HARDWOODS DISTRIBUTION INCOME FUND

2008

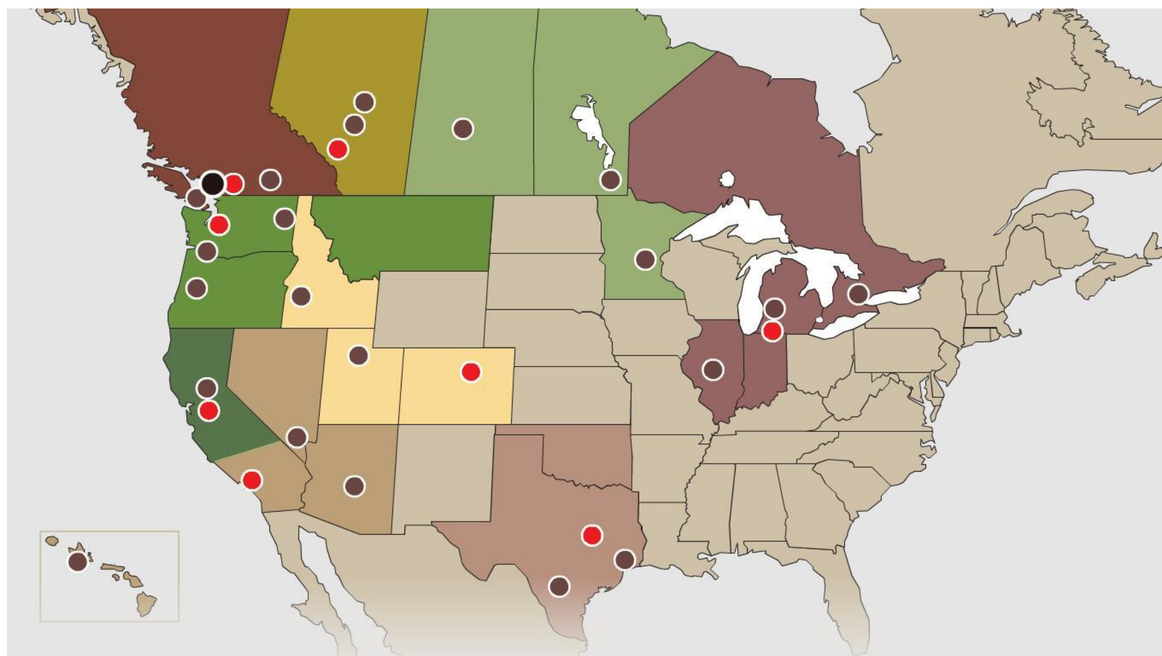
Annual Report To Unitholders

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. At December 31, 2008, we are one of the largest distributors of hardwood lumber and sheet goods in North America, operating a network of 29 distribution centers organized into nine regional clusters.



To Our Unitholders

2008 was a year of targeted action as we responded to extremely challenging economic conditions.

Following two years of declining residential construction markets, business conditions shifted from bad to worse in 2008 as the global credit and financial markets crisis put a further brake on the economy. By year-end, both the US and Canadian markets were in recession and most of the market sectors and geographic regions that we serve had been affected.

Our sales tracked the economic slowdown, with revenue declining in each quarter of 2008. With the shrinking market came increased competition for the remaining available sales, putting downward pressure on our margins. We also experienced an increase in bad debts with economic conditions forcing some of our customers out of business.

Adapting to Economic Change

In this environment, adapting quickly to the new economic realities was essential, and our flexible business model made it possible for us to do so.

Our distribution network is built on a hub and satellite model that provides service to nine distinct geographic regions in the US and Canada. The hub centres act as the core warehouse facility for each region, feeding the satellite centres around it. When demand grows, new satellite centres can be easily added to service the expanded market. When demand declines, satellite centres with lower sales potential can be closed, with the hub facility and other satellite centres in the region assuming responsibility for ongoing service to the affected market. As virtually all of our facilities and equipment are leased, we are able to implement these changes relatively quickly, without incurring major financial penalties.

During 2008, we moved decisively to downsize our network, closing a total of seven satellite branches thereby reducing our number of branches by 19%. Four of the affected branches were located in California, a market that has been particularly hard hit by the slowdown in the housing market. The remaining branch closures were in Montana, Oklahoma and Alberta.

We implemented other cost-cutting measures throughout our remaining operations, reducing personnel levels, canceling our year-end bonus program for management and staff and implementing a company-wide salary freeze. In addition, we sublet underutilized warehouse

space to reduce our premises expense, trimmed excess trucking capacity, and adjusted our US medical plan to reduce company-funded costs.

Combined, these initiatives helped us reduce sales and administrative expenses by $2.0 million in 2008, which was achieved despite incurring a $1.8 million increase in bad debt expense and $1.5 million in one-time restructuring and reorganization costs during the year.

Making Required Adjustments

In addition to these operational initiatives, we made a number of timely corporate moves to bolster our position. In March, we completed an internal reorganization of our business to reduce our exposure to new taxes on income trusts that come into effect in 2011. The reorganization did not have any effect on our operations or business activities, but will help us achieve approximately $7.0 million in tax savings over the next six years. We have since announced the reorganization of our Canadian holdings to provide further assurance that the Fund will not be paying the new income trust tax.

During the third quarter, we sold our remaining US currency hedge contracts for a profit just weeks in advance of a sharp decline in the value of the Canadian dollar. The hedge contracts, which were fixed at an average rate of $1.06 US, would have represented a significant liability for us at today's Canadian dollar values.

To help us maintain adequate access to capital, we also secured a new US banking facility, which provides financing through September 2011 at competitive interest rates and with less onerous covenant requirements than we had previously.

Finally, we made the difficult but necessary decision to reduce and ultimately suspend cash distributions in recognition of the deteriorating economic environment. Through this and a variety of other measures, we have succeeded in reducing our long-term debt from $39.2 million two years ago, to $17.6 million at December 31, 2008 – a critical achievement and one that greatly enhances our financial stability going forward.

Moving Forward

Overall, we believe we have taken the right steps to protect our business through these extremely challenging times. We are facing challenges with tight covenants on our financing at a time when our business is under pressure. We will continue to take all steps possible to respond to these issues. With no expectation of economic improvement in 2009, we will continue to rationalize our costs in line with the slower sales pace, and manage the increased risk of bad debt that comes with the current economic environment.

Our strategy will not be entirely defensive, however. Following a positive initial response to our green building products in 2008, we have now created the new Hardwoods "Greenbelt" label and we are expanding our line-up of environmentally friendly products with a mix of both imported and domestic products. We are marketing these new products to our existing industrial customer base, as well as to architects and building project specifiers looking for "green" product solutions. In addition, we are continuing to work closely with customers to find innovative product and service solutions that help support their businesses through the current downturn.

As we have said in the past, market downturns are difficult, but they provide opportunities as well. Our goal is to survive this downturn, while seeking out opportunities that enhance our market position and enable us to benefit from the eventual market recovery.

At the close of a challenging year, I want to thank our employees for the hard work and sacrifice that these difficult times demand, and our directors and trustees for their valuable input and guidance. Most of all, I thank our investors for their continued confidence in Hardwoods. While we anticipate continued challenges in the year ahead, we fully intend to emerge successfully from this downturn and participate fully in the eventual economic recovery.

Maurice E. Paquette

President and Chief Executive Officer

Management's Discussion and Analysis

March 25, 2009

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, 2008 and 2007. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). 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:

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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 press release includes, but is not limited to: we believe we have taken the right steps to protect our business through these extremely challenging times, and we will continue to take decisive action as required; we will continue to rationalize our costs in line with the slower sales pace, and manage the increased risk of bad debt that comes with the current economic environment; our focus will remain on continued cost reduction as we work to align expenditures as closely as possible to sales levels; inventory levels and working capital will also be tightly managed and we will continue to work to minimize customer credit risk, which is expected to remain elevated until business conditions improve; the aforementioned initiatives, together with a continued focus on debt reduction will help provide support to our balance sheet as we work through this downturn; we will aggressively pursue market opportunities for our growing lines of "green" building products, while also continuing to support its successful import program; our goal is to maintain a strong market position through the downturn and to emerge positioned to participate fully in the eventual recovery; the current economic environment has elevated Hardwoods' business risk, particularly (1) financing risk related to the ability of Hardwoods to debt-finance its operations has increased in the current tight credit environment, (2) bad debt risk has increased, as Hardwoods customers face reduced demand, and pressure on credit availability in their own businesses, (3) the possibility that key suppliers could fail has increased, which could potentially disrupt Hardwoods supply chain, and (4) demand for Hardwoods' products could weaken still further, given that US housing starts fell to historic lows in the fourth quarter of 2008, and the impact on Hardwoods sales often lags changes in the residential construction cycle by six to twelve months; 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 and 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; management does not anticipate being in default of the fixed charge covenant ratio under its U.S. lending agreement in the first quarter of 2009; further weakening of the housing and renovation market, or incurring significant customer or credit losses, could cause the U.S. subsidiary to violate its fixed charge coverage ratio in 2009 which could cause the Fund's U.S. subsidiary bank indebtedness to become immediately due and payable, and the Fund and its U.S. subsidiary may not be able to access funds under its revolving credit facility, and in the event of such as circumstance, the Fund anticipates it would need to raise additional capital in the form of equity or debt to supplement or replace its existing credit facilities in order to have sufficient liquidity to meet its obligations in 2009; and, we do not

intend to restrict future distributions in order to fully extinguish our bank debt obligations upon their maturity.

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 our performance; the general state of the economy does not worsen; 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 long term 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; 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 our performance; our results are dependent upon the general state of the economy; 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 long term 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; 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; we are dependent upon the financial condition and results of operations of our business; our credit facilities affect our liquidity, contain restrictions

on our ability to borrow funds, and impose restrictions on distributions that can be made by Hardwoods LP and Hardwoods USLP; 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 this MD&A, our Annual Information Form and 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, unrealized foreign currency gains and losses, 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 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 "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, 2008, 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, 2008 we operated 29 distribution facilities organized into nine geographic regions throughout North America.

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 at least 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, and is milled by hundreds of small mills. 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. More recently, the global economic crisis has resulted in supply/demand imbalances. While manufacturers have sharply curtailed production, supply continues to outpace demand and has resulted in a pronounced downward trend in hardwood pricing as discussed in greater detail below,

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 for hardwood lumber and plywood products continued to worsen in 2008 with further deterioration in both the US and Canadian housing and remodeling markets. Meanwhile, issues related to subprime mortgages came to a head in the US, creating a crisis for the US banking industry, which in turn, spread to global financial markets. With financial and credit markets in turmoil, and investor and consumer confidence greatly weakened, economies all around the world began to move into recession, further reducing demand for furniture, cabinets, recreational vehicles and other products that include the hardwood lumber and sheet good products that we distribute.

In the face of this reduced demand, manufacturers of hardwood lumber scaled back production by approximately 20% in 2008, following the 11% reduction implemented in 2007. Despite this significant curtailment, demand for most hardwood products continued to lag supply and prices for many hardwood products continued to slide. According to the Hardwood Review, average hardwood prices fell by 7% in 2008, furthering the 8% price decline experienced in 2007. So far in 2009 this trend has continued, with average prices falling by another 7% in the first two and a half months of the year.

The combination of reduced demand and lower hardwood prices had a negative impact on our financial results. Our 2008 sales declined by 17.6% in the fourth quarter and by 22.7% on a full-year basis, compared to the same periods in 2007. Our US business, which traditionally represents about two thirds of our total revenue, was hardest hit with fourth quarter sales down by 37.2% and full-year sales down by 25.8%. By comparison, Canadian sales fell by 17.9% in the fourth quarter and by 14.8% on a full-year basis, reflecting Canada's somewhat stronger economy.

The impact of lower sales was exacerbated by lower gross profit margins. At 16.7% and 18.0% for the fourth quarter and full year respectively, margins fell below our optimal level of 18.5%. The decline in gross margins reflects the impact of our own price discounting as we worked to reduce inventory levels and respond to increased competition. However, we were able to offset a portion of the margin decline with a series of aggressive cost-cutting efforts that reduced sales and administrative expense by $2.0 million in 2008. This S&A reduction was achieved despite incurring a $1.8 million increase in bad debt expense and $1.5 million in one-time restructuring and reorganization costs during the year.

Our cost saving initiatives included the closure of seven satellite branches during the year, which reduced the size of our branch network from 36 to 29, and contributed to a 19% reduction in our workforce. In order to maintain our geographic coverage, we focused the closures on satellite branches with limited sales potential, while keeping our hub distributions operational in all nine of our geographic markets. This enabled us to continue providing service to customers throughout our geographic coverage areas.

Additional cost-cutting measures included subletting underutilized warehouse space to reduce premises expense, reducing our trucking contracts to save on freight, adjusting our US medical plan to reduce company-funded costs, canceling our year-end bonus plan for management and staff and implementing a salary freeze.

Maintaining a strong balance sheet and carefully managing cash were key priorities in 2008, and we achieved both objectives. The decision to reduce and ultimately suspend distributions helped us reduce our bank indebtedness (net of cash) by $7.7 million during the year. We also continued to tightly manage our inventory, with inventory levels falling to $30.9 million at the end of the year, from $38.4 million a year ago, while keeping inventory turnover relatively constant at 7 times annually.

Overall we believe we took the appropriate steps to manage our business in line with economic conditions.

Looking ahead, we anticipate that extremely challenging business conditions will prevail through 2009 and possibly into 2010. A depressed housing market and the global recession are expected to continue reducing demand for furniture, cabinets, recreational vehicles and other products that utilize hardwood lumber and sheet goods. Prices for hardwood lumber are also expected to remain at low levels.

The current economic environment has elevated our business risk, particularly in the following areas:

1. Financing risk related to the ability of Hardwoods to debt-finance its operations has increased in the current tight credit environment. Hardwoods obtained an amendment to its US banking agreement in order to meet its financial covenant for the fourth quarter of 2008, but it is uncertain if Hardwoods US results will prove strong enough to remain in compliance with its bank agreement throughout 2009;

2. The risk of bad debts has increased, as Hardwoods' customers face reduced demand and similar pressures on credit availability in their own businesses;

3. The possibility that key suppliers could fail has increased, which could potentially disrupt Hardwoods supply chain; and,

4. Demand for Hardwoods' products could weaken still further, given that US housing starts fell to historic lows in the fourth quarter of 2008, and the impact on Hardwoods sales often lags changes in the residential construction cycle by six to twelve months. The lag exists because kitchen cabinets and furniture, which are a key end use for hardwood products, are purchased late in the building process.

With the expectation of a prolonged economic downturn and an enhanced level of risk, our focus will remain on continued cost reduction as we work to align expenditures as closely as possible to sales levels. Inventory levels and working capital will also be tightly managed and we will continue to work to minimize customer credit risk, which is expected to remain elevated until business conditions improve. These initiatives, together with a continued focus on debt reduction will help provide support to our balance sheet as we work through this downturn.

Simultaneously, we will aggressively pursue market opportunities for our growing lines of "green" building products, while also continuing to support its successful import program. Our goal is to maintain a strong market position through the downturn and to emerge positioned to participate fully in the eventual recovery.

Results of Operations

3.1 Years Ended December 31, 2008 and December 31, 2007

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

	For the year Ended December 31, 2008	For the year Ended December 31, 2007
Total sales	$ 256,301	$ 331,765
Sales in the US (US$)	*156,398*	*210,785*
Sales in Canada	*89,581*	*105,171*
Gross profit	46,096	62,737
Gross profit %	*18.0%*	*18.9%*
Selling and administrative expenses	(41,425)	(43,360)
Realized gain on foreign currency contracts	1,247	1,883
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 5,918	$ 21,260
Add (deduct):		
Amortization	(1,471)	(1,866)
Interest	(1,219)	(2,402)
Non-cash foreign currency gains (losses)	(333)	641
Intangibles impairment	(8,612)	-
Goodwill impairment	(82,083)	-
Non-controlling interest	20,031	(109)
Income tax recovery (expense)	31,526	(1,905)
Net earnings (loss) for the period	$ (36,243)	$ 15,619
Basic and fully diluted earnings (loss) per Class A Unit	$ (2.515)	$ 1.084
Average Canadian dollar exchange rate for one US dollar	1.066	1.075

Sales

For the year ended December 31, 2008, total sales were $256.3 million, down 22.7% from $331.8 million in 2007. Sales in the United States, as measured in US dollars, decreased 25.8% to $156.4 million, compared to $210.8 million in 2007 reflecting weaker market conditions and lower hardwood prices. As described in section 2.0 of this report, the general US economy experienced a worsening recession, led by a severe contraction in housing which drives significant demand for the hardwoods products we sell. All of our regions in the US experienced sales declines in 2008, although California experienced the most significant slowdown in demand. In response, we amalgamated our California distribution centres into three locations, closing four warehouse operations that we previously operated in the state.

Sales in Canada, as measured in Canadian dollars, were $89.6 million, down 14.8% from $105.2 million in 2007. While conditions in the domestic market did not decline as dramatically as in the US, the Canadian economy and housing market also slowed in 2008.

Gross Profit

Gross profit for the year ended December 31, 2008 was $46.1 million, compared to $62.7 million in 2007. The 26.5% reduction in gross profit primarily reflects the 22.7% decrease in sales, as well as a lower gross profit margin. As a percentage of sales, gross profit was 18.0% in 2008, compared to 18.9% in 2007. The decrease reflects the negative impact of more intense market competition on product pricing. We also proactively lowered the selling price of some inventory in order to decrease our inventory levels to match a reduced pace of sales. In addition, we wrote-down in the fourth quarter the carrying value of some specialized inventory held for a significant customer that went out of business, which reduced our gross profit margin.

Selling and Administrative Expenses

Selling and Administrative (S&A) expenses were $41.4 million in 2008 compared to $43.4 million in 2007. Recognizing the more challenging sales environment facing our business, we took steps to control expenses and achieved $5.3 million in cost reductions in 2008, principally in the area of people costs by reducing staff and cancelling year-end bonus payments. These reductions were partially offset by $1.5 million of non-recurring costs associated with branch closures and corporate structure changes made in 2008, and $1.8 million in additional bad debt expense incurred as economic conditions deteriorated during the year. Taken together, S&A was reduced by $2.0 million, or 4.5%. As a percentage of sales, S&A expenses were 16.2% of sales in 2008, compared to 13.1% in 2007, reflecting lower sales.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of $1.2 million on foreign currency contracts that matured or were sold in 2008, a decrease of $0.7 million compared to a realized gain of $1.9 million in 2007. In the third quarter of 2008 the Fund ceased purchasing currency derivatives and sold its remaining foreign currency contracts. 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 $5.9 million, compared to $21.3 million in 2007. The $15.4 million decrease in EBITDA reflects lower gross profit and the $0.7 million decrease in realized gains on foreign currency contracts, partially offset by the $2.0 million reduction in S&A.

Interest Expense

Interest expense was $1.2 million in 2008, compared to $2.4 million in 2007. The reduced interest expense reflects lower interest rates, as well as reduced bank indebtedness, described more fully in section 4.6 of this report.

Non-Cash Foreign Currency Gains and Losses

For the year ended December 31, 2008, non-cash foreign currency losses were $0.3 million. This included $2.0 million in mark-to-market valuation losses on foreign currency contracts; the terms of such contracts are described further under Financial Instruments in section 5.0 of this report. These losses were partially offset by $1.3 million in foreign exchange gains arising on translation of US dollar denominated intercompany debt advanced by the Fund to a wholly-owned US subsidiary. Under GAAP, a portion of such intercompany debt is not considered to be a permanent investment, and accordingly foreign currency gains or losses that arise on translation of the non-permanent portion of the intercompany debt are recognized in the calculation of net earnings. In addition, $0.4 million in non-cash foreign currency gains were recorded related to the translation of a US dollar denominated income tax receivable held by a Canadian subsidiary of the Fund.

Goodwill and Intangibles Impairment

Impairment testing of intangibles and goodwill is undertaken annually, or more frequently in the event that circumstances occur that more likely than not reduces the fair value of a reporting unit below its carrying amount. In 2008, Hardwoods experienced a significant change in circumstances in the form of reduced sales demand for its products and a resulting decline in its net earnings. This change of circumstance caused management to reduce its expectations for future cash flows from the Fund's US and Canadian subsidiary operations. Testing results indicated that the value of intangibles and goodwill exceeded their carrying value by $8.6 million and $82.1 million respectively. No intangibles or goodwill impairment was determined in the comparative period in 2007.

Non-controlling Interest

Non-controlling interest ("NCI") was reduced by $20.0 million in 2008, compared to an increase in NCI of $0.1 million in the comparable period in 2007. NCI includes the Class B Unit's interest in pretax earnings or loss in the period, less an adjustment to NCI 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. The $20.0 million reduction to NCI in 2008 primarily reflects the NCI's share of the $90.7 million in goodwill and intangibles impairment recognized in the period.

Income Taxes

Income tax recovery in 2008 was $31.5 million, compared to income tax expense of $1.9 million in 2007. The $31.5 million income tax recovery primarily reflects $23.0 million of future income tax assets associated with the recording of the goodwill and intangibles impairments in 2008. It also reflects $7.8 million of current and future income tax benefits resulting from the refinancing and reorganization of the Fund's internal affairs. The refinancing and reorganization was undertaken in the first quarter of 2008.

Net Loss

Net loss for 2008 was $36.2 million, compared to net earnings of $15.6 million in 2007. The $51.8 million decrease in earnings primarily reflects the $90.7 million increase in impairment in goodwill and other intangible assets, a $1.0 million decrease in non-cash foreign currency gains, and a $15.4 million decrease in EBITDA. These decreases in net earnings were partially offset by the $1.2 million decrease in interest expense, a $20.1 million increase in recovery from non-controlling interest, a $33.4 million decrease in income tax expense, and a $0.4 million reduction in amortization expense.

3.2 Three Months Ended December 31, 2008 and December 31, 2007

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

	For the three months Ended December 31, 2008	For the three months Ended December 31, 2007
Total sales	$ 56,650	$ 68,767
Sales in the US (US$)	*29,270*	*46,643*
Sales in Canada	*19,423*	*23,665*
Gross profit	9,485	12,488
Gross profit %	*16.7%*	*18.2%*
Selling and administrative expenses	(10,915)	(10,024)
Realized gain on foreign currency contracts	-	648
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ (1,430)	$ 3,112
Add (deduct):		
Amortization	(326)	(437)
Interest	(284)	(487)
Non-cash foreign currency gains (losses)	1,498	(634)
Intangibles impairment	(3,144)	-
Goodwill impairment	(17,477)	-
Non-controlling interest	4,881	277
Income tax recovery	3,341	284
Net earnings (loss) for the period	$ (12,941)	$ 2,115
Basic and fully diluted earnings (loss) per Class A Unit	$ (0.898)	$ 0.147
Average Canadian dollar exchange rate for one US dollar	1.2115	0.9812

Sales

For the three months ended December 31, 2008 sales were $56.7 million, down from $68.8 million in the same period in 2007. The 17.6% reduction in sales reflects a 30.0% decrease in underlying sales activity, partially offset by a 12.4% increase in sales due to the positive effect of a weaker Canadian dollar. Fourth quarter sales activity at our US operations (as measured in US dollars) was down 37.2%, and sales in Canada declined by 17.9%. Lower sales reflect the challenging business conditions previously discussed in section 2.0 of this MD&A.

Gross Profit

Gross profit for the three months ended December 31, 2008 was $9.5 million, a decrease of $3.0 million, or 24.0%, from the $12.5 million reported in the same period in 2007. The decrease in gross profit dollars reflects lower sales, as well as a decrease in gross profit as a percentage of sales to 16.7% in the fourth quarter of 2008, compared to 18.2% in the same period in 2007. Although some quarter-to-quarter variation in gross profit percentage is considered normal for our business, gross profit of 16.7% in the three months ended December 31, 2008 is below our typical range of 18% to 19% and our goal of 18.5% of sales or higher. The lower gross profit percentage in the fourth quarter of 2008 reflects extremely competitive conditions amidst a

contracting market, a continued downward trend in hardwood product prices, and a write-down in the fourth quarter to the carrying value of some specialized inventory held for a significant customer that went out of business.

Selling and Administrative Expenses

S&A expenses increased $0.9 million to $10.9 million in the fourth quarter of 2008, from $10.0 million during the same period in 2007. The $0.9 million increase to S&A expenses reflects a $1.4 million negative foreign exchange impact of a weaker Canadian dollar on the conversion of S&A expenses at our US operations. Had exchange rates remained consistent with the fourth quarter of 2007, our reported S&A expenses would have been $9.4 million. Our fourth quarter of 2008 S&A includes $0.5 million of non-recurring costs associated with closing branches and restructuring our California operations. Cost savings achieved by cancelling year-end incentive plan payments for management and staff were offset by increased bad debt expense in the fourth quarter of 2008, compared to the same period in the prior year. As a percentage of sales, fourth quarter S&A expenses were 19.3% of sales, compared to 14.6% in 2007.

Realized Gain on Foreign Currency Contracts

The Fund discontinued its foreign currency hedging program in the third quarter of 2008. Accordingly, no gains or losses were realized on foreign currency contracts during the fourth quarter of 2008, compared to $0.6 million of gains during the same period in 2007. 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

For the three months ended December 31, 2008, EBITDA was a loss of $1.4 million, compared to a $3.1 million profit during the same period in 2007. The $4.5 million reduction in EBITDA reflects the $3.0 million decrease in gross profit, the $0.6 million decrease in realized gain on foreign currency contracts, and the $0.9 million increase in S&A expenses.

Non-Cash Foreign Currency Gains and Losses

For the three months ended December 31, 2008, non-cash foreign currency gains were $1.5 million. This gain arose due to translation of US dollar denominated income tax receivables, and translation of US dollar denominated intercompany debt advanced by the Fund to a wholly-owned US subsidiary, as explained previously in section 3.1 of this report. In the comparative three-month period ended December 31, 2007, a non-cash loss of $0.6 million arose related to the mark-to-market valuation of foreign currency contracts that were outstanding at that time.

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 2008 the Fund completed impairment testing. As a result of worsening market conditions, it was determined that the carrying value of goodwill for the three months ended December 31, 2008 exceeded the fair value of goodwill by $17.5 million, while the carrying value of other intangibles exceeded the fair value of other intangibles by $3.1 million. Similar testing in 2007 determined no impairment existed in the carrying value of goodwill or other intangible assets.

Non-controlling Interest

The non-controlling interest generated a $4.9 increase to earnings in the fourth quarter of 2008, compared to $0.3 million positive earnings impact in Q4 2007. The change primarily reflects recognition of the NCI's share of the $20.6 million in goodwill and intangibles impairment recognized during the period.

Income Tax Recovery

An income tax recovery of $3.3 million was recorded in the fourth quarter of 2008, compared to a $0.3 million recovery in the comparable period in 2007. The income tax recovery in Q4 2008 primarily reflects a future income tax recovery related to accounting book value to tax value differences arising from the goodwill and intangibles impairment recorded during the period.

Net Loss

We recorded a net loss of $12.9 million in the fourth quarter of 2008, compared to net earnings of $2.1 million during the same period in 2007. The $15.0 million decrease in net earnings primarily reflects the $4.5 million decrease in EBITDA and the $20.6 million increase in goodwill and intangible impairment. This was partially offset by a $2.1 million increase in non-cash foreign currency gains, the $4.6 million increase in recovery from the non-controlling interest, the $3.0 million increase in income tax recovery, the $0.2 million decrease in interest expense, and a $0.1 million decrease in amortization expense.

4.0 Liquidity and Capital Resources

4.1 Distributable Cash and Cash Distributions

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

	Year ended December 31, 2008	Year ended December 31, 2007	3 months ended December 31, 2008	3 months ended December 31, 2007
Net cash provided by operating activities	$ 20,229	$ 20,629	$ 6,028	$ 10,514
Decrease in non-cash operating working capital	(14,836)	(2,777)	(7,679)	(7,291)
Cash flow from operations before changes in non-cash operating working capital	5,393	17,852	(1,651)	3,223
Capital expenditures	(425)	(571)	(79)	(18)
Distributable Cash	$ 4,968	$ 17,281	$ (1,730)	$ 3,205
Distributions relating to the period:				
Class A Units	$ 7,565 [1]	$ 12,355	$ -	$ 3,243
Class B Units [2]	-	-	-	-
Total Units	$ 7,565	$ 12,355	$ -	$ 3,243
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	$ 0.276	$ 0.959	$ (0.096)	$ 0.178
Distributions relating to the period:				
Class A Units	$ 0.525 [1]	$ 0.857	$ -	$ 0.225
Class B Units [2]	$ -	$ -	$ -	$ -
Total Units	$ 0.420	$ 0.686	$ -	$ 0.180
Payout ratio [3]	152.3%	71.5%	0.0%	101.2%

	March 23, 2004 to December 31, 2008
Cumulative since inception:	
Distributable Cash	75,617
Distributions relating to the period	66,754
Payout ratio [3]	88.3%

[1] Includes the cash distributions of $0.075 per Class A Unit per month which relate to the operations of the Fund for January to June 2008, and cash distributions of $0.025 per Class A Unit per month which relate to the operations of the Fund for July to September 2008.
[2] 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, 2008 balance sheet.
[3] 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 the notes to 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 2008, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of $5.0 million, or $0.276 per unit. Distributions relating to the period were $7.6 million, or $0.525 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, 2008. In the fourth quarter of 2008 the Fund and its subsidiaries generated negative total Distributable Cash available to Class A and Class B Unitholders of $(1.7) million, or $(0.096) per unit, and made no distributions relating to the period. These distributions represent an overall payout ratio of 152.3% for the year ended December 31, 2008, and 0% for the fourth quarter of 2008. The income tax characterization of distributions paid to unitholders in 2008 was 50.2% fully taxable distributions, 40.4% eligible dividends, and 9.4% return of capital.

4.2 Standardized Distributable Cash and Cash Distributions

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

	Year ended December 31, 2008	Year ended December 31, 2007	3 months ended December 31, 2008	3 months ended December 31, 2007
Net cash provided by operating activities	$ 20,229	$ 20,629	$ 6,028	$ 10,514
Capital expenditures	(425)	(571)	(79)	(18)
Standardized Distributable Cash	$ 19,804	$ 20,058	$ 5,949	$ 10,496
Distributions relating to the period:				
Class A Units	$ 7,565 (1)	$ 12,355	$ -	$ 3,243
Class B Units (2)	-	-	-	-
Total Units	$ 7,565	$ 12,355	$ -	$ 3,243
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	$ 1.099	$ 1.114	$ 0.330	$ 0.583
Distributions per Total Units	$ 0.420	$ 0.686	$ -	$ 0.180
Standardized payout ratio (3)	38.2%	61.6%	0.0%	30.9%

	March 23, 2004 to December 31, 2008
Cumulative since inception:	
Standardized Distributable Cash	83,160 (4)
Distributions relating to the period	66,754
Standardized Payout ratio (3)	80.3%

[1] Includes the cash distributions of $0.075 per Class A Unit per month which relate to the operations of the Fund for January to June 2008, and cash distributions of $0.025 per Class A Unit per month which relate to the operations of the Fund for July to September 2008.
[2] 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, 2008 balance sheet.
[3] Payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.
[4] 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 and significant changes in market demand for our products. 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.

	Year ended December 31, 2008	Year ended December 31, 2007	3 months ended December 31, 2008	3 months ended December 31, 2007
Standardized Distributable Cash	$ 19,804	$ 20,058	$ 5,949	$ 10,496
Decrease in non-cash operating working capital	(14,836)	(2,777)	(7,679)	(7,291)
Distributable Cash	$ 4,968	$ 17,281	$ (1,730)	$ 3,205

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, 2008 and 2007 is provided below.

(in thousands of Canadian dollars)

Source (use) of funds	Year ended December 31, 2008	Year ended December 31, 2007
Accounts receivable	$ 7,858	$ 1,470
Income taxes recoverable	(805)	(445)
Inventory	11,820	1,627
Prepaid expenses	155	(70)
Accounts payable and accrued liabilities	(4,192)	195
Decrease in non-cash operating working capital	$ 14,836	$ 2,777

Continued compliance with financial covenants under our credit facilities is important to ensure that we maintain adequate availability of financing to meet our working capital requirements. The terms of our revolving credit facilities are addressed in section 4.6 of this report.

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 2008 totalled $0.4 million, compared to $0.6 million in 2007. The decrease reflects our efforts to decrease cash outlays on capital items, consistent with our overall focus on cost reduction.

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. As discussed in section 2.0 of this report, we experienced a significant market downturn in demand for hardwoods products in 2008. In response to this reduced demand, we closed seven branch locations in 2008, reducing our available distribution infrastructure to 1.1 million square feet. We believe these reductions to our distribution network are appropriate and enable us to better match our operating costs to current market demand.

Selected Unaudited Consolidated Financial Information

						IPO
	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	March 23, 2004
Number of distribution centres in operation	29	36	36	39	37	37
Total square footage of distribution centres	1.1 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.

Maintenance of a skilled workforce is also important to managing the productive capacity of our business. 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 relative to available market demand, as measured by sales, has been largely sustained since the Fund's IPO in March 2004.

Selected Unaudited Consolidated Financial Information

	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	IPO March 23, 2004
Number of employees	190	236	252	259	224	216
Annual sales per employee ($ millions)	1.3	1.4	1.4	1.4	1.7	

4.5 Utilization of Distributable Cash

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Year ended December 31, 2008	Year ended December 31, 2007	3 months ended December 31, 2008	3 months ended December 31, 2007
Distributable Cash	$ 4,968	$ 17,281	$ (1,730)	$ 3,205
Cash Distributions paid in the period	(8,646)	(12,254)	(360)	(3,190)
Distributable Cash retained (shortfall)	$ (3,678)	$ 5,027	$ (2,090)	$ 15
Decrease (increase) in non-cash operating working capital	14,836	2,777	7,679	7,291
Decrease (increase) in long-term receivables	403	1,640	217	137
Decrease (increase) in deferred financing fees	(221)	-	(17)	-
Proceeds from disposal of property, plant and equipment	25	26	25	-
Decrease (increase) in bank indebtedness, net of cash	$ 11,365	$ 9,470	$ 5,814	$ 7,443

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, 2008, the Fund generated Distributable Cash of $5.0 million, paid cash distributions of $8.6 million, resulting in a Distributable Cash shortfall of $3.7 million. 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 $14.8 million and our investment in long-term receivables by $0.4 million. We invested $0.2 million in deferred financing fees associated with our new US credit line described in section 4.6 below. Taking these factors together, we were able to pay down our bank indebtedness (net of cash) by $11.4 million in 2008.

For the three months ended December 31, 2008, the Fund generated negative Distributable Cash of $(1.7) million and paid cash distributions of $0.4 million. We decreased our investment in non-cash operating working capital by $7.7 million, reflecting the seasonality of the business and slowing market demand, and reduced our investment in long-term receivables by $0.2 million. Taking these factors together, we were able to pay down our bank indebtedness (net of cash) by $5.8 million in the fourth quarter of 2008.

4.6 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	As at December 31, 2008		As at December 31, 2007	
Cash and cash equivalents	$	(85)	$	(295)
Bank indebtedness		17,561		25,515
Net Debt	$	17,476	$	25,220
Unitholders' Equity	$	68,772	$	105,994
Total Capitalization	$	86,248	$	131,214
Net debt to total capitalization		20.3%		19.2%
Previous 12 months EBITDA	$	5,918	$	21,260
Net debt to previous 12 months EBITDA		2.95		1.19

As discussed previously in section 4.5 of this report, the Fund paid down its net debt by $11.4 million in the twelve months ended December 31, 2008. This pay-down was partially offset by the $3.7 million negative impact of a weaker Canadian dollar on the conversion of our US dollar-denominated net debt. Taken together, the Fund's net debt balance decreased by $7.7 million, from $25.2 million at December 31, 2007 to $17.5 million at December 31, 2008. Overall net debt compared to total capitalization stood at 20.3% as of December 31, 2008, compared to 19.2% at December 31, 2007. The ratio of net debt to EBITDA in the previous 12 months is 2.95 times at December 31, 2008 compared to 1.19 times at December 31, 2007. Net debt to EBITDA serves as an indicator of our financial leverage. With the downturn in economic conditions in 2008, our EBITDA results decreased significantly as explained previously in section 3.1 of this report. Despite making significant progress in reducing our debt in 2008, as a result of lower EBITDA, our overall financial leverage has increased.

We have independent credit facilities in both Canada and the U.S. The amount made available under these revolving credit facilities is, from time to time, limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at December 31, 2008 is provided below.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

As at December 31, 2008	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	$22 million	$36.5 million (US$ 30 million)
Credit facility expiry date	November 30, 2009	September 30, 2011
Available to borrow	$11.7 million	$22.2 million (US$18.3 million)
Credit facility borrowings	$ 0.3 million	$16.2 million (US$13.3 million)
Unused credit facility available	$11.4 million	$ 7.2 million (US$5.9 million)

Financial covenants:		
a. EBITDA / Interest (1)		
Covenant minimum	3.0	
Covenant actual	17.0	
b. Debt / EBITDA (1)		
Covenant maximum	2.5	
Covenant actual	0.1	
c. (EBITDA - cash taxes - capital expenditures) / (Interest + Distributions) (2)		
Covenant minimum		0.75
Covenant actual (3)		1.05

[1] EBITDA and Interest calculated on a trailing twelve month basis in accordance with the terms of the Canadian credit facility. Debt calculated as at December 31, 2008.
[2] Calculated for the six months ended December 31, 2008, in accordance with the terms of the US credit facility.
[3] The covenant minimum is 0.75 for the fourth quarter of 2008, 0.50 for the first quarter of 2009, 0.75 for the second quarter of 2009, and 1.0 thereafter.

At December 31, 2008, preliminary financial results for a U.S. subsidiary of the Fund indicated that it would breach its fixed charge coverage ratio, the only financial covenant which it is subject to under its U.S. credit agreement. Subsequent to year end, the Fund's U.S. subsidiary and its lender amended their credit agreement with changes to be retroactively effective to the December 31, 2008 reporting period. Under the amendment, the Fund's U.S. subsidiary was compliant with its financial covenant at December 31, 2008.

We have forecast the Fund's financial results and cash flows for 2009. The forecasts are based on management's best estimates of operating conditions in the context of the current economic climate, today's capital market conditions and the depressed state of the housing and renovation markets in both Canada and the United States. Currently management does not anticipate being in default of the fixed charge covenant ratio under its U.S. lending agreement in the first quarter of 2009. However, due to the difficulty in predicting the continued severity and duration of the current economic and financial crisis, management is uncertain whether its U.S. subsidiary will remain in compliance with its financial covenant during the remainder of 2009. Further weakening of the housing and renovation market, or incurring significant customer or credit losses, could cause the U.S. subsidiary to violate its fixed charge coverage ratio in 2009. This could cause the Fund's U.S. subsidiary bank indebtedness to become immediately due and

payable, and the Fund and its U.S. subsidiary may not be able to access funds under its revolving credit facility. In the event of such as circumstance, the Fund anticipates it would need to raise additional capital in the form of equity or debt to supplement or replace its existing credit facilities in order to have sufficient liquidity to meet its obligations in 2009.

The accompanying Audited Financial Statements have been prepared assuming the Fund will continue as a going concern which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts should the Fund be unable to continue as a going concern. The principal terms of the credit facilities of Hardwoods LP and Hardwoods US LP are available at www.sedar.com.

The terms of the agreements with our lenders provide that distributions cannot be made to our unitholders in the event that our subsidiaries are not compliant with their financial covenants. As shown in the preceding table, our operating subsidiaries were compliant with all required credit ratios as at December 31, 2008, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Subsequent to year end, on February 2, 2009, we reduced the maximum amount of our Canadian facility to $12.0 million in order to realize cost savings by reducing standby fees that would otherwise be payable in 2009 on the unused portion of our Canadian credit facility.

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 September 2011, 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, 2008. These obligations relate to operating leases on various premises and automobiles, and become due in the fiscal years indicated:

(in thousands of Canadian dollars)

Total	2009	2010	2011	2012	2013	2014 & thereafter
$ 19,244	$ 7,389	$ 5,742	$ 2,703	$ 1,726	$ 1,026	$ 658

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 were marked-to-market at the end of each quarter, with the fair value recorded on the balance sheet.

5.0 Financial Instruments

Up to June 30, 2008, the Fund used currency contracts to assist in forward planning for the business as it related to managing the Fund's exposure to fluctuations in exchange rates between the Canadian dollar and the United States dollar. In particular, monthly foreign currency contracts were purchased to cover the estimated amount of US dollar denominated Distributable Cash that must be converted to Canadian dollars to pay distributions to Class A Unitholders.

As discussed in the Fund's Second Quarter Report to Unitholders, effective July 2008 the Fund reduced its monthly distributions with the expectation that little or no cash flows would be converted from the Fund's US subsidiaries to pay distributions until such time as sales demand and associated business results for the Fund's US subsidiaries improved. Accordingly, in the third quarter the Fund ceased purchasing additional foreign exchange contracts until such time as the amount and timing of resumption of distributions from the Fund's US subsidiaries are known. In the third quarter of 2008 the Fund determined that its remaining currency contracts were no longer needed to hedge US dollar cash flow, and realized cash proceeds of $0.2 million from the sale of these contracts.

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, 2008, sales of $0.4 million were made to related parties, and the subsidiaries of the Fund purchased $0.1 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 and Adoption of Changes in Accounting Policies

7.1 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. We review 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. During the year ended December 31, 2008 it was determined that the carrying value of all remaining goodwill and other intangible assets was impaired, and accordingly these amounts were charged to income during the year.

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, we are now required to recognize the value of future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. We are 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.

7.2 Adoption of Changes in Accounting Policies

In the second quarter of 2008 the Canadian Accounting Standards Board confirmed January 1, 2011, as the date International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles (Canadian GAAP) for public companies. Changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect our reported financial position and results of operations. It may also affect certain business functions. We have adopted an IFRS changeover plan to help guide this transition. It is expected that our changeover plan will be modified and updated as we proceed through the changeover process. Key elements of our current changeover plan include:

Year	Key Activities
2008	Complete IFRS education and training with our accounting staff. Identify an IFRS project manager. Determine intended use of outside consultants, if any. Analyze differences between our current accounting policies and IFRS.
2009	Make preliminary selections of IFRS accounting policies. Identify one-time elective exemptions available on initial IFRS adoption. Identify the information required to deliver the preliminary selections of IFRS accounting policies. Identify system changes (accounting, policies, procedures, information technology) required to get that information. Develop a master conversion plan for changes identified. Adopt formal project plan. Automate and test data collection. Identify and address the impact of changes IFRS makes to the Fund's business drivers, including debt covenants, incentive plans, and management reporting, budgeting, and other items. Link IFRS to CEO/CFO certification processes and update certification documentation. Estimate anticipated impacts of IFRS adoption on our financial statements.
2010	Commence IFRS accounting to provide comparative figures for 2011 IFRS startup date. Prepare IFRS communication plan for stakeholders.
2011	Commence IFRS reporting.

Effective January 1, 2008, we adopted four new Canadian Institute of Chartered Accountants ("CICA") accounting standards: (a) Handbook Section 1535, Capital Disclosures; (b) Handbook Section 3031, Inventories; (c) Handbook Section 3862, Financial Instruments - Disclosures; and Handbook Section 3863, Financial Instruments - Presentation. The main requirements of these new standards and the resulting financial statement impact are described below.

(a) Capital Disclosures (Section 1535):

CICA Section 1535 requires disclosure of: (i) an entity's objectives, policies and process for managing capital; (ii) quantitative data about what the entity considers as capital; (iii) whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. Refer to note 4 of the Audited Financial Statements for additional disclosures.

(b) Inventories (Section 3031):

CICA 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. Refer to note 5 Audited Financial Statements for additional disclosures.

Consistent with the transitional rules for Section 3031, we have not restated any prior period amounts as a result of adopting the accounting changes. As allowed under the transition rules, the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policy related to inventory. The adoption of this new standard resulted in a decrease in the carrying value of opening inventory of $317,000, a decrease in non-controlling interests of $62,000, and an increase in deficit of $255,000 on the balance sheet at January 1, 2008, to reflect trade discounts from suppliers for inventory purchases that previously had been recognized in earnings when received.

(c) Financial Instruments – Disclosures (Section 3862) and Financial Instruments - Presentation (Section 3863):

CICA Section 3032 and 3063 replaces CICA Handbook Section 3861, Financial Instruments – Disclosures and Presentation, revising and enhancing disclosure requirements to provide

additional information on the nature and extent of risks arising from financial instruments to which the entity is exposed and how it manages those risks. Refer to note 6 for additional disclosures.

Effective January 1, 2009, we will adopt new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. This section replaces CICA Handbook Section 3062, *Goodwill and Intangible Assets*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. As the Fund does not have any goodwill or intangible assets at December 31, 2008 the adoption of this new standard is not expected to impact the amounts presented in the financial statements.

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 23, 2009, which is available to readers at www.sedar.com.

9.0 Disclosure Controls and Procedures and Internal Control Over Financial Reporting

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, the Fund carried out an evaluation of the effectiveness of the Fund's disclosure controls and procedures as of December 31, 2008. The evaluation was carried out under the supervision of, and with the participation of the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"). Based on the evaluation, the CEO and CFO concluded that the Fund's disclosure controls and procedures were effective as of December 31, 2008.

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, the Fund carried out an evaluation of the effectiveness of the Fund's internal controls over financial reporting ("ICFR") as of December 31, 2008. The evaluation was carried out within the COSO framework and under the supervision of, and with the participation of the CEO and the CFO. Based on the evaluation, the CEO and CFO concluded that the Fund's ICFR were effective as of December 31, 2008.

The CEO and CFO acknowledge responsibility for the design of ICFR, and confirm that there were no changes in these controls that occurred during the most recent interim period ended December 31, 2008 which materially affected, or are reasonably likely to materially affect, the Fund's ICFR.

10.0 Selected Financial Information

10.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2008	Q3 2008	Q2 2008	Q1 2008	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Total sales	$ 56,650	$ 62,115	$ 66,488	$ 71,048	$ 68,767	$ 81,878	$ 89,400	$ 91,720
Net earnings	$ (12,941)	$ 885	$ (33,716)	$ 9,529	$ 2,115	$ 4,698	$ 4,800	$ 4,006
Basic and fully diluted earnings (loss) per Class A Unit	$ (0.898)	$ 0.061	$ (2.340)	$ 0.661	$ 0.147	$ 0.326	$ 0.333	$ 0.278
EBITDA	$ (1,430)	$ 1,344	$ 3,091	$ 2,913	$ 3,112	$ 6,411	$ 6,350	$ 5,387
Distributable Cash	$ (1,730)	$ 1,000	$ 2,427	$ 3,271	$ 3,205	$ 5,211	$ 4,868	$ 3,997
Total distributions to Class A and Class B Units	$ -	$ 1,081	$ 3,242	$ 3,242	$ 3,243	$ 3,086	$ 3,086	$ 2,940
Payout ratio	0.0%	108.2%	133.6%	99.1%	101.2%	59.2%	63.4%	73.6%

The table above provides selected quarterly financial information for our eight most recently completed fiscal quarters. 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 quarters 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 June 30, 2008, and three months ended December 31, 2008), 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 dollars except per unit amounts)

	Year ended December 31, 2008	Year ended December 31, 2007	Year ended December 31, 2006	Year ended December 31, 2005
Total sales	$ 256,301	$ 331,765	$ 362,528	$ 355,775
Net earnings (loss)	(36,243)	15,619	3,637	13,351
Basic and fully diluted earnings (loss) per Class A Unit	(2.515)	1.084	0.252	0.927
Total assets	103,350	173,727	198,404	214,669
Total long-term financial liabilities	13,652	34,187	37,372	34,215
Distributions per Unit relating to the period:				
Class A Units	$ 0.525	$ 0.857	$ 0.921	$ 1.075
Class B Units	$ -	$ -	$ -	$ 0.851
Total Units	$ 0.420	$ 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 procedure, 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

Auditor's Report to the Unitholders

We have audited the consolidated balance sheets of Hardwoods Distribution Income Fund (the "Fund") as at December 31, 2008 and 2007 and the consolidated statements of earnings (loss) and deficit, comprehensive income (loss), accumulated other comprehensive loss and cash flows 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, 2008 and 2007 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 13, 2009, except for notes 1 and 10 which are as of March 17, 2009

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

December 31, 2008 and 2007

	2008	2007
Assets		
Current assets:		
Cash and cash equivalents	$ 85	$ 295
Accounts receivable (note 6(c))	32,218	36,474
Income taxes recoverable	2,316	1,041
Inventory (note 5)	30,868	38,400
Prepaid expenses	1,039	1,060
Foreign currency contracts (note 8)	-	1,533
	66,526	78,803
Long-term receivables (note 6(c))	3,639	2,191
Property, plant and equipment (note 7)	2,168	2,413
Deferred financing costs	235	21
Future income taxes (note 13)	30,782	-
Foreign currency contracts (note 8)	-	528
Intangible assets (note 9)	-	9,013
Goodwill (note 9)	-	80,758
	$ 103,350	$ 173,727
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 10)	$ 17,561	$ 25,515
Accounts payable and accrued liabilities	3,365	6,950
Distributions payable to Unitholders	-	1,081
	20,926	33,546
Deferred gain on sale-leaseback of land and building	572	538
Foreign currency contracts (note 8)	-	47
Future income taxes (note 13)	-	3,534
Non-controlling interests (note 11)	13,080	30,068
Unitholders' equity:		
Fund Units (note 12)	133,454	133,454
Deficit	(49,958)	(5,895)
Accumulated other comprehensive loss	(14,724)	(21,565)
	68,772	105,994
Continuance of operations (note 1)		
Commitments (note 15)		
Contingencies (note 19)		
Subsequent events (notes 1, 6(c)(*ii*) and 10)		
	$ 103,350	$ 173,727

See accompanying notes to consolidated financial statements.

Approved on behalf of the Trustees:

(Signed) Graham M. Wilson Trustee   **(Signed) Terry M. Holland** Trustee

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statements of Earnings (Loss) and Deficit
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2008 and 2007

	2008	2007
Sales	$ 256,301	$ 331,765
Cost of sales	210,205	269,028
Gross profit	46,096	62,737
Expenses (income):		
Selling and administrative	41,425	43,360
Amortization:		
Plant and equipment	941	1,091
Deferred financing costs	36	11
Other intangible assets	573	843
Deferred gain on sale-leaseback of land and building	(79)	(79)
Interest	1,219	2,402
Foreign exchange gains	(914)	(2,524)
Intangibles impairment (note 9)	8,612	-
Goodwill impairment (note 9)	82,083	-
	133,896	45,104
Earnings (loss) before non-controlling interests and income taxes	(87,800)	17,633
Non-controlling interests (note 11)	20,031	(109)
Earnings (loss) before income taxes	(67,769)	17,524
Income tax expense (recovery) (note 13):		
Current	(734)	441
Future	(30,792)	1,464
	(31,526)	1,905
Net earnings (loss) for the year	(36,243)	15,619
Deficit, beginning of year (note 3)	(6,150)	(9,159)
Distributions declared to Unitholders	(7,565)	(12,355)
Deficit, end of year	$ (49,958)	$ (5,895)
Basic and diluted earnings (loss) per Unit	$ (2.52)	$ 1.08
Weighted average number of Units outstanding	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Comprehensive Income (Loss)
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2008 and 2007

	2008	2007
Net earnings (loss) for the year	$ (36,243)	$ 15,619
Other comprehensive income (loss):		
Unrealized gains (losses) on translation of self-sustaining foreign operations	6,841	(10,385)
Comprehensive income (loss)	$ (29,402)	$ 5,234

Consolidated Statement of Accumulated Other Comprehensive Loss
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2008 and 2007

	2008	2007
Accumulated other comprehensive loss, beginning of year	$ (21,565)	$ (11,180)
Other comprehensive income (loss)	6,841	(10,385)
Accumulated other comprehensive loss, end of year	$ (14,724)	$ (21,565)

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statements of Cash Flows
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2008 and 2007

	2008	2007
Cash flows provided by (used in) operating activities:		
Net earnings (loss) for the year	$ (36,243)	$ 15,619
Items not involving cash:		
Amortization	1,471	1,866
Imputed interest income on employee loans	(67)	(60)
Loss (gain) on sale of property, plant and equipment	(14)	(21)
Unrealized foreign exchange losses (gains)	333	(641)
Intangibles impairment	8,612	-
Goodwill impairment	82,083	-
Non-controlling interests	(20,031)	109
Future income taxes	(30,751)	980
	5,393	17,852
Change in non-cash operating working capital (note 14)	14,836	2,777
Net cash provided by operating activities	20,229	20,629
Cash flows used in financing activities:		
Decrease in bank indebtedness	(11,575)	(9,769)
Increase in deferred financing fees	(221)	-
Distributions paid to Unitholders	(8,646)	(12,254)
Net cash used in financing activities	(20,442)	(22,023)
Cash flows provided by (used in) investing activities:		
Additions to property, plant and equipment	(425)	(571)
Proceeds on disposal of property, plant and equipment	25	26
Decrease in long-term receivables, net	403	1,640
Net cash provided by investing activities	3	1,095
Decrease in cash	(210)	(299)
Cash, beginning of year	295	594
Cash, end of year	$ 85	$ 295
Supplemental information:		
Interest paid	$ 1,219	$ 2,402
Income taxes paid	75	936
Transfer of accounts receivable to long-term customer notes receivable, net of write offs, being a non-cash transaction	2,508	667

See accompanying notes to consolidated financial statements.

1. Nature and continuance of operations:

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.

Effective for the year ended December 31, 2008, the Fund has adopted Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1400, *General Standards of Financial Statement Presentation*. Section 1400 was amended to require management to assess and disclose an entity's ability to continue as a going concern. The Fund has forecast its financial results and cash flows for 2009. The forecasts are based on management's best estimates of operating conditions in the context of the current economic climate, today's capital market conditions and the depressed state of the housing and renovation markets in both Canada and the United States.

At December 31, 2008, preliminary financial results for a U.S. subsidiary of the Fund indicated that it would breach its fixed charge coverage ratio, the only financial covenant which it is subject to under its U.S. credit agreement. Subsequent to year end, the Fund's U.S. subsidiary and its lender amended their credit agreement with changes to be retroactively effective to the December 31, 2008 reporting period. Under the amendment, the Fund's U.S. subsidiary was compliant with its financial covenant at December 31, 2008. Currently management does not anticipate being in default of the fixed charge covenant ratio under its U.S. lending agreement in the first quarter of 2009. However, due to the difficulty in predicting the continued severity and duration of the current economic and financial crisis, management is uncertain whether its U.S. subsidiary will remain in compliance with its financial covenant during the remainder of 2009. Further weakening of the housing and renovation market, or incurring significant customer or credit losses, could cause the U.S. subsidiary to violate its fixed charge coverage ratio in 2009. This could cause the Fund's U.S. subsidiary bank indebtedness to become immediately due and payable, and the Fund and its U.S. subsidiary may not be able to access funds under its revolving credit facility. In the event of such as circumstance, the Fund anticipates it would need to raise additional capital in the form of equity or debt to supplement or replace its existing credit facilities in order to have sufficient liquidity to meet its obligations in 2009.

The accompanying consolidated financial statements have been prepared assuming the Fund will continue as a going concern which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts should the Fund be unable to continue as a going concern.

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 lower of cost and net realizable value. Cost is determined using the weighted average cost method and includes invoice cost, duties, freight, and other directly attributable costs of acquiring the inventory.

Volume rebates and other supplier discounts are included in income when earned. Volume discounts and supplier trade discounts are accounted for as a reduction of the cost of the related inventory and are earned when inventory is sold.

(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.

2. Significant accounting policies (continued):

(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. During the year ended December 31, 2008, management performed impairment tests at June 30, 2008 and at December 31, 2008 and recorded aggregate intangibles impairments of $8.6 million (2007 - nil). See also note 9 to these consolidated financial statements.

(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 year ended December 31, 2008, management performed impairment tests at June 30, 2008 and at December 31, 2008 and recorded aggregate goodwill impairments of $82.1 million (2007 - nil). See also note 9 to these consolidated financial statements.

(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 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.

2. Significant accounting policies (continued):

(k) Income taxes (continued):

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. 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.

(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 has used currency derivatives to manage its exposure to fluctuations in exchange rates between the Canadian and the United States dollar. The foreign currency contracts were recognized in the balance sheet and measured at fair value, with changes in fair value recognized currently in the statement of earnings.

(o) Earnings (loss) per Unit:

Basic earnings (loss) per Unit is calculated by dividing net earnings (loss) by the weighted average number of Units outstanding during the reporting period. Diluted earnings (loss) 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 (loss) per Unit, diluted and basic earnings (loss) per Unit are the same amount.

2. Significant accounting policies (continued):

(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 assessment of the Fund's ability to continue as a going concern, 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:

(*i*) International Financial Reporting Standards:

The CICA will transition Canadian generally accepted accounting principles ("GAAP") for publicly accountable entities to International Financial Reporting Standards ("IFRS"). The Fund's consolidated financial statements are to be prepared in accordance with IFRS for the fiscal year commencing January 1, 2011. The impact of the transition to IFRS on the Fund's consolidated financial statements has not been determined.

(*ii*) Goodwill and intangible assets:

Effective January 1, 2009, the Fund will adopt new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. This section replaces CICA Handbook Section 3062, *Goodwill and Intangible Assets*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. As the Fund does not have any goodwill or intangible assets at December 31, 2008, the adoption of this new standard will not impact the amounts presented in the financial statements.

3. Adoption of new accounting standards:

Effective January 1, 2008, the Fund adopted four new accounting standards: (a) Handbook Section 1535, *Capital Disclosures*; (b) Handbook Section 3031, *Inventories*; (c) Handbook Section 3862, *Financial Instruments - Disclosures*; and Handbook Section 3863, *Financial Instruments - Presentation*. The main requirements of these new standards and the resulting financial statement impact are described below.

(a) Capital Disclosures (Section 1535):

CICA Section 1535 requires disclosure of: (*i*) an entity's objectives, policies and process for managing capital; (*ii*) quantitative data about what the entity considers as capital; (*iii*) whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. Refer to note 4 for additional disclosures.

3. Adoption of new accounting standards (continued):

(b) Inventories (Section 3031):

CICA 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. Refer to note 5 for additional disclosures.

Consistent with the transitional rules for Section 3031, the Fund has not restated any prior period amounts as a result of adopting the accounting changes. As allowed under the transition rules, the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policy related to inventory. The adoption of this new standard reflects trade discounts from suppliers for inventory purchases that previously had been recognized in earnings when received.

The effect of the adoption of Section 3031 is summarized in the following table:

	As at December 31, 2007	Adjustment on adoption of new standards	As at January 1, 2008
Inventory	$ 38,400	$ (317)	$ 38,083
Non-controlling interests	30,068	(62)	30,006
Unitholders equity:			
Deficit	$ (5,895)	$ (255)	$ (6,150)

(c) Financial Instruments - Disclosures (Section 3862) and Financial Instruments - Presentation (Section 3863):

CICA Section 3032 and 3063 replaces CICA Handbook Section 3861, *Financial Instruments - Disclosures and Presentation,* revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the entity is exposed and how it manages those risks. Refer to note 6 for additional disclosures.

4. Capital disclosures:

The Fund's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Fund considers its capital to be bank indebtedness (net of cash) plus Unitholders' equity. The Fund's capitalization is as follows:

	2008	2007
Cash and cash equivalents	$ (85)	$ (295)
Bank indebtedness	17,561	25,515
Net debt	17,476	25,220
Unitholders' equity	68,772	105,994
Total capitalization	$ 86,248	$ 131,214

4. Capital disclosures (continued):

The Fund monitors on a monthly basis the ratio of net debt to earnings before interest, income taxes, depreciation and amortization ("EBITDA"). Net debt to EBITDA serves as an indicator of the Fund's financial leverage. The maximum ratio of net debt to EBITDA allowed under the Canadian credit facility is 2.50 times, and the minimum ratio of EBITDA to interest is 3.0 times. Under the U.S. credit facility, as amended on March 17, 2009, a Fixed Charge Coverage Ratio ((EBITDA less capital expenditures less cash taxes)/(interest plus distributions)) is not permitted to be less than 0.75 for the periods ended September 30, 2008 and December 31, 2008, not less than 0.50 for the period ended March 31, 2009, not less than 0.75 for the period ended June 30, 2009, and not less than 1.0 thereafter. Refer to note 10 for additional disclosures.

The terms of the agreements with the Fund's lenders provide that distributions cannot be made to its unitholders in the event that its subsidiaries did not meet the foregoing leverage as well as certain additional credit ratios. Following the amendment to the USLP credit facility on March 17, 2009 (notes 1 and 10), the operating subsidiaries were fully compliant with all required credit ratios as at December 31, 2008, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Distributions are one of the ways the Fund manages its capital. Distributions of the Fund's available cash are made to the maximum extent possible, subject to reasonable reserves established by the Trustees of the Fund. Distributions are made by the Fund having given consideration to a variety of factors including the outlook for the business, financial leverage, and the ratio of distributions to available cash of the Fund. There were no changes in the Fund's approach to capital management during the year ended December 31, 2008. On November 3, 2008 the Trustees of the Fund suspended further monthly distributions until such time as market conditions and the Fund's generation of cash has improved.

5. Inventory:

	2008	2007
Lumber	$ 12,077	$ 15,077
Sheet goods	14,990	17,884
Specialty	2,356	3,067
Goods in-transit	1,445	2,372
	$ 30,868	$ 38,400

During the year ended December 31, 2008 inventory write-downs totaling $3.1 million (2007 - $2.4 million) were recorded to reduce certain inventory items to their net realizable value. The write-down for the year ended December 31, 2008 included $0.6 million for inventory stocked specifically for a large customer which declared bankruptcy subsequent to year end.

Cost of sales for the year ended December 31, 2008 were $210.2 million (2007 - $269.0 million), which included $201.8 million (2007 - $259.8 million) of costs associated with inventory. The other $8.4 million (2007 - $9.2 million) related principally to freight and other related selling expenses.

6. Financial instruments:

Financial instrument assets include cash and cash equivalents, which are designated as held-for-trading and measured at fair value, and current and long-term receivables which are designated as loans and receivables and measured at amortized cost. Financial instrument liabilities include bank indebtedness, accounts payable, accrued liabilities and distributions payable. All financial liabilities are designated as other liabilities and are measured at amortized cost. There are no financial instruments classified as available-for-sale or held-to-maturity. Financial instruments of the Fund also included foreign currency contracts which are derivative financial instruments (note 6(b)) and measured at fair value prior to settlement in August 2008.

(a) Fair values of financial instruments:

The carrying values of cash and cash equivalents, accounts receivable, income tax recoverable, 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 were carried at market values as disclosed in note 8 prior to their settlement.

(b) Derivative financial instruments:

Until August 2008 the Fund used foreign currency contracts to assist in forward planning for the business relating to managing its exposure to fluctuations in exchange rates between the Canadian dollar and the U.S. dollar. The foreign currency contracts were recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of earnings.

All of the outstanding foreign currency contracts were settled with the counterparty during the year ended December 31, 2008. Refer to note 8 for additional disclosure.

(c) Financial risk management:

Trustees of the Fund and the Board of Directors of the Fund's subsidiaries have the overall responsibility for the establishment and oversight of the Fund's risk management framework. The Fund's risk management policies are established to identify and analyze the risks faced by the Fund, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and in response to the Fund's activities. Through its standards and procedures management has developed a disciplined and constructive control environment in which all employees understand their roles and obligations. Management regularly monitors compliance with the Fund's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Fund.

The Fund has exposure to credit, liquidity and market risks from its use of financial instruments.

6. Financial instruments (continued):

(c) Financial risk management (continued):

(*i*) Credit risk:

Credit risk is the risk of financial loss to the Fund if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Fund's receivables from customers. Employee housing loans, customer notes and security deposits also present credit risk to the Fund.

The following is a breakdown of the Fund's current and long-term receivables and represents the Fund's exposure to credit risk related to its financial assets:

	2008	2007
Trade accounts receivable - Canada	$ 8,404	$ 11,086
Trade accounts receivable - United States	23,423	25,131
Sundry receivable	495	645
Current portion of long-term receivables	2,243	658
	34,565	37,520
Less: allowance for doubtful accounts	2,347	1,046
	$ 32,218	$ 36,474
Long-term receivables:		
Employee housing loans	$ 1,507	$ 1,130
Customer notes	3,772	1,166
Security deposits	603	553
	5,882	2,849
Less: current portion, included in accounts receivable	2,243	658
	$ 3,639	$ 2,191

Trade accounts receivable:

The Fund's exposure to credit risk is influenced mainly by individual characteristics of each customer. 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 advanced to customers whenever possible by registering security interests in the assets of the customer and by obtaining personal guarantees. Credit limits are established for each customer and are regularly reviewed. In some instances the Fund may choose to transact with a customer on a cash-on-delivery basis. Our largest individual customer balance amounted to 8.2% of trade accounts receivable and customer notes receivable at December 31, 2008.

6. Financial instruments (continued):

(c) Financial risk management (continued):

(*i*) Credit risk (continued):

The aging of trade receivables was:

	2008	2007
Current	$ 17,037	$ 20,245
Past due 31-60 days	6,696	8,345
Past due 61-90 days	3,706	3,453
Past due 90+ days	4,388	4,174
	$ 31,827	$ 36,217

The Fund determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer. Accounts that are considered uncollectable are written off. The total allowance at December 31, 2008 was $2.3 million (2007 - $1.0 million). The amount of the allowance is considered sufficient based on the past experience of the business, the security the Fund has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

Bad debt expense for the year ended December 31, 2008 was $3.9 million which equates to 1.5% of sales. For the year ended December 31, 2007 bad debt expense was $2.1 million which equates to 0.6% of sales. Historically bad debt expense has averaged approximately 0.6% of sales.

Employee housing loans:

Employee loans are non-interest bearing and are granted to employees who are relocated. Employee loans are secured by a deed of trust or mortgage depending upon the jurisdiction. Employees are required to make an annual payment from their profit share. These loans are measured at their fair market value upon granting the loan and subsequently measured at amortized cost.

Customer notes:

Customer notes are issued to certain customers to provide fixed repayment schedules for amounts owing that have been agreed will be repaid over longer periods of time. The terms of each note are negotiated with the customer. For notes issued the Fund requires a fixed payment amount, personal guarantees, general security agreements, and in some cases security over specific property or assets. Customer notes bear market interest rates ranging from 8%-18%.

Security deposits:

Security deposits are recoverable on leased premises at the end of the related lease term. The Fund does not believe there is any material credit risk associated with its security deposits.

6. Financial instruments (continued):

(c) Financial risk management (continued):

(*ii*) Liquidity risk:

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund's approach to managing liquidity is to ensure that it will have sufficient cash available to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Fund's reputation. At December 31, 2008, in Canada, a subsidiary of the Fund had a revolving credit facility of up to $22.0 million. In the US, a subsidiary of the Fund has a revolving credit facility of up to $36.5 million (US$30.0 million). These credit facilities can be drawn down to meet short-term financing requirements, including fluctuations in non-cash working capital. The amount made available under the revolving credit facilities from time to time is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund, as well as by continued compliance with credit ratios and certain other terms under the credit facilities. At December 31, 2008 the Canadian and U.S. credit facilities have $11.5 million and $7.2 million (US$5.9 million), respectively of additional borrowing capacity.

Subsequent to December 31, 2008, the Fund reduced the size of its Canadian credit facility to $12.0 million from a previous maximum of $22.0 million. The reduction in facility size was initiated in order to save approximately $20,000 in standby fees for unused borrowing capacity during 2009. The revised facility maximum of $12.0 million is considered adequate to the working capital financing needs of the Canadian operation, which at December 31, 2008 had borrowings under the facility of $0.3 million.

(*iii*) Market risk:

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates, and commodity prices will affect the Fund's net earnings or value of its holdings of financial instruments.

Interest rate risk:

The Fund is exposed to interest rate risk on its credit facilities which bear interest at floating market rates.

Based upon December 31, 2008 bank indebtedness balance of $17.6 million, a 1% increase or decrease in the interest rates charged will result in decrease or increase to annual net earnings by $0.1 million.

6. Financial instruments (continued):

(c) Financial risk management (continued):

(*iii*) Market risk (continued):

Currency risk:

As the Fund conducts business in both Canada and the United States it is exposed to currency risk. Most of the hardwood lumber sold by the Fund in Canada is purchased in U.S. dollars from suppliers in the United States. Although the Fund reports its financial results in Canadian dollars, approximately two-thirds of its sales are generated in the United States. Changes in the currency exchange rates of the Canadian dollar against the U.S .dollar will affect the results presented in the Fund's financial statements and cause its earnings to fluctuate. In addition, changes in the costs of hardwood lumber purchased by the Fund in the United States as a result of the changing value of the Canadian dollar against the U.S. dollar are usually absorbed by the Canadian market. When the hardwood lumber is resold in Canada it is generally sold at a Canadian dollar equivalent selling price, and accordingly revenues in Canada are effectively increased by decreases in value of the Canadian dollar and vice versa. Fluctuations in the value of the Canadian dollar against the U.S. dollar will affect the amount of cash available to the Fund for distribution to its Unitholders.

The Fund no longer maintains foreign currency contracts to mitigate the potential impact of foreign exchange on U.S. dollar distributions made by its U.S. operations. These contracts did not eliminate the Fund's exposure to fluctuations in the exchange rate between the Canadian dollar and the U.S. dollar.

The foreign currency contracts allowed the Fund to determine in advance, for the period and amount covered by the contracts, the rates of exchange that would be realized when translating into Canadian dollars that portion of distributable cash contributed by the United States operation. Currently no distributions are being made from the Fund's U.S. subsidiary.

At December 31, 2008 the Fund's Canadian subsidiaries exposure to foreign denominated working capital financial instruments was in relation to accounts receivable from U.S. customers (US$0.1 million), income taxes recoverable (US$1.3 million), and accounts payable to U.S. suppliers ($0.1 million).

Based on the Fund's exposure to foreign denominated financial instruments, the Fund estimates a $0.05 weakening in the Canadian dollar as compared to the U.S. dollar would have reduced the net loss for the year ended December 31, 2008 by approximately $0.1 million. A $0.05 strengthening of the Canadian dollar as compared to the U.S. dollar would have had the equal but opposite effect.

This foreign currency sensitivity is focused solely on the currency risk associated with the Fund's Canadian subsidiaries exposure to foreign denominated financial instruments as at December 31, 2008 and does not take into account the effect of a change in currency rates will have on the translation of the balance sheet and operations of the Fund's U.S. subsidiaries nor is it intended to estimate the potential impact changes in currency rates would have on the Fund's sales and purchases.

6. Financial instruments (continued):

(c) Financial risk management (continued):

(*iii*) Market risk (continued):

Commodity price risk:

The Fund does not enter in to any commodity contracts. Inventory purchases are transacted at current market rates based on expected usage and sale requirements and increases or decreases in prices are reflected the Fund's selling prices to customers.

7. Property, plant and equipment:

December 31, 2008	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 2,308	$ 1,610	$ 698
Mobile equipment	3,776	2,458	1,318
Leasehold improvements	840	688	152
	$ 6,924	$ 4,756	$ 2,168

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

8. Foreign currency contracts:

In August 2008, a subsidiary of the Fund agreed to settle all of its remaining foreign currency contracts with the counter-party. The amount received by the Fund's subsidiary in settling the remaining twenty-two outstanding contracts was $0.2 million.

For the year ended December 31, 2008, the Fund's subsidiary has realized cash of $1.2 million (2007 - $1.9 million) from the settlement of foreign currency contracts. For the year ended December 31, 2008, a loss of $0.8 million (2007 - $0.6 million gain) is recorded in the statement of earnings as the cash realized was less than the $2.0 million fair value of the contracts recorded at December 31, 2007 due to the strengthening of the U.S. dollar during that period.

9. Intangible assets and goodwill:

During the year ended December 31, 2008, management reviewed for impairment the carrying value of intangible assets and the carrying value of goodwill. Results of testing indicated impairment in the carrying value of intangible assets in the Fund's U.S. reporting unit of $5.5 million (US$5.4 million), and in the Fund's Canadian reporting unit of $3.1 million. Testing also indicated impairment in the carrying value of goodwill in the Fund's U.S. reporting unit of $47.6 million (US$46.7 million), and in the Fund's Canadian reporting unit of $34.5 million. This impairment reduces all intangible asset and goodwill balances to zero, and is attributable primarily to the significant decline in sales in both the U.S. and in Canada. Sales declined due to reduced residential housing starts and remodeling sales, branch shutdowns in the recreational vehicle industry, and a decline in consumer confidence and overall economic activity.

10. Bank indebtedness:

	2008	2007
Checks issued in excess of funds on deposit	$ 1,087	$ 1,034
Credit facility, Hardwoods LP	265	5,538
Credit facility, Hardwoods USLP (December 31, 2008 - US$13,308; December 31, 2007 - US$19,109)	16,209	18,943
	$ 17,561	$ 25,515

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. At December 31, 2008, Hardwoods LP had a revolving credit facility of up to an aggregate amount of $22.0 million. On January 30, 2009, the maximum aggregate amount of the Hardwoods LP revolving credit facility was reduced to $12.0 million. Hardwoods USLP has a revolving credit facility of up to an aggregate amount of $36.5 million (US$30.0 million). As described in note 6(c)(*ii*), the amount made available under these credit facilities is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund.

The Hardwoods LP credit facility 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 was renegotiated in September 2008 and now expires September 30, 2011. Subsequent to year end, on March 17, 2009 Hardwoods USLP and the lender agreed to amend certain financial covenants in the Hardwoods USLP credit facility (note1). Costs paid to the lender with respect to entering into the new facility of US$207,000 are being amortized over the three year term of the credit facility. The Hardwoods USLP facility is 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 U.S. 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.

10. Bank indebtedness (continued):

Hardwoods LP's interest 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 ("Debt to EBITDA ratio"), as defined by the credit agreement. The Debt to EBITDA ratio as calculated under the Hardwoods LP credit agreement is not permitted to exceed 2.5 times. In addition, the ratio of Hardwoods LP's earnings before interest, taxes, depreciation and amortization to interest is not permitted to be less than 3.0 times, all as defined by the Hardwoods LP credit agreement.

Hardwoods USLP's rates vary with its Fixed Charge Coverage Ratio ("FCCR"), the ratio of earnings before interest, taxes, depreciation, and amortization less cash taxes and capital expenditures (as adjusted for certain items), to the sum of interest expense plus distributions, all as defined by the credit agreement. Hardwoods USLP's applicable margin is dependent upon the FCCR and ranges from 0.25% to 0.75% for prime rate loans and from 1.75% to 2.25% on LIBOR revolving loans. The FCCR as calculated under the Hardwoods USLP credit agreement is not permitted to be less than 0.5 until March 31, 2009, not less than 0.75 from April 1to June 30, 2009, and not less than 1.00 thereafter. Distributions by Hardwoods USLP are permitted to be made to the extent that after giving effect to the distribution, the FCCR does not fall below its minimum required level, and at least $4.0 million of unused borrowing capacity is available in Hardwoods USLP.

The average annual interest rates paid for the year ended December 31, 2008 were 6.26% and 5.18% (2007 - 6.7% and 7.2%) for the Hardwoods LP and Hardwoods USLP credit facilities, respectively.

11. Non-controlling interests:

	2008	2007
Balance, beginning of year (note 3(b))	$ 30,006	$ 33,788
Interest in earnings:		
Interest in earnings before taxes	(17,560)	3,527
Adjustment to non-controlling interest from subordination of Class B Unit Holders	(2,471)	(3,418)
Increase (decrease)	(20,031)	109
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	3,105	(3,829)
Balance, end of year	$ 13,080	$ 30,068

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.

11. Non-controlling interests (continued):

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 U.S. 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, 2008.

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, 2008, the amount of such deficiency was $7.2 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;

11. Non-controlling interests (continued):

- 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, 2008, the amount of such deficiency was $1.9 million.
- 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.

The cumulative deficiency prior to December 31, 2007, which is no longer recoverable by the Class B LP Unitholders and the Class B USLP Unitholders, has been recorded as an adjustment to the non-controlling interest's share of earnings in the amount of $2.5 million for the year ended December 31, 2008 and $3.4 million for the year ended December 31, 2007.

12. 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 11). 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.

12. Fund Units (continued):

(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 percent discount to the market price at the time.

13. Income taxes:

	2008	2007
Current	$ (734)	$ 441
Future	(30,792)	1,464
	$ (31,526)	$ 1,905

Effective March 31, 2008 the Fund completed an internal reorganization that involved the refinancing of inter-corporate debt in the form of notes issued and held by subsidiaries of the Fund. The reorganization does not have any effect upon the management or business activities of the Fund's operating subsidiaries. As a result of the internal re-organization, income tax losses arose of approximately US$10.3 million which are available to reduce U.S. taxable income. Based on statutory income tax rates in effect for the Fund's U.S. subsidiary, this amounts to an estimated $3.6 million tax benefit available to subsidiaries of the Fund. This $3.6 million benefit was recorded at March 31, 2008 and is comprised of an estimated $0.8 million current income tax recovery and $2.8 million future income tax recovery.

In addition, during the quarter ending March 31, 2008, tax pools consisting principally of Canadian tax loss carry forward, of approximately $16.0 million were recorded by a subsidiary of the Fund as a result of the Fund's re-organization plan. The tax loss carry forwards will result in a reduction of tax otherwise payable under the Canadian federal government's tax on publicly traded income trusts. Based on tax rates expected to apply at the date such tax pools will be utilized, an additional $4.2 million of future income tax benefit was recorded by the Fund at March 31, 2008.

13. Income taxes (continued):

During the year ended December 31, 2008, the Company recorded a future tax recovery of approximately $22.3 million as a result of the write-down of the goodwill and intangible assets. Goodwill and intangible assets remain deductible for Canadian and U.S. tax purposes.

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% (2007 - 39.4%) to earnings before income taxes for the following reasons:

	2008	2007
Earnings before income tax	$ (67,769)	$ 17,524
Computed tax expenses at statutory rate	$ (26,701)	$ 6,904
Income of Fund distributed directly to Unitholders	(2,382)	(4,317)
Income and deductions not subject to tax	(422)	(812)
Taxes paid as a result of Subordination Agreement	92	712
Adjustment to non-controlling interest not subject to tax	(698)	(930)
State and branch profits tax	50	75
Reconciling items related to goodwill and intangible impairment	5,611	-
Restructuring	(7,802)	-
Other	726	273
	$ (31,526)	$ 1,905

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.

13. 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, 2008 is as follows:

	2008	2007
Future income tax assets:		
Accounts receivable	$ 380	$ 154
Inventory	351	383
Employee housing loans	77	73
Property, plant and equipment	309	249
Goodwill	19,307	-
Tax loss carry forwards and future interest deductions	10,318	-
Deferred gain on sale-leaseback of land and building	180	170
	30,922	1,029
Future income tax liabilities:		
Prepaid expenses	(88)	(84)
Property, plant and equipment	(52)	(111)
Goodwill	-	(4,368)
	(140)	(4,563)
Net future income tax asset (liability)	$ 30,782	$ (3,534)

At December 31, 2008, subsidiaries of the Fund have operating loss carry forwards for income tax purposes of approximately $16.6 million in Canada and US$10.0 million in the United States that may be utilized to offset future taxable income. These losses, if not utilized expire between 2014 and 2028.

14. Changes in non-cash operating working capital and additional cash flow disclosures:

	2008	2007
Source (use) of funds		
Accounts receivable	$ 7,858	$ 1,470
Income taxes recoverable/payable	(805)	(445)
Inventory	11,820	1,627
Prepaid expenses	155	(70)
Accounts payable and accrued liabilities	(4,192)	195
Decrease in non-cash operating working capital	$ 14,836	$ 2,777

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. The Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the year ended December 31, 2008, $8.6 million (2007 - $12.3 million) in discretionary cash distributions were paid to Unitholders.

15. 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:

2009	$ 7,389
2010	5,742
2011	2,703
2012	1,726
2013	1,026
	18,586
Thereafter	658
	$ 19,244

(b) At December 31, 2008, the Fund's subsidiaries had no commitments (2007 - $22,304 (US$22,500)) under letters of credit.

16. Segment disclosure:

Information about geographic areas is as follows:

	2008	2007
Revenue from external customers:		
Canada	$ 89,581	$ 105,171
United States	166,720	226,594
	$ 256,301	$ 331,765
Property, plant and equipment:		
Canada	$ 752	$ 1,003
United States	1,416	1,410
	$ 2,168	$ 2,413
Goodwill		
Canada	$ -	$ 34,477
United States	-	46,281
	$ -	$ 80,758

17. 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, 2008, Hardwoods USLP contributed and expensed $377,750 (US$354,362) (2007- $403,817 (US$375,643)) 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, 2008, Hardwoods LP contributed and expensed $256,469 (2007 - $246,475) in relation to the LP Plan

18. Related party transactions:

For the year ended December 31, 2008, sales of $427,795 (2007 - $736,573) were made to affiliates of SIL, and the Fund made purchases of $98,005 (2007 - $184,732) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During year ended December 31, 2008, the Fund paid $108,000 (2007 - $108,000) to affiliates of SIL under the terms of an agreement to provide services for management information systems. This cost is included in the selling and administrative expense in the statement of earnings.

19. 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. There's a warmth to the look and touch of hardwoods that no other material can match.

Unitholder Information

Trustees

R. Keith Purchase
Trustee

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

R. Keith Purchase
Director

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Vice Chair, Sauder Industries

William Sauder
Vice 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
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Company of Canada