sales

For the three months ended December 31, 2007 sales were $68.8 million, down from $83.1 million in the same period in 2006. The 17.3% reduction in sales reflects a 9.7% decrease in sales due to the negative effect of a stronger Canadian dollar and a 7.6% decrease in underlying sales activity. Fourth quarter sales activity at our US operations (as measured in US dollars) was down 9.4%, and sales in Canada declined by 3.3%. Lower sales reflect the challenging business conditions previously discussed in section 2.0 of this MD&A.

Gross Profit

Gross profit in the three months ended December 31, 2007 was $12.5 million, a decrease of $2.6 million, or 17.3%, from the $15.1 million reported in the same period in 2006. As a percentage of sales, gross profit remained steady at 18.2% in the 2007 and 2006 periods. Accordingly, the decrease in gross profit dollars reflects lower sales. Some quarter-to-quarter variation in gross profit percentage is considered normal for our business, with 18% to 19% representing a typical range. As an average, our goal is to achieve a gross profit percentage of 18.5% of sales or higher.

Selling and Administrative Expenses

S&A expenses decreased $1.4 million to $10.0 million in the fourth quarter of 2007, from $11.4 million during the same period in 2006. Of the $1.4 million S&A reduction, $1.0 million is due to the beneficial impact of a stronger Canadian dollar on the conversion of S&A expenses at our US operations. The remaining reduction to S&A expenses reflects the absence of some non-recurring expenses that affected 2006 results, but were not present in 2007. As a percentage of sales, fourth quarter S&A expenses were 14.6% of sales, compared to 13.7% in 2006, reflecting lower sales.

Realized Gain on Foreign Currency Contracts

Foreign currency contracts which matured during the fourth quarter of 2007 provided $0.6 million in gains, compared to $0.3 million in gains in the 2006 comparative period. This improvement was driven by the Canadian dollar being on average 14% stronger in the fourth quarter of 2007, compared to the same period in 2006. The terms of our foreign currency contracts and the Fund's use of currency derivatives to mitigate the economic impact of fluctuations between the Canadian and US dollar are described in section 5.0 of this report.

EBITDA

EBITDA was $3.1 million in the three months ended December 31, 2007, compared to $4.1 million in the same period in 2006. The $1.0 million change in EBITDA reflects the $2.6 million decrease in gross profit due to reduced sales, a $1.4 million reduction in S&A expenses, and a $0.3 million increase in realized gain on foreign currency contracts.

Mark-To-Market Adjustment on Foreign Currency Contracts

For the three months ended December 31, 2007, the mark-to-market valuation of our outstanding foreign currency contracts created an adjustment loss of $0.6 million, compared to an adjustment loss of $1.2 million in the same period in 2006. Further discussion of our foreign currency contracts can be found under Financial Instruments in section 5.0 of this report.

Goodwill and Intangibles Impairment

As described in section 3.1 of this report, in 2006 the Fund completed its annual impairment test and determined that the carrying value of goodwill exceeded the fair value of goodwill by $7.6 million, while the carrying value of other intangibles exceeded the fair value of other intangibles by $0.3 million. Similar testing in 2007 determined no impairment existed in the carrying value of goodwill or other intangible assets.

Non-controlling Interest

Non-controlling interest in the fourth quarter of 2007 was a $0.3 increase to earnings, compared to $1.5 million positive earnings impact in the comparable period in 2006. The change in non-controlling interest reflects higher profits in Q4 2007 compared to 2006, partly offset by an adjustment to the non-controlling interest in earnings made in 2007 and described previously in section 3.1 of this report.

Net Earnings

Net earnings in the fourth quarter of 2007 were $2.1 million, compared to a net loss of $4.8 million in 2006. The $6.9 million improvement in net earnings primarily reflects the $7.9 million decrease in goodwill and intangible

impairment, a $0.6 million decrease in mark-to-market adjustment losses on foreign currency contracts, a $0.1 million increase in income tax recovery, a $0.2 million decrease in interest expense and a $0.1 million decrease in amortization expense. This was partially offset by the $1.0 million decrease in EBITDA and a $1.2 million increase in non-controlling interest in the fourth quarter.

4.0 LIQUIDITY AND CAPITAL RESOURCES

4.1 Distributable Cash and Cash Distributions

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

	Year ended December 31 2007	Year ended December 31 2006	3 months ended December 31 2007	3 months ended December 31 2006
Net cash provided by operating activities	$ 20,629	$ 18,539	$ 10,514	$ 10,513
Increase (decrease) in non-cash operating working capital	(2,777)	(889)	(7,291)	(6,702)
Cash flow from operations before changes in non-cash operating working capital	17,852	17,650	3,223	3,811
Capital expenditures	(571)	(902)	(18)	(97)
Distributable cash	$ 17,281	$ 16,748	$ 3,205	$ 3,714
Distributions relating to the period:				
Class A Units	$ 12,355 (1)	$ 13,265	$ 3,243 (2)	$ 2,940
Class B Units	– (3)	–	– (3)	– (3)
Total Units	$ 12,355	$ 13,265	$ 3,243	$ 2,940
Outstanding units and per unit amounts:				
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,500	18,012,500	18,012,500	18,012,500
Distributable Cash per Total Units	$ 0.959	$ 0.930	$ 0.178	$ 0.206
Distributions relating to the period:				
Class A Units	$ 0.857 (1)	$ 0.921	$ 0.225 (2)	$ 0.204
Class B Units	$ – (3)	$ –	$ – (3)	$ – (3)
Total Units	$ 0.686	$ 0.736	$ 0.180	$ 0.163
Payout Ratio (4)	71.5%	79.2%	101.2%	79.2%

1 Includes the cash distributions of $0.068 per Class A Unit per month which relate to the operations of the Fund for January, February, and March 2007; $0.0714 per Class A Unit per month which relate to the operations of the Fund for April through September 2007; and $0.075 per Class A Unit per month which relate to the operations of the Fund for October through December 2007 inclusive.

2 Includes the cash distributions of $0.075 per Class A Unit per month which relate to the operations of the Fund for October, November, and December 2007.

3 On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the December 31, 2007 balance sheet.

4 Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

4.1 Distributable Cash and Cash Distributions (continued)

Selected Unaudited Consolidated Financial Information
(in thousands of Canadian dollars except per unit amounts)

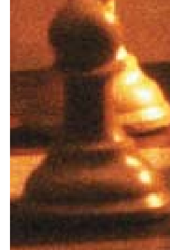
	March 23, 2004 to December 31 2007
Cumulative since inception:	
Distributable Cash	$ 70,649
Distributions relating to the period	59,189
Payout ratio (1)	83.8%

1 Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

We pay distributions on Class A Units at the end of the month following the month in which the cash is earned. Distributions may also be made quarterly on Class B Units in an amount equivalent on an after-tax per-unit basis to distributions made on Class A Units, pursuant to the terms of a subordination agreement as outlined in the Fund's Annual Information Form. Except as outlined in the terms of the subordination agreement with the Class B Units, there are no limitations on distributions from the subsidiaries of the Fund arising from the existence of a minority interest in a subsidiary of the Fund. Further description of the subordination arrangement is included in note 8 of the accompanying Audited Financial Statements.

The Fund's subordination feature is designed to stay in place until the EBITDA and certain distributable cash tests established at the time of the IPO are met. The terms of these tests are described in the notes to the accompanying Audited Financial Statements.

In 2007, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of $17.3 million, or $0.959 per unit. Distributions relating to the period were $12.4 million, or $0.857 per unit, to our public unitholders (Class A Units). In accordance with the terms of a subordination feature in place with the previous owners (Class B Units), no distributions were made to the previous owners related to the year ended December 31, 2007. In the fourth quarter of 2007 the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of $3.2 million, or $0.178 per unit, and made distributions relating to the period of $3.2 million, or $0.225 per unit to our public unitholders only (Class A Units). These distributions represent an overall payout ratio of 71.5% for the year ended December 31, 2007, and 101.2% for the fourth quarter of 2007. The income tax characterization of distributions paid to unitholders in 2007 was 70.62% fully taxable distributions, 24.83% eligible dividends, and 4.56 % return of capital.



4.2 Standardized Distributable Cash and Cash Distributions

Selected Unaudited Consolidated Financial Information
(in thousands of Canadian dollars except per unit amounts)

	Year ended December 31 2007	Year ended December 31 2006	3 months ended December 31 2007	3 months ended December 31 2006
Net cash provided by operating activities	$ 20,629	$ 18,539	$ 10,514	$ 10,513
Capital expenditures	(571)	(902)	(18)	(97)
Standardized distibutable cash	$ 20,058	$ 17,637	$ 10,496	$ (10,416)
Distributions relating to the period:				
Class A Units	$ 12,355[1]	$ 13,265	$ 3,243[2]	$ 2,940
Class B Units	– [3]	–	– [3]	– [3]
Total Units	$ 12,355	$ 13,265	$ 3,243	$ 2,940
Outstanding units and per unit amounts:				
Class A units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,500	18,012,500	18,012,500	18,012,500
Standardized distributable cash per Total Units	$ 1.114	$ 0.979	$ 0.583	$ 0.578
Distributions per Total Units	$ 0.686	$ 0.736	$ 0.180	$ 0.163
Standardized payout ratio [4]	61.6%	75.2%	30.9%	28.2%

	March 23, 2004 to December 31 2007
Cumulative inception:	
Standardized Distributable Cash	63,356[5]
Distributions relating to the period	59,189
Standardized payout ratio [4]	93.4%

1 Includes the cash distributions of $0.068 per Class A Unit per month which relate to the operations of the Fund for January, February, and March 2007; $0.0714 per Class A Unit per month which relate to the operations of the Fund for April through September 2007; and $0.075 per Class A Unit per month which relate to the operations of the Fund for October through December 2007 inclusive.

2 Includes the cash distributions of $0.075 per Class A Unit per month which relate to the operations of the Fund for October, November, and December 2007.

3 On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the December 31, 2007 balance sheet.

4 Standardized payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.

5 Calculation of cumulative Standardized Distributable Cash since inception excludes a $10.3 million increase in non-cash operating working capital, which relates to a final working capital adjustment payment made to the former owners to complete the initial purchase of the Business.

In addition to our Distributable Cash, the Interpretive Guidance also recommends disclosure of Standardized Distributable Cash. This is provided in the table above. Management believes that the calculation of Standardized Distributable Cash distorts the Fund's quarter-to-quarter distributable cash and payout ratios, as our non-cash operating working capital fluctuates significantly as a result of the seasonality of our business. The board of directors of our operating entities look beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. As a result, management believes that our historical measure of Distributable Cash, which excludes the impact of changes in non-cash working capital, is a better measure for determining our operating performance.

The table below reconciles Standardized Distributable Cash to our Distributable Cash.

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

	Year ended December 31 2007	Year ended December 31 2006	3 months ended December 31 2007	3 months ended December 31 2006
Standardized Distributable Cash	$ 20,258	$ 17,637	$ 10,496	$ 10,416
Increase (decrease) in non-cash operating working capital	(2,777)	(889)	(7,291)	(6,702)
Distributable Cash	$ 17,281	$ 16,748	$ 3,205	$ 3,714

4.3 Working Capital

Our business requires an ongoing investment in working capital, comprised of accounts receivable, income taxes recoverable, inventory, and prepaid expenses, partly offset by short term credit provided by suppliers in the form of accounts payable and accrued liabilities. Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers and payments made to our suppliers. Historically the first and fourth quarters are seasonally slower periods for construction activity and therefore demand for hardwood products decreases. As a result, sales and working capital requirements may be lower in these quarters. A summary of changes in our non-cash operating working capital during the years ended December 31, 2007 and 2006 is provided below.

(in thousands of Canadian dollars)

	2007	2006
Accounts Receivable	$ 1,470	$ (122)
Income taxes recoverable	(445)	(510)
Inventory	1,627	3,070
Prepaid expenses	(70)	123
Accounts payable and accrued liabilities	195	(1,672)
	$ 2,777	889

4.4 Capital Expenditures and Productive Capacity

Our capital expenditures are typically low as we lease all of our buildings and contract out all freight delivery services. Capital expenditures are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Annual maintenance capital requirements are expected to average approximately $1.0 million per year, but may be higher or lower than this in a particular year based on the needs of the business. Management believes this annual amount is sufficient to maintain the existing productive capacity of the business as it relates to our needs for property, plant and equipment. Our actual capital expenditures in 2007 totalled $0.6 million.

In addition to maintaining the productive capacity of our property, plant and equipment, management also manages the productive capacity of the business in terms of: (1) available distribution infrastructure; and (2) maintenance of a skilled work force.

Available distribution infrastructure refers to the physical capacity of the distribution network maintained by our business, and may be measured in terms of the number and total square footage of distribution centres in operation. Since the Fund's IPO in March 2004, we have made a number of adjustments to our distribution network, including opening, closing, and relocating some of our distribution facilities. However as shown in the table below, productive capacity, as measured by the distribution infrastructure available to our business, has been largely sustained at levels consistent with the Fund's IPO.

Selected Unaudited Consolidated Financial Information
(in thousands of Canadian dollars except per unit amounts)

	December 31 2007	December 31 2006	December 31 2005	December 31 2004	IPO March 23 2004
Number of distribution centres in operation	36	36	39	37	37
Total square footage of distribution centres	1.3 million	1.3 million	1.3 million	1.3 million	1.3 million

Maintenance of a skilled workforce is also critical to managing the productive capacity of our business. We utilize a number of strategies to attract, train, retain and reward our employees. Our staffing levels reflect decisions regarding our distribution network and our expectations for sales demand based upon prevalent economic conditions. Trends in our workforce capacity, as measured in terms of number of employees and average annual sales dollars per employee, are summarized below. Although the productive capacity of our human capital is difficult to measure directly, we believe the productive capacity of our business in terms of our human capital has been largely sustained since the Fund's IPO in March 2004.

Selected Unaudited Consolidated Financial Information
(in thousands of Canadian dollars except per unit amounts)

	December 31 2007	December 31 2006	December 31 2005	December 31 2004	IPO March 23 2004
Number of employees	236	252	259	224	216
Annual sales per employee in $ millions	1.4	1.4	1.4	1.7	n/a

4.5 Utilization of Distributable Cash

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

	Year ended December 31 2007	Year ended December 31 2006	3 months ended December 31 2007	3 months ended December 31 2006
Distributable Cash	$ 17,281	$ 16,748	$ 3,205	$ 3,714
Cash Distributions paid in the period	(12,254)	(13,516)	(3,190)	(2,940)
Distributable Cash retained	$ 5,027	$ 3,232	$ 15	$ 774
Decrease (increase) in non-cash operating working capital	2,777	889	7,291	6,702
Decrease (increase) in long-term receivables	1,640	2,002	137	433
Decrease (increase) in deferred financing fees	–	(33)	–	(33)
Proceeds from disposal of property, plant and equipment	26	34	–	17
Decrease (increase) in bank indebtedness, net of cash	$ 9,470	$ 6,124	$ 7,443	$ 7,893

Our utilization of Distributable Cash and its relation to working capital use and bank line financing are summarized above.

For the year ended December 31, 2007, the Fund generated Distributable Cash of $17.3 million, paid cash distributions of $12.3 million, and retained $5.0 million of Distributable Cash. We also generated cash by reducing our investment in non-cash operating working capital (primarily accounts receivable and inventory, less accounts payable and accrued liabilities) by $2.8 million and our investment in long-term receivables by $1.6 million. Taking these factors together, the Fund was able to pay down its bank indebtedness (net of cash) by $9.5 million in 2007.

For the three months ended December 31, 2007, the Fund generated Distributable Cash of $3.2 million and paid cash distributions of $3.2 million. We decreased our investment in non-cash operating working capital by $7.3 million (reflecting the seasonality of the business), and reduced our investment in long-term receivables by $0.1 million. Taking these factors together, the Fund was able to pay down its bank indebtedness (net of cash) by $7.4 million in the fourth quarter of 2007.

We believe that our credit facilities, combined with the retained portion of our Distributable Cash, are sufficient to meet our current working capital requirements. The terms of our revolving credit facilities are addressed in section 4.6 of this report.

4.6 Revolving Credit Facilities and Debt Management Strategy

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

	As at December 31 2007	As at December 31 2006
Cash and cash equivalents	$ (295)	$ (594)
Debt	25,515	39,152
Net debt	$ 25,220	38,558
Unitholders' equity	$ 105,994	$ 113,310
Total Capitalization	$ 131,214	$ 151,868
Net debt to total capitalization	19.2%	25.4%
Previous 12 months EBITDA	$ 21,260	$ 21,821
Net debt to previous 12 months EBITDA	1.19	1.77

We have independent credit facilities in both Canada and the U.S. In Canada, our operating line extends to November 30, 2009 and comprises a maximum facility of $22.0 million. The balance outstanding on the Canadian operating line as at December 31, 2007 was $5.5 million. In the US, our operating line extends to March 31, 2010 and comprises a maximum facility of US$35 million. As at December 31, 2007 the US credit facility had a balance outstanding of $18.9 million (US $19.1 million). The principal terms of the credit facilities available to Hardwoods LP and Hardwoods US LP are described in more detail in the Fund's Annual Information Form.

As discussed previously in section 4.5 of this report, the Fund paid down its net debt by $9.5 million in the twelve months ended December 31, 2007. The impact of a stronger Canadian dollar on the conversion of our US dollar-denominated net debt also provided a $3.9 million benefit. Taken together, the Fund's net debt balance decreased $13.4 million, from $38.6 million at December 31, 2006 to $25.2 million at December 31, 2007. Overall net debt compared to total capitalization stood at 19.7% as of December 31, 2007, compared to 25.4% at December 31, 2006. The ratio of net debt to EBITDA in the previous 12 months is 1.19 times at December 31, 2007 compared to 1.77 times at December 31, 2006. Net debt to EBITDA serves as an indicator of our financial leverage. The maximum ratio of net debt to EBITDA allowed under our Canadian credit facility is 2.50 times, and the maximum ratio of net debt to EBITDA allowed under our US credit facility is 2.85 times.

The terms of the agreements with our lenders provide that distributions cannot be made to our unitholders in the event that our subsidiaries did not meet the foregoing leverage as well as some additional credit ratios. Our operating subsidiaries were fully compliant with all required credit ratios as at December 31, 2007, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Our debt management strategy is to roll and renew, as opposed to repay and retire, our revolving credit facilities in Canada and the US when they expire in November 2009 and March 2010, respectively. We do not intend to restrict future distributions in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn upon our available revolving credit facilities will depend upon the seasonal needs of the business and cash generating capacity of the Fund. When making distribution decisions, we will consider the amount of financial leverage and therefore bank debt, we believe is appropriate for the Fund given existing and expected market conditions and available business opportunities. We do not target a specific financial leverage amount.

4.7 Contractual Obligations

The table below sets forth our contractual obligations as at December 31, 2007. These obligations relate to operating leases on various premises and automobiles, and become due in the fiscal years indicated:

(in thousands of Canadian dollars)

2008	$ 6,451
2009	5,207
2010	3,330
2011	1,240
2012	715
2013 and thereafter	684
Total	$ 17,627

4.8 Off-Balance Sheet Arrangements

The Fund has no off-balance sheet arrangements. The foreign currency contracts discussed under Financial Instruments in section 5.0 of this report are marked-to-market at the end of each quarter, with the fair value recorded on the balance sheet.

5.0 FINANCIAL INSTRUMENTS

We use currency contracts to assist in forward planning for our business as it relates to managing our 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, 2007 a subsidiary of the Fund held foreign currency contracts covering the period 24 months into the future as follows:

Month	Sell US dollars	Contract exchange rate $C / $US	Receive CDN dollars
January 2008	US$675,000	1.3001	C$877,568
February 2008	US$675,000	1.3001	C$877,568
March 2008	US$675,000	1.3001	C$877,568
April 2008	US$675,000	1.3001	C$877,568
May 2008	US$675,000	1.1255	C$759,712
June 2008	US$675,000	1.1255	C$759,712
July 2008	US$675,000	1.1255	C$759,712
August 2008	US$675,000	1.1255	C$759,712
September 2008	US$675,000	1.1255	C$759,712
October 2008	US$675,000	1.1255	C$759,712
November 2008	US$675,000	1.1255	C$759,712
December 2008	US$675,000	1.1255	C$759,712
January 2009	US$675,000	1.1255	C$759,712
February 2009	US$675,000	1.1255	C$759,712
March 2009	US$675,000	1.1255	C$759,712
April 2009	US$675,000	1.1255	C$759,712
May 2009	US$675,000	1.0882	C$734,535
June 2009	US$675,000	1.0595	C$715,162
July 2009	US$675,000	1.0625	C$717,187
August 2009	US$675,000	1.0560	C$712,800
September 2009	US$675,000	1.0010	C$675,675
October 2009	US$675,000	0.9315	C$628,762
November 2009	US$675,000	0.9901	C$668,317
December 2009	US$675,000	1.0119	C$683,032

The fair value of the 24 monthly currency contracts covering the period January 2007 to December 2009 has been reflected in the financial statements and represents a current asset of $1.5 million, a long-term asset of $0.5 million, and a long term liability of $47,000 as at December 31, 2007. Based on our current monthly distribution rate of $0.075 per unit to public unitholders, the principal value of our monthly foreign currency contracts is sufficient to fully cover the estimated amount of US dollar denominated distributable cash that must be converted to Canadian dollars to pay distributions to Class A Unitholders.

6.0 RELATED PARTY TRANSACTIONS

Related parties refers to affiliates of the previous owners of the Business who have retained a 20% interest in Hardwoods through ownership of Class B Hardwoods LP units and Class B Hardwoods USLP units, respectively. For the year ended December 31, 2007, sales of $0.7 million were made to related parties, and the subsidiaries of the Fund purchased $0.2 million from related parties. These sales and purchases took place at prevailing market prices. Subsidiaries of the Fund also paid $108,000 to related parties to provide services for management information systems.

7.0 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 estimate of the potential of recovering our accounts receivable, and incorporates current and expected collection trends.

Valuation of Inventories: We anticipate that 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.

Valuation of Other Intangible Assets and Goodwill: Other intangible assets represent customer relationships acquired at the time of our IPO and are recorded at cost, less accumulated amortization. Amortization is provided for on a straight line basis over 15 years. Goodwill is recorded at cost and is not amortized. Management reviews the carrying value of goodwill and of other intangible assets annually, or more frequently if events or changes in circumstances indicate that an asset may be impaired. An excess of carrying value over fair value is charged to income in the period in which the impairment is determined.

Future Income Taxes: In response to the Canadian federal government's legislation to tax publicly traded income trusts which was substantively enacted in the second quarter of

2007, the Fund is now required to recognize the value of future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Management is required to make estimates and assumptions regarding future business results as well as the amount and timing of certain future discretionary tax deductions available to the Fund. These management estimates and assumptions can have a material impact upon the amount of future income tax assets and liabilities that are recognized by the Fund.

All significant accounting policies have been included in note 2 to the Audited Financial Statements.

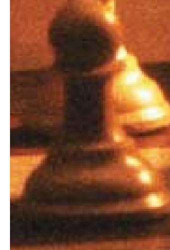
8.0 RISKS AND UNCERTAINTIES

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of in our Annual Information Form dated March 17, 2008, which is available to readers at www.sedar.com.

9.0 DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROL OVER FINANCIAL REPORTING

The Fund's management is responsible for establishing and maintaining disclosure controls and procedures to provide reasonable assurance that material information related to the Fund, including its consolidated subsidiaries, is made known to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), by others within those entities on a timely basis so that appropriate decisions can be made regarding public disclosure. The CEO and CFO have evaluated the Fund's disclosure controls and procedures and have concluded that they are effective as of December 31, 2007.

The Fund's management are also responsible for designing internal controls over financial reporting, or causing it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. As of December 31, 2007, the CEO and CFO have designed, or caused to be designed under their supervision, such internal controls over financial reporting. Additionally, the CEO and CFO have identified no changes in the Fund's internal control over financial reporting that occurred during the Fund's most recent interim period that has materially affected, or is reasonably likely to materially affect, the Fund's internal control over financial reporting.



10.0 SELECTED FINANCIAL INFORMATION

10.1 Quarterly Financial Information

(in thousands of dollars)

	Q4 2007	Q3 2007	Q2 2007	Q1 2007	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Total sales	68,767	81,878	89,400	91,720	83,120	90,974	95,054	93,380
Net earnings [(1)]	2,115	4,698	4,800	4,006	(4,826)	2,656	3,939	1,868
Basic and fully diluted earnings (loss) per Class A Unit [(1)]	0.147	0.326	0.333	0.278	(0.335)	0.184	0.273	0.130
EBITDA	3,112	6,411	6,350	5,387	4,088	6,727	6,427	4,579
Distributable Cash	3,205	5,211	4,868	3,997	3,714	4,921	4,716	3,397
Total distributions to Class A and Class B Units	3,243	3,086	3,086	2,940	2,940	2,940	3,693	3,692
Payout ratio	101.2%	59.2%	63.4%	73.6%	79.2%	59.7%	78.3%	108.7%

1 Quarterly net earnings and basic and fully diluted earnings per Class A Unit for 2007 have been restated to reflect an adjustment to the non-controlling interest's share of earnings resulting from the Fund's subordination feature, further discussion of which is provided in section 3.1 of this report and in the Audited Financial Statements. The impact of the adjustment is to increase net earnings by $1.5 million in Q1 2007, $0.7 million in Q2 2007 and $0.6 million in Q3 2007. The adjustment has no impact on the Fund's EBITDA, cash flow from operations, or Distributable Cash for any period presented.

The table above provides selected quarterly financial information for the eight most recently completed fiscal quarters of the Fund. 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 an indication of future performance. Historically, the first and fourth quarter have been seasonally slower periods for our business. In addition, net earnings reported in each quarter may be impacted by changes to the foreign exchange rate of the Canadian and US dollar, write-downs in the carrying value of goodwill and other intangible assets (which occurred in the three months ended December 31, 2006), and gains or losses on foreign currency contracts which are described under Financial Instruments in section 5.0 of this report.

10.2 Annual Financial Information

(in thousands of Canadian dollars except per Unit amounts)

	Year ended December 31 2007	Year ended December 31 2006	Year ended December 31 2005
Total sales	$ 331,765	$ 362,528	$ 355,775
Net earnings	15,619	3,637	13,351
Basic and fully diluted earnings per Class A Unit	1.084	0.252	0.927
Total assets	173,727	198,404	214,669
Total long-term financial liabilities	34,187	37,372	34,215
Distributions per Unit relating to the period:			
Class A Units	$ 0.857	$ 0.921	$ 1.075
Class B Units	$ –	$ –	$ 0.851
Total Units	$ 0.686	$ 0.736	$ 1.031

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 herewith expresses their opinion on the consolidated financial statements of the Fund.

MAURICE E. PAQUETTE
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Auditors' Report to the Unitholders

We have audited the consolidated balance sheets of Hardwoods Distribution Income Fund (the "Fund") as at December 31, 2007 and 2006 and the consolidated statements of earnings and retained earnings (deficit), cash flows, comprehensive income (loss) and accumulated other comprehensive loss for the years then ended. 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 audits.

We conducted our audits 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, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

CHARTERED ACCOUNTANTS
VANCOUVER, CANADA
February 12, 2008

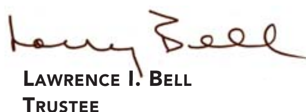
Consolidated Balance Sheets

(Expressed in thousands of Canadian dollars)
December 31, 2007 and 2006

	2007	2006
Assets		
Current assets:		
Cash and cash equivalents	$ 295	$ 594
Accounts receivable	36,474	43,767
Income taxes recoverable	1,041	596
Inventory	38,400	44,584
Prepaid expenses	1,060	1,098
Foreign currency contracts (note 5)	1,533	1,129
	78,803	91,768
Long-term receivables (note 4)	2,191	3,236
Property, plant and equipment (note 6)	2,413	3,219
Deferred financing costs	21	32
Foreign currency contracts (note 5)	528	385
Intangible assets	9,013	10,878
Goodwill	80,758	88,886
	$ 173,727	$ 198,404
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 7)	$ 25,515	$ 39,152
Accounts payable and accrued liabilities	6,950	7,590
Distributions payable to Unitholders	1,081	980
	33,546	47,722
Foreign currency contracts (note 5)	47	141
Deferred gain on sale-leaseback of land and building	538	719
Non-controlling interests (note 8)	30,068	33,859
Future income taxes (note 10)	3,534	2,653
Unitholders' equity:		
Fund Units (note 9)	133,454	133,454
Deficit	(5,895)	(8,973)
Accumulated other comprehensive loss	(21,565)	(11,171)
	105,994	113,310
Commitments (note 12)		
Contingencies (note 17)		
	$ 173,727	$ 198,404

See accompanying notes to consolidated financial statements.

Approved on behalf of the Trustees:



LAWRENCE I. BELL
TRUSTEE

TERRY M. HOLLAND
TRUSTEE

Consolidated Statements of Earnings and Retained Earnings (Deficit)

(Expressed in thousands of Canadian dollars)
Years ended December 31, 2007 and 2006

	2007	2006
Sales	$ 331,765	$ 362,528
Cost of sales	269,028	296,486
Gross profit	62,737	66,042
Expenses (income):		
Selling and administrative	43,360	45,559
Amortization:		
Plant and equipment	1,091	1,208
Deferred financing costs	11	77
Other intangible assets	843	899
Deferred gain on sale-leaseback of land and building	(79)	(84)
Interest	2,402	3,127
Foreign currency contracts	(2,524)	(58)
Intangibles impairment (note 2(g))	–	326
Goodwill impairment (note 2(h))	–	7,566
	45,104	58,620
Earnings before non-controlling interests and income taxes	17,633	7,422
Non-controlling interests (note 8)	109	1,484
Earnings before income taxes	17,524	5,938
Income taxes (note 10)	1,905	2,301
Net earnings for the year	15,619	3,637
Retained earnings (deficit), beginning of year (note 3)	(9,159)	1,886
Distributions declared to Unitholders	(12,355)	(14,496)
Deficit, end of year	$ (5,895)	$ (8,973)
Basic and diluted earnings per Unit	$ 1.08	$ 0.25
Weighted average number of Units outstanding	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

(Expressed in thousands of Canadian dollars)
Years ended December 31, 2007 and 2006

	2007	2006
Cash flows provided by (used in) operating activities:		
Net earnings for the year	$ 15,619	$ 3,637
Items not involving cash:		
Amortization	1,866	2,100
Imputed interest income on employee loans	(60)	–
Gain on sale of property, plant and equipment	(21)	(32)
Mark-to-market adjustment on unrealized foreign currency contracts	(641)	1,280
Intangibles impairment (note 2(g))	–	326
Goodwill impairment (note 2(h))	–	7,566
Non-controlling interests	109	1,484
Future income taxes	980	1,289
	17,852	17,650
Change in non-cash operating working capital (note 11)	2,777	889
Net cash provided by operating activities	20,629	18,539
Cash flows used in financing activities:		
Decrease in bank indebtedness	(9,769)	(7,733)
Increase in deferred financing fees	–	(33)
Distributions paid to Unitholders	(12,254)	(13,516)
Net cash used in financing activities	(22,023)	(21,282)
Cash flows provided by investing activities:		
Additions to property, plant and equipment	(571)	(902)
Proceeds on disposal of property, plant and equipment	26	34
Decrease in long-term receivables, net	1,640	2,002
Net cash provided by investing activities	1,095	1,134
Decrease in cash	(299)	(1,609)
Cash, beginning of year	594	2,203
Cash, end of year	$ 295	$ 594
Supplemental information:		
Interest paid	$ 2,402	$ 3,127
Income taxes paid	936	1,572
Transfer of accounts receivable to long-term customer notes receivable, net of write-offs, being a non-cash transaction	667	2,167

See accompanying notes to consolidated financial statements.

Consolidated Statement of Comprehensive Income (Loss)

(Expressed in thousands of Canadian dollars)
Years ended December 31, 2007 and 2006

		2007		2006
Net earnings for the year	$	15,619	$	3,637
Other comprehensive income (loss):				
Unrealized gains (losses) on translation of self-sustaining foreign operations		(10,385)		(129)
Comprehensive income	$	5,234	$	3,508

Consolidated Statement of Accumulated Other Comprehensive Loss

(Expressed in thousands of Canadian dollars)
Years ended December 31, 2007 and 2006

		2007		2006
Accumulated other comprehensive loss, beginning of year (note 3)	$	(11,180)	$	(11,042)
Other comprehensive loss		(10,385)		(129)
Accumulated other comprehensive loss, end of year	$	(21,565)	$	(11,171)

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(Tabular amounts expressed in thousands of Canadian dollars)
Years ended December 31, 2007 and 2006

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 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.

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 deposit 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 and customer notes receivable.

(d) Inventory:

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

(e) 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
Machinery and equipment	3 to 10 years
Mobile equipment	7 years
Leasehold improvements	Over the term of the lease

(f) 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 facility.

(g) Intangible assets:

Intangible assets represent customer relationships acquired at the time the Business was purchased from SIL (note 1) and are recorded at cost less accumulated amortization and any write-downs. Amortization is provided for on a straight-line basis over 15 years. Management reviews the carrying value of intangible assets 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 is charged to earnings in the period in which the impairment is determined. During the fourth quarter ended December 31, 2007, management performed its annual impairment test and determined that no impairment had occurred (2006 - $326,000).

(h) Goodwill:

Goodwill is recorded at cost less any write-downs 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 is charged to earnings in the period in which the impairment is determined. During the fourth quarter ended December 31, 2007, management performed its annual impairment test and determined that no impairment had occurred (2006 - $7,566,000). The write-down of goodwill in 2006 was related solely to the Fund's Canadian business, Hardwoods LP. The goodwill impairment in Hardwoods LP was largely due to the anticipated reduction of cash flows resulting from the Canadian federal government's intention to tax Canadian income trusts commencing in 2011, as well as lower than previously anticipated revenue and cash flows to be generated.

(i) 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. Recoverability of

2. Significant accounting policies (continued)

assets is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount for the asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount that the carrying amount of the asset exceeds its fair value.

(j) Sales-leaseback of land and building:

During the year ended December 31, 2005, a subsidiary of the Fund sold a building and related land and leased back the facilities. The gain on the sale has been deferred and is amortized in proportion to the rental payments over the lease term.

(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 allocates 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 until January 1, 2011. Accordingly, no provision for current income taxes has been made in respect of the Fund itself.

On June 12, 2007, the Canadian federal government's legislation to tax publicly traded income trusts passed third reading in the House of Commons and thus the associated income tax became substantively enacted for accounting purposes. The legislation imposes a tax on distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until January 1, 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. Historically the Fund had been exempt from recognizing future income tax assets and liabilities associated with temporary differences arising in the Fund and its subsidiary Hardwoods LP. As a result of the substantive enactment of the new tax legislation, the Fund has recognized future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. The impact on the Fund's consolidated financial statements was recorded in the year ended December 31, 2007 and the effect was an increase in the future income tax liability by $95,000 and an increase in future income tax expense of $95,000.

(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 transfer 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 accumulated other comprehensive loss 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 earnings.

(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. 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 and impairment analysis of goodwill and other intangible assets, the determination of the 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.

(q) Future changes in accounting standards:

On December 1, 2006, the Canadian Institute of Chartered Accountants ("CICA") issued four new accounting standards: Handbook Section 1535, Capital Disclosures ("Section 1535"), Handbook Section 3031, Inventories ("Section 3031"),

2. Significant accounting policies (continued)

Handbook Section 3862, Financial Instruments – Disclosures ("Section 3862") and Handbook Section 3863, Financial Instruments – Presentation ("Section 3863"). These new standards become effective for the Fund on January 1, 2008.

Section 1535 specifies the disclosure of: (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has compiled with any capital requirements; and, (iv) if it has not complied, the consequences of such non-compliance.

Section 3031 provides significantly more guidance on the measurement of inventories, with an expanded definition of cost and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition the section has additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory write-downs.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

While the Fund is currently evaluating the implications of the adoption of these new standards, their adoption is not expected to materially impact the amounts presented in the financial statements.

3. Adoption of new accounting standards:

Effective January 1, 2007, the Fund adopted five new CICA accounting standards: (a) Handbook Section 1530, Comprehensive Income; (b) Handbook Section 3855, Financial Instruments - Recognition and Measurement; (c) Handbook Section 3861 Financial Instruments - Disclosure and Presentation; (d) Handbook Section 3865, Hedges; and (e) Handbook Section 1506, Accounting Changes. The main requirements of these new standards and the resulting financial statement impact are described below.

Consistent with the requirements of the new accounting standards, the Fund has not restated any prior period amounts as a result of adopting the accounting changes, other than to classify unrealized foreign currency translation gain or losses on net investments in self-sustaining foreign operations in accumulated other comprehensive loss within Unitholders' Equity. As required under the transition rules the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policies described below.

The effect of the adoption of these standards is summarized in the following table:

	As at December 31 2006	Reclassification to accumulated other comprehensive loss	Adjustment on adoption of new standards	As at January 1 2007
Long-term receivables	$ 3,236	$ –	$ (365)	$ 2,871
Non-controlling interests	33,859	–	(71)	33,788
Future income taxes	2,653	–	(99)	2,554
Unitholders equity:				
Cumulative translation adjustment	(11,171)	11,171	–	–
Accumulated other comprehensive loss	–	(11,171)	(9)	(11,180)
Deficit	$ (8,973)	$ –	$ (186)	$ (9,159)

(a) Comprehensive Income (Section 1530):

CICA Section 1530 introduces the term Comprehensive Income, which consists of net earnings and other comprehensive income ("OCI"). OCI represents changes in Unitholders' equity during the period arising from transactions and other events with non-owner sources and in the case of the Fund includes unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations. As a result of adopting this standard, a new Statement of Comprehensive Income now forms part of the Fund's consolidated financial statements which includes the current period net earnings and OCI. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Unitholders' Equity in the balance sheet. The Fund's accumulated other comprehensive income balance at December 31, 2007 and December 31, 2006 is comprised entirely of cumulative foreign currency translation adjustments arising on translation of the Fund's United States operations to Canadian dollars.

3. Adoption of new accounting standards (continued)

(b) Financial Instruments – Recognition and Measurement (Section 3855):

CICA Section 3855 sets out criteria for the recognition and measurement of financial instruments for fiscal years beginning on or after October 1, 2006. This standard requires all financial instruments within its scope, including derivatives, to be included on the balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized cost. Changes in fair value are to be recognized in either the Statements of Earnings or the Statement of Comprehensive Income.

All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the item. As such, any of the Fund's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if these requirements had always been in effect. Any changes to the carrying values of assets and liabilities prior to January 1, 2007 are recognized by adjusting opening deficit or opening accumulated other comprehensive income.

All financial instruments are classified into one of the following five categories: held-for-trading, held to maturity, loans and receivables, available for sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification:

(i) Held to maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net earnings using the effective interest method.

(ii) Available for sale financial assets are measured at fair value, with unrealized gains and losses recorded in other comprehensive income until the asset is realized, at which time they will be recorded in net earnings.

(iii) Held for trading financial instruments are measured at fair value. All gains and losses resulting from changes in their fair value are included in net earnings in the period in which they arise.

(iv) All derivative financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses resulting from changes in their fair value are included in net earnings in the period in which they arise.

Upon adoption of these new standards, the Fund has classified its financial instruments as follows:

(v) Accounts receivable and long term receivables are classified as loans and receivables, which are initially measured at fair value and subsequently measured at amortized cost. Housing loans provided to employees by the Fund to assist in their relocation to new operating locations were identified to be loans with a non-market rate of interest, requiring an adjustment based on the fair market value of the loans at their inception, adjusted for the accretion of the fair market value discount in the period from inception to the adoption of the new accounting standard. This change in accounting standard resulted in a decrease in the carrying value of employee housing loans receivable of $365,000, a decrease in non-controlling interests of $71,000 and future income taxes of $99,000, and an increase in deficit of $186,000 on the balance sheet at January 1, 2007.

(vi) The Fund's foreign currency contracts are a derivative financial instrument and as such are classified as held for trading, with all gains and losses included in net earnings in the period in which they arise. This is consistent with the Fund's historic accounting treatment of the foreign currency contracts and thus there was no change in accounting on adoption.

(c) Financial Instruments - Disclosure and Presentation (Section 3861):

CICA Section 3861 sets out standards which address the presentation of financial instruments and non-financial derivates, and identifies the related information that should be disclosed. These standards also revise the requirements for entities to provide accounting policy disclosures, including disclosure of the criteria for designating as held-for-trading those financial assets or liabilities that are not required to be classified as held-for-trading; whether categories of normal purchases and sales of financial assets are accounted for at trade date or settlement date; the accounting policy for transaction costs on financial assets and financial liabilities classified as other than held-for-trading; and provide several new requirements for disclosure about fair value.

(d) Hedging (Section 3865):

CICA Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. The Fund currently does not hold any financial instruments designated for hedge accounting.

(e) Accounting Changes (Section 1506):

CICA Section 1506 revised the standards on changes in accounting policy, estimates or errors to require a change in

3. Adoption of new accounting standards (continued)

accounting policy to be applied retrospectively (unless doing so is impracticable), changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. The impact of this new standard cannot be determined until such time as the Fund makes a change in accounting policy, other than the changes resulting from the implementation of the new CICA Handbook standards discussed in this note.

(f) Cash Flow Statements (Section 1540):

Amendments to CICA 1540, Cash Flow Statements, require entities to disclose total cash distributions on financial instruments classified as equity in accordance with a contractual agreement and the extent to which total cash distributions are non-discretionary. This disclosure requirement is effective for interim and annual financial statements for fiscal periods ending on or after March 31, 2007. The Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the year ended December 31, 2007 $12.3 million (2006 - $13.5 million) in discretionary cash distributions were paid to Unitholders.

4. Long-term receivables:

	2007	2006
Employee housing loans	$ 1,130	$ 1,766
Customer notes	1,166	2,277
Security deposits	553	606
	2,849	4,649
Less: current portion, included in accounts receivable	658	1,413
	$ 2,191	$ 3,236

Long-term receivables consist of non-interest bearing housing loans receivable from employees related to their relocation, interest bearing notes receivable from certain customers, and security deposits recoverable on leased premises. The housing loans are secured by a deed of trust or mortgage depending upon the jurisdiction. The customer notes receivable have various security arrangements and bear interest rates ranging from 8% - 18%.

5. Foreign currency contracts:

At December 31, 2007 a subsidiary of the Fund held foreign currency contracts covering the period 24 months into the future with terms as follows:

	Sell US Dollars	Contract Exchange Rate ($Cdn / $US)	Receive CDN Dollars
2008			
January	US$675,000	1.3001	Cdn$877,568
February	US$675,000	1.3001	Cdn$877,568
March	US$675,000	1.3001	Cdn$877,568
April	US$675,000	1.3001	Cdn$877,568
May	US$675,000	1.1255	Cdn$759,712
June	US$675,000	1.1255	Cdn$759,712
July	US$675,000	1.1255	Cdn$759,712
August	US$675,000	1.1255	Cdn$759,712
September	US$675,000	1.1255	Cdn$759,712
October	US$675,000	1.1255	Cdn$759,712
November	US$675,000	1.1255	Cdn$759,712
December	US$675,000	1.1255	Cdn$759,712
2009			
January	US$675,000	1.1255	Cdn$759,712
February	US$675,000	1.1255	Cdn$759,712
March	US$675,000	1.1255	Cdn$759,712
April	US$675,000	1.1255	Cdn$759,712
May	US$675,000	1.0882	Cdn$734,535
June	US$675,000	1.0595	Cdn$715,162
July	US$675,000	1.0625	Cdn$717,187
August	US$675,000	1.0560	Cdn$712,800
September	US$675,000	1.0010	Cdn$675,675
October	US$675,000	0.9315	Cdn$628,762
November	US$675,000	0.9901	Cdn$668,317
December	US$675,000	1.0119	Cdn$683,032

5. Foreign currency contracts (continued)

The fair value of the 24 monthly currency contracts covering the period January 2008 to December 2009 have been reflected in the financial statements and represent a current asset of $1,533,476, a long-term asset of $528,165 and a long-term liability of $46,842 at December 31, 2007. The fair values were determined based on valuations obtained from the counter-party.

6. Property, plant and equipment:

December 31, 2007	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 2,345	$ 1,534	$ 811
Mobile equipment	3,195	1,853	1,342
Leasehold improvements	792	532	260
	$ 6,332	$ 3,919	$ 2,413

December 31, 2006	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 2,312	$ 1,228	$ 1,084
Mobile equipment	3,322	1,549	1,773
Leasehold improvements	765	403	362
	$ 6,399	$ 3,180	$ 3,219

7. Bank indebtedness:

	2007	2006
Checks issued in excess of funds on deposit	$ 1,034	$ 797
Credit facility, Hardwoods LP	5,538	10,788
Credit facility, Hardwoods USLP (2007 - US$19,109; 2006 - US$23,655)	18,943	27,567
	$ 25,515	$ 39,152

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 $34,695,500 (US$35,000,000) less the net exposure under the foreign currency contracts facility as described in note 5.

The Hardwoods LP credit facility was renegotiated in November 2006 and now expires November 30, 2009, and 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 were renegotiated in December 2006 and now expire March 31, 2010. They 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.

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 year ended December 31, 2007 were 6.7% and 7.2% (2006 - 6.6% and 7.2%) for the Hardwoods LP and Hardwoods USLP credit facilities, respectively.

8. Non-controlling interests:

	2007	2006
Balance, beginning of the year (note 3)	$ 33,788	$ 32,047
Interest in earnings		
Interest in earnings before taxes	3,527	1,484
Adjustment to non-controlling interest from subordination of Class B Unit Holders	(3,418)	–
	109	1,484
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP and other	(3,829)	328
Balance, end of the year	$ 30,068	$ 33,859

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, 2007.

Prior to the Subordination End Date, advances and distributions on the LP Units and the USLP Units will be made in the following order of priority:

- At the end of each month, cash advances or distributions will be made to the holders of Class A LP Units and Class A USLP Units in a combined amount that is sufficient to provide available cash to the Fund to enable the Fund to make cash distributions upon the Units for such month at least equal to $0.08542 per Unit or, if there is insufficient available cash to make distributions or advances in such amount, such lesser amount as is available as determined by the board of directors of the general partners;
- At the end of each fiscal quarter of Hardwoods LP and Hardwoods USLP, including the fiscal quarter ending on the fiscal year end, available cash of Hardwoods LP and Hardwoods USLP will be advanced or distributed in the following order of priority:
  - First, in payment of the monthly cash advance or distribution to the holders of Class A LP Units and Class A USLP Units as described above, for the month then ended;
  - Second, to the holders of Class A LP Units and Class A USLP Units, to the extent that the combined monthly cash advances or distributions in respect of the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on Class A LP Units and Class A USLP Units were not made or were made in amounts less than a combined amount at least equal to $1.025 per Unit, the amount of any such deficiency. As of December 31, 2007, the amount of such deficiency was $2.4 million;
  - Third, to the holders of Class B LP Units and Class B USLP Units 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 advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter or, if there is insufficient available cash to make advances or distributions in such amount, such lesser amount as is available;
  - Fourth, to the holders of Class B LP Units and Class B USLP Units, to the extent only that combined advances or distributions in respect of any fiscal quarter(s) during the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on one Class B LP Unit and one Class B USLP Unit were not made, or were made in amounts less, on a pro-rated basis, that the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such 12 month period, the amount of such deficiency. As of December 31, 2007, the amount of such deficiency was $3.1 million. The cumulative deficiency prior to December 31, 2006, which is no longer recoverable by the Class B LP Unitholders and Class B USLP Unitholders, has been recorded as an adjustment to the non-controlling interest's share of earnings in the amount of $3.4 million;

8. Non-controlling interrests (continued)

- Fifth, to the extent of any excess, to the holders of the Class A LP Units and Class B LP Units and Class A USLP Units and Class B USLP Units, respectively, so that the combined advances or distributions on one Class A LP Unit and one Class A USLP Unit are the same as the combined advances or distribution on one Class B LP Unit and one Class B USLP Unit in respect of the 12 month period then ended (and not, for greater certainty, any previous 12 month period).

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.

9. Fund Units:

(a) 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 8). 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.

(b) The Trustees of the Fund approved the adoption of a Unitholders Rights Plan (the "Rights Plan") dated December 12, 2006, that is intended to ensure fair treatment for all Unitholders in the event of a take-over bid or any other attempt to acquire a controlling interest in the Fund. The Rights Plan has been accepted by the Toronto Stock Exchange and was approved at the meeting of Unitholders on May 14, 2007. The Rights Plan will continue in effect until the annual general meeting of Unitholders in 2010. Provisions of the Rights Plan include the limitation on Unitholder ownership at 20% of outstanding units in the absence of a take-over bid for all outstanding units and a requirement for a take-over bid to be open for a minimum of 60 days. At the effective date of the Rights Plan, beneficial owners of 20% or more of the units of the Fund (including holders of securities exchangeable for units of the Fund) were deemed to be "Grandfathered Persons" and are exempt from the definition of an "Acquiring Person" under the Rights Plan provided their beneficial interest in the outstanding units does not increase by more than 1.0% following December 12, 2006. The rights become exercisable only when a person or party acquires 20% or more of the Units, or in the case of a Grandfathered Person increases their beneficial interest in Units by more than 1.0%, each without complying with certain provisions of the Rights Plan. Each right would entitle each holder of Units (other than the acquiring person or party) to purchase additional Units of the Fund at a 50 per cent discount to the market price at the time.

10. Income taxes:

	2007	2006
Current	$ 441	$ 1,054
Future	1,464	1,247
	$ 1,905	$ 2,301

Under current income tax regulations subsidiaries of the Fund are only subject to U.S. tax, thus income tax expense differs from that calculated by applying U.S. federal and state statutory income tax rates in effect in that jurisdiction in which the U.S. subsidiary is subject to tax of 39.4% (2006 - 39.4%) to earnings before income taxes for the following reasons:

	2007	2006
Earnings before income tax	$ 17,524	$ 5,938
Computed tax expenses at statutory rate	$ 6,904	$ 2,340
Income of Fund distributed directly to Unitholders	(4,317)	(763)
Income and deductions not subject to tax	(812)	(386)
Taxes paid as a result of Subordination Agreement	712	843
Adjustment to non-controlling interest not subject to tax	(930)	–
Branch profits tax	54	165
Deductible state taxes	21	(8)
Other	273	110
	$ 1,905	$ 2,301

Taxes paid as a result of Subordination Agreement represent additional taxes incurred by subsidiaries of the Fund due to distributions having not been made to the non-controlling interests on a proportional basis.

10. Income taxes (continued)

The tax effect of temporary differences that give rise to significant portions of the future income tax assets and liabilities at December 31, 2007 is as follows:

	2007	2006
Future income tax assets:		
Accounts receivable	$ 154	$ 272
Inventory	383	453
Employee housing loans	73	–
Property, plant and equipment	249	–
Accrued liabilities	–	21
Deferred gain on sale-leaseback of land and building	170	227
	1,029	973
Future income tax liabilities:		
Prepaid expenses	(84)	(91)
Property, plant and equipment	(111)	(69)
Goodwill	(4,368)	(3,466)
	(4,563)	(3,626)
Net future income tax liability	$ (3,534)	$ (2,653)

11. Changes in non-cash operating working capital:

	2007	2006
Accounts receivable	$ 1,470	$ (122)
Income taxes recoverable	(445)	(510)
Inventory	1,627	3,070
Prepaid expenses	(70)	123
Accounts payable and accrued liabilities	195	(1,672)
	$ 2,777	$ 889

12. Commitments:

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

2008	$ 6,451
2009	5,207
2010	3,330
2011	1,240
2012	715
	16,943
Thereafter	684
	$ 17,627

(b) At December 31, 2007, the Fund's subsidiaries were committed in the amount of $22,304 (US$22,500) (2006 - $26,222 (US$22,500)) under letters of credit.

13. Segment disclosure:

Information about geographic areas is as follows:

	2007	2006
Revenue from external customers:		
Canada	$ 105,171	$ 109,024
United States	226,594	253,504
	$ 331,765	$ 362,528
Property, plant and equipment:		
Canada	$ 1,003	$ 1,156
United States	1,410	2,063
	$ 2,413	$ 3,219
Goodwill		
Canada	$ 34,477	$ 34,477
United States	46,281	54,409
	$ 80,758	$ 88,886

14. Financial instruments:

(a) Fair values of financial instruments:

The carrying values of cash and cash equivalents, trade accounts receivable, accounts payable and accrued liabilities and distributions payable approximate their fair values 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 values 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 it is unable to collect in full amounts receivable from its customers. The Fund employs established credit approval practices and engages credit attorneys when appropriate 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. Our largest individual customer balance amounted to 5.3% of accounts receivable and customer notes receivable at December 31, 2007.

(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

14. Financial instruments (continued)

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.

15. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP 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 year ended December 31, 2007, Hardwoods USLP contributed and expensed $403,817 (US$375,643) (2006 - $394,505 (US$347,826)) 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 year ended December 31, 2007, Hardwoods LP contributed and expensed $246,475 (2006 - $266,153) in relation to the LP Plan.

16. Related party transactions:

For the year ended December 31, 2007, sales of $736,573 (2006 - $1,141,799) were made to affiliates of SIL, and the Fund made purchases of $184,732 (2006 - $77,932) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the year ended December 31, 2007, the Fund expensed $108,000 (2006 - $108,000) for management information systems services provided by affiliates of SIL. This cost is included in selling and administrative expense in the consolidated statement of earnings and retained earnings (deficit).

17. Contingencies:

The Fund and its subsidiaries are subject to legal proceedings that arise in the ordinary course of its business. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for through insurance or otherwise, would be material in relation to the Fund's consolidated financial statements.

The Beauty of Hardwood

People love hardwood and find many different ways to bring it into their lives. Whether in furniture, kitchen cabinets, doors and mouldings, or custom interior millwork, 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.

HARDWOODS

Unitholder Information

Trustees

Lawrence I. Bell
Chair, Canada Line

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

Lawrence I. Bell
Chair, Canada Line

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Chair, Sauder Industries

Richard N. McKerracher
President, Sauder Industries

Officers

Maurice E. Paquette
President & Chief Executive Officer

Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California Region

Garry W. Warner
Vice President, Northwestern Region

Kevin L. Slabaugh
Vice President, Pacific Mountain Region

Head Office

#306 – 9440 202nd Street
Langley, BC Canada V1M 4A6
Telephone: 604-881-1988
Facsimile: 604-881-1995

Auditors

KPMG LLP
Vancouver, British Columbia

Listings
The Toronto Stock Exchange
Trading under HWD.UN

Transfer Agent
Computershare Trust
Company of Canada

Investor Relations

Rob Brown
Chief Financial Officer
Telephone:604-881-1990
Email:
robbrown@hardwoods-inc.com