HARDWOODS DISTRIBUTION

INCOME FUND

2010

Annual Report

To Unitholders

About the Fund

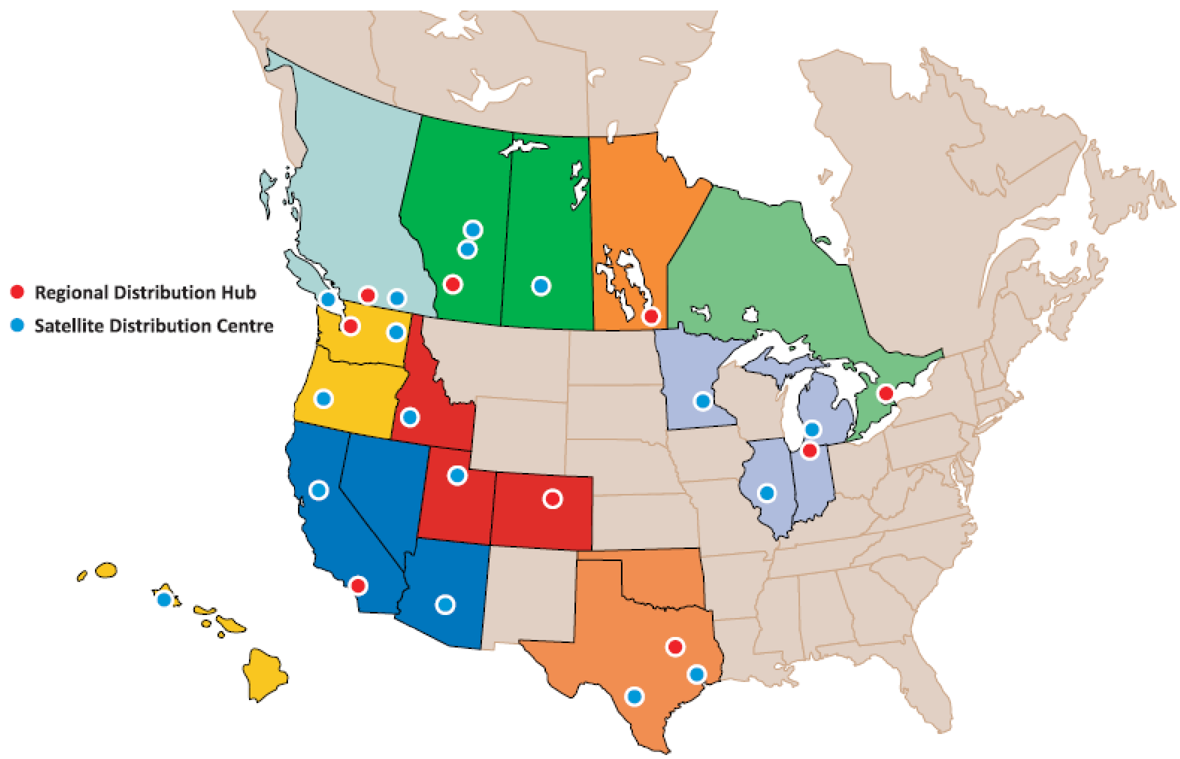
Hardwoods Distribution Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust. The Fund was launched on March 23, 2004 with the completion of an initial public offering (IPO) of 14.4 million trust units (“Class A Units”). Net proceeds of the IPO were used to acquire an 80% interest 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 in business for over 50 years. We sell quality lumber, hardwood plywood and specialty products to cabinet makers, custom millworkers, furniture makers and other industrial customers that manufacture products made from hardwood. Demand for products made from hardwood comes from multiple sectors of the North American economy, including new home construction, renovation, non-residential construction, and institutional markets. There is warmth to the look and touch of hardwoods that no other material can match, and people place a high value on products crafted from real wood. Hardwood products are a part of our daily lives in the homes we live in (cabinets, mouldings, custom finishing, and home furniture) and places we visit (furniture, cabinetry, and 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).

Our role in the industry is to provide the critical link between mills that manufacture large volumes of hardwood lumber and sheet goods, and industrial customers that require smaller quantities of many different hardwood products for their own manufacturing processes. We provide a means for hundreds of hardwood mills to get their product to thousands of small-to-mid-sized industrial manufacturers. We add value to our suppliers by buying their product in volume and paying them promptly, effectively acting as their third-party sales force. We add value for our customers by providing them with the materials they need on a just-in-time basis, in smaller quantities and offering a wider range of product selection than the customer would be able to purchase directly from an individual mill. We also provide an important source of financing for our customers by allowing them to buy material from us on approved credit.

We are one of the largest distributors of hardwood lumber and sheet goods in North America. We are larger than most of our suppliers, customers, and direct competitors. 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.



As shown in the map above, we operate 26 distribution centres organized into nine regions, providing geographic coverage in 14 states and 5 provinces across the US and Canada. To maximize inventory management, we operate utilizing a hub-and-spoke distribution system. Our major hub distribution centres hold the bulk of our inventory, and make regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third-party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

The North American economy recently experienced a significant economic downturn, particularly in housing and construction, which are key markets for the hardwoods products that we distribute. This reduction in hardwood demand reduced our sales and financial performance in 2008 and 2009. A partial recovery in our sales and earnings was achieved in 2010, despite the fact that current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends. We believe that when a sustained economic recovery takes hold prospects for our industry are attractive.

To Our Unitholders

2010 brought a return to sales growth, and to positive Distributable Cash and net earnings performance for the Fund. Our gains reflect the success of our strategies to grow market share and reduce expenses, as well as the positive impact of gradually improving market conditions.

Improving Markets

In the US, our sales increased by 13.2%, supported by a 5.8% increase in housing starts in 2010 compared to 2009. We also benefited from significant growth in the US recreational vehicle (RV) manufacturing sector. With nation-wide deliveries of these vehicles up significantly year-over-year, demand for the hardwood products used to finish RV interiors increased sharply. In Canada, we capitalized on improved market conditions to increase our Canadian sales by 5.7% year-over-year. Our growth was aided by a 27.4% increase in housing starts in 2010, and an improvement in the Canadian repair and remodeling market where expenditures were up an estimated 5.5%. Higher prices for hardwood lumber also contributed to stronger top-line results in both Canada and the US, with average prices up 7.7% at the end of 2010, compared to the end of 2009.

Taking our US and Canadian results together, our overall sales increased by 3.5% in 2010. This performance improvement reflects a 10.2% increase in underlying sales activity, partially offset by a 6.7% decrease in sales due to the negative impact of a stronger Canadian dollar.

Responding to Competitive Pressure

Although market demand improved, competition remained intense in 2010. Following four years of reduced demand for hardwoods products, weakened competitors struggled to stay in business. Many competed on price, reducing their selling margins in the process. This put pressure on our own margins as we aggressively defended our market share. The result was a negative impact on our gross profit percentage, which fell to 17.4% in 2010, from 18.1% in 2009. We normally target a margin range of 18% to 19%, in line with our historical performance.

I am pleased to report that we succeeded in offsetting all of the negative impact of weaker margins with sales growth and a continued focus on expense reduction. Our selling and administrative ("S&A") expenses fell by $5.9 million, or 16.5%, in 2010. This achievement reflects reduced bad debt expense, the positive impact of a stronger Canadian dollar on our US operating costs, and lower premises expense as a result of more competitive rental rates and the rationalization of our distribution network. As a result of these savings, we generated $4.1 million in Distributable Cash and attained positive earnings of $1.0 million, despite the decline in margins.

Shifting to a Market-Expansion Strategy

While expense reduction has played a vital role in seeing us safely through the market downturn, we believe we are now at the point in the business cycle where we must strengthen our emphasis on market expansion. During 2010, we began to increase investment in our people and service capabilities to support growing sales. More recently, we introduced an updated business strategy to guide us as we move into this next period of market recovery.

End-Market Diversification: A key thrust of our strategy is increased end-market diversification. While we expect that the residential construction market will continue to provide an important source of demand for hardwood products, recovery in this market is expected to be slow and uneven. Looking ahead, we believe the commercial and institutional construction sectors present attractive opportunities for Hardwoods. Hardwood products are used in a diverse range of commercial and institutional applications, from office buildings, restaurant and bar interiors, hotel lobbies, and retail point-of-purchase displays, to educational and health care facilities. Although a portion of our current customer base services these end-markets, we believe with increased focus we can expand our presence here and tap into additional and more stable sources of demand.

To help us target these sectors, we are assembling customer lists and refining our product offering to better support the inventory needs of these customers. We have also strengthened our sales team with new expertise, and we are providing existing sales staff with training in the more detailed selling process required by these sectors. Our intention is to establish a clear presence in the commercial and institutional construction market over the next two years, and to build new customer relationships and a following for our line of products.

Leveraging our Import Program: Hardwoods is uniquely positioned on the import side of the business, with a growing line of high-quality branded products and an established quality assurance team on the ground in Asia. The quality of our import products readily competes with North American products, and we can deliver that quality at a better price point.

During 2010, our import sales grew 17% and played a key role in our improved revenue results. Going forward, we will leverage our ability to provide a superior quality/value ratio as we work to expand our customer base in selected sectors and geographic markets.

Focus on High-Potential Geographic Markets: A third part of our strategy is to focus our resources on geographies that we believe hold the highest potential for market share growth. Currently we have identified three densely populated regional markets where hardwood demand is significant, but where we hold a relatively small market share. While we already have a presence in each of these regions, going forward, we will seek to grow market share through organic growth initiatives, complemented by attractively priced acquisitions opportunities that may become available.

Tight Management of the Business: While 2011 will see us increase investment in the strategies outlined above, I want to emphasize that we will not abandon our careful approach to managing our business.

What We See Ahead

Market conditions are gradually improving and we see opportunities to expand our business, but our outlook remains cautious. Housing starts in the US remain near historical lows and market competition continues to be intense. Disciplined expense and cash management will remain a priority, and we will continue to keep a close eye on receivables and inventory. We will also continue to evaluate our branch network to determine where we can adjust capacity, either upward or downward, to better align our business with market opportunities. In line with this, we recently closed our Las Vegas, Nevada branch while simultaneously increasing investment in other regions.

Looking ahead, we recognize that current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends. We believe that when a sustained economic recovery takes hold, prospects for our industry will become increasingly attractive. We intend to participate fully in the recovery with both a strong market position and a stable financial position.

We generated $4.1 million in Distributable Cash in 2010, a significant turnaround from the $0.1 million of negative Distributable Cash generated in the same period in 2009. Although this improvement is encouraging, cumulative Distributable Cash generated by the Fund since distributions were suspended nine fiscal quarters ago is just $2.2 million. Trustees of the Fund regularly evaluate market conditions, and will consider reinstating a distribution when satisfied with the sustainable and predictable cash generation capability of the Fund.

Regarding the January 2011 implementation of new taxes on Canadian income trusts, the Fund's taxable earnings currently flow through corporate subsidiaries in both Canada and the US, which are already subject to corporate taxation. Accordingly, the new trust tax is not expected to have any near-term impact on the Fund's tax situation. The tax free roll-over rules for income trusts do not expire until the end of 2012 so adequate time remains to convert to an alternate structure should the Board of Trustees determine it is advantageous to do so. We continue to monitor the situation closely.

Overall, the year ahead looks positive for Hardwoods. Our talented team of employees and managers are moving the business forward and we continue to be guided by directors and trustees who are helping us make the right strategic moves.

In closing, I thank you, our investors, for your continued confidence in Hardwoods. We believe the hardwoods industry is on the path to recovery, and we look forward to rewarding your trust in us with improving results.

Lance R. Blanco

President and Chief Executive Officer

Management's Discussion and Analysis

March 28, 2011

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 (the "Fund) for the years ended December 31, 2010 and 2009. 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:

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

The forward-looking information in this MD&A includes, but is not limited to: we do not anticipate significant demand-driven growth in 2011; we do expect to achieve continued improvement in our financial performance as a result of our own initiatives; our intention, introduced in the latter part of 2010 to shift our emphasis from cost reduction to market expansion and focus our business on areas of improving market opportunity, including increasing our emphasis on end-market diversification, leveraging our import products, and focusing on high-potential geographic markets; our expectation that our selling and administrative costs will increase in 2011as we implement our strategies and support increased sales activity; our expectation that market conditions will remain challenging and we will continue to exercise tight control of costs, inventories and working capital, while working to minimize customer credit risk; our anticipation of continued gradual improvement in our results in the year ahead; our belief that the new trust tax is not expected to have any near-term impact on the Fund's tax situation, and that adequate time remains to convert to an alternate structure should the Board of Trustees determine it is advantageous to do so, and our intention to continue to monitor the situation closely; the intention of our Trustees to look for indications of a sustainable and predictable return of the Fund's cash generation capability before any decision is taken to reinstate distributions to unitholders, including consideration of the need to invest in additional working capital in order to support sales growth; and our perspective that discussions are presently underway with respect renewal or replacement of our US credit facility which expires in September of this year, and based upon such discussions we do not anticipate any difficulties in renewing or securing replacement financing for this credit facility.

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 our operating limited partnerships; our future growth may be restricted by the payout of substantially all of our operating cash flow; and, other risks described in our Annual Information Form and this MD&A.

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 a 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 a 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 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 a 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 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, 2010, the following units of the Fund were issued and outstanding:

Units	14,523,858
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

Serving customers for over 50 years, 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, 2010 we operated 26 distribution facilities organized into nine geographic regions covering 14 states and 5 provinces throughout North America. To maximize inventory management, we utilize a hub and spoke distribution system, with major hub distribution centres holding the bulk of our inventory and making regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third-party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

Approximately 40% of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods and other specialty products, including 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 role in the industry is to provide the critical link between mills that manufacture large volumes of hardwood lumber and sheet goods, and industrial customers that require smaller quantities of many different hardwood products for their own manufacturing processes. We provide a means for hundreds of hardwood mills to get their product to thousands of small-to-mid-sized industrial manufacturers. We add value to our suppliers by buying their product in volume and paying them promptly, effectively acting as their third-party sales force. We add value for our customers by providing them with the materials they need on a just-in-time basis, in smaller quantities and offering a wider range of product selection than the customer would be able to purchase directly from an individual mill. We are also provide and important source of financing for our customers by allowing them to buy material from us on approved credit.

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, global economic conditions and weaker US housing markets have resulted in supply/demand imbalances and greater variability in product pricing.

The North American economy is currently experiencing a sluggish recovery after a significant economic downturn in housing and construction, which are key markets for the hardwoods products that we distribute. However, current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends, and we believe that when a sustained economic recovery takes hold, prospects for our industry are attractive.

2.0 Overview and Outlook

Stronger demand and prices for hardwood products and successful implementation of our strategic initiatives contributed to improved financial performance in 2010. We improved revenue, EBITDA, and net earnings results, and ended the year having generated Distributable Cash of $4.1 million.

Although the economic recovery remained fragile, housing starts increased by 5.8% in the US, and by a more significant 27.4% in Canada when compared to 2009. We were also able to capitalize on opportunities within specific sectors and geographic markets. For example, a significant increase in nation-wide deliveries by the US recreational vehicle manufacturing industry contributed to significantly higher sales for our Lake States' operations. In addition, we continued to make inroads into the Ontario market, which is Canada's largest consumer of wood products. During 2010, we expanded our sales force in this region and succeeded in capturing additional market share. We also leveraged a modest recovery in the California market to grow sales there.

Combined with an increase in average hardwood lumber prices, these factors enabled us to increase total revenues by 3.5% in 2010. This was comprised of a 10.2% increase in underlying sales activity (sales growth of 13.2% in the US and 5.7% in Canada), partially offset by a 6.7% decrease in reported sales due to the negative impact of a stronger Canadian dollar.

As we anticipated, our gross profit dollar performance did not keep pace with our revenue gains. Market competition based on price remained intense through the year, and resulted in a gross profit margin of 17.4%, compared to 18.1% in 2009.

On a full-year basis, we were able to offset the negative impact of the lower margins with continued reduction of our sales and administrative ("S&A") expenses. We achieved a $5.9 million decrease in S&A for the full year and $2.1 million decrease in the fourth quarter, primarily as a result of reduced bad debt expense and the positive impact of a stronger Canadian dollar on our US operating costs. We also continued to align our branch network with customer demand, closing our Las Vegas location in the fourth quarter and redeploying our sales personnel to regions offering higher sales potential.

Moving forward into 2011, forecasters continue to call for gradually improving market conditions, but the Fund's outlook remains cautious. In the US, unemployment hovers around 9% and lenders continue to foreclose on delinquent homeowners, creating a market in which new homebuilders must compete with an excess of unsold properties. In Canada, housing starts are expected to moderate, with industry forecasts calling for a slight dip in Canadian housing starts in 2011 compared to 2010. It remains to be seen what impact recent government measures to tighten Canadian mortgage lending rules will have on 2011 housing starts. The new measures, which came into effect on March 18, 2011, reduced the maximum mortgage loan amortization from 35 years to 30, and increased the minimum down payment on government-backed insured mortgages.

Given the market outlook, we do not anticipate significant demand-driven growth in 2011. However, we do expect to achieve continued improvement in our financial performance as a result of our own initiatives. In the latter part of 2010 we introduced an updated business strategy which shifts our emphasis from cost reduction to market expansion, and focuses our business on areas of improving market opportunity.

End-Market Diversification: As part of this strategy, we are increasing our emphasis on the commercial and institutional construction markets to help offset the slow recovery anticipated for the residential construction market. Both the commercial and institutional markets fared better than residential construction during the downturn and are currently enjoying a more robust recovery. Recent initiatives related to this strategy include identifying potential customers and their needs, strengthening our sales team with new expertise, and expanding training for our existing sales staff as we work to expand our presence in these markets.

Leverage Import Products: We believe we have one of the strongest import programs in the industry, offering branded products with a high quality-to-price ratio. We plan to continue building on the 17% growth we achieved in import sales in 2010 as we seek out new products and introduce our import line to a broader range of customers.

Focus on High-Potential Geographic Markets: We will also focus on increasing our market share in geographies we have specifically selected that are densely populated, where hardwood demand is significant, but where we currently hold a relatively small market share. To achieve our objective, we will pursue organic growth initiatives, complemented by possible acquisition activity should attractively priced opportunities become available.

We expect our S&A expenses will increase in 2011 as we implement our strategies and support increased sales activity. However, with the expectation that market conditions will remain challenging, we will also continue to exercise tight control of costs, inventories and working capital, while working to minimize customer credit risk. Overall, we anticipate continued gradual improvement in our results in the year ahead.

We generated $4.1 million in Distributable Cash in 2010, a significant turnaround from the $0.1 million of negative Distributable Cash generated in the same period in 2009. Although this improvement is encouraging, cumulative Distributable Cash generated by the Fund since distributions were suspended nine fiscal quarters ago is just $2.2 million. Trustees of the Fund regularly evaluate market conditions, and will consider reinstating a distribution when satisfied with the sustainable and predictable cash generation capability of the Fund.

Regarding the January 2011 implementation of new taxes on Canadian income trusts, the Fund’s taxable earnings currently flow through corporate subsidiaries in both Canada and the US, which are already subject to corporate taxation. Accordingly, the new trust tax is not expected to have any near-term impact on the Fund’s tax situation. The tax free roll-over rules for income trusts do not expire until the end of 2012 so adequate time remains to convert to an alternate structure should the Board of Trustees determine it is advantageous to do so. We continue to monitor the situation closely.

3.0 Results of Operations

3.1 Years Ended December 31, 2010 and December 31, 2009

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

		For the year Ended December 31, 2010		For the year Ended December 31, 2009
Total sales	$	197,655	$	190,923
Sales in the US (US$)		*114,532*		*101,212*
Sales in Canada		*79,653*		*75,339*
Gross profit		34,357		34,482
Gross profit %		*17.4%*		*18.1%*
Selling and administrative expenses		(29,740)		(35,636)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$	4,617		(1,154)
Add (deduct):				
Amortization		(532)		(870)
Interest		(709)		(586)
Non-cash foreign currency losses		(161)		(1,553)
Non-controlling interest		(643)		2,347
Income tax expense		(1,616)		(8,424)
Net earnings (loss) for the period	$	956	$	(10,240)
Basic and fully diluted earnings (loss) per Class A Unit	$	0.07	$	(0.71)
Average Canadian dollar exchange rate for one US dollar		1.030		1.142

Sales

For the year ended December 31, 2010, our total sales increased to $197.7 million, up 3.5% from $190.9 million in 2009. This performance improvement reflects a 10.2% increase in underlying sales activity, partially offset by a 6.7% decrease in sales upon conversion, due to the negative effect of a stronger Canadian dollar.

Our US business accounted for approximately 60% of our sales in 2010. Sales in the US, as measured in US dollars, increased 13.2% to $114.5 million, from $101.2 million in 2009. Substantially all of the $13.3 million in sales growth came from two of our five US operating regions: our Lakes States region and our California region. Our Lake States' operations capitalized on a rebound in demand from the recreational vehicle manufacturing industry, which is heavily concentrated in this region. Improved sales from the Lake States' region also reflect continued success in the introduction of our import product lines. Sales gains at our California operations reflect a modest recovery in market demand for hardwoods products following several years of significant economic contraction in this region, as well as our efforts to realign our sales and branch operations in this market.

Our Canadian business accounted for approximately 40% of our sales in 2010. Sales in Canada, as measured in Canadian dollars, were up 5.7% to $79.7 million, from $75.3 million in 2009. This increase reflects stronger market demand for hardwoods products driven by increased housing starts and higher residential renovation expenditures, as well as by improvements in the non-residential construction sector. Average prices for hardwood lumber products were also higher year-over-year. Sales in our Ontario region were particularly strong, accounting for over two-thirds of our sales growth in Canada for the year.

Gross Profit

Gross profit for the year ended December 31, 2010 was $34.4 million, largely unchanged from the $34.5 million we achieved in 2009. Although sales increased by 3.5% in 2010, the higher sales were offset by a lower gross profit margin for the year. As a percentage of sales, gross profit was 17.4% in 2010, compared to 18.1% in 2009. The decrease in gross profit margin reflects highly competitive market conditions. Under normal market conditions, we view 18% to 19% as a target range for gross profit margin for our business. However conditions in hardwoods markets remain challenging and intensified competition based on price has resulted in a gross profit margin below our target range at this point in the business cycle.

Selling and Administrative Expenses

We successfully reduced Selling and Administrative (S&A) expenses to $29.7 million in 2010, from $35.6 million in 2009. The lower S&A reflects a $3.1 million decrease in bad debt expense due to fewer customer credit failures, a $1.9 million positive impact of a stronger Canadian dollar on the conversion of S&A costs at our US operations, a $0.8 million reduction in premises expense reflecting lower rental rates and smaller square footage rented on facility lease renewals, and $0.4 million in expense recoveries related to proceeds from legal settlements. In addition, $1.5 million in restructuring costs incurred in 2009 were not repeated in 2010. The year-over-year improvement in S&A expense was partially offset by increased investment in staffing ($1.4 million) and higher sales and warehouse costs ($0.3 million) as we supported the 10.3% increase in underlying sales activity achieved in 2010. In total, we reduced 2010 S&A by $5.9 million, or 16.5%, compared to the prior year. As a percentage of sales, S&A expenses were 15.0% of sales in 2010, compared to 18.7% in 2009.

EBITDA

EBITDA increased to $4.6 million in 2010, from a loss of $1.2 million in 2009. This $5.8 million improvement reflects the $5.9 million reduction in S&A expenses, less the $0.1 million decrease in gross profit.

Amortization Expense

Amortization expense was $0.5 million in 2010, compared to $0.9 million in the prior year. This reduction reflects three factors: a change in estimated useful life of our forklift fleet, resulting in lower annual depreciation on this asset class; the positive impact of a stronger Canadian dollar on conversion of amortization at our US operations; and minimal capital expenditures were made in 2010 and 2009 to acquire new depreciable assets.

Non-Cash Foreign Currency Losses

For the year ended December 31, 2010, we reported non-cash foreign currency losses of $0.2 million. These losses relate to the foreign currency translation of US dollar-denominated balances held by the Fund and its Canadian subsidiaries. In 2009, our non-cash foreign currency losses were $1.6 million, reflecting the translation of US dollar-denominated intercompany debt advanced by the Fund to a wholly-owned US subsidiary at that time.

Non-controlling Interest

Non-controlling interest ("NCI") increased by $0.6 million in 2010, representing its 20% share of pre-tax earnings for the year. In 2009, the NCI was reduced by $2.3 million, reflecting the NCI's interest in pre-tax loss in 2009, less a further 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.

Income Taxes

Income tax expense declined to $1.6 million in 2010, from $8.4 million in 2009. The higher income tax expense incurred in 2009 reflects a reduction to net future income tax assets resulting from the continued downturn in financial results at our US operations at that time.

Net Earnings (Loss)

Net earnings increased to $1.0 million in 2010, from a net loss of $10.2 million in 2009. This $11.2 million improvement primarily reflects a $5.8 million increase in EBITDA, a $0.3 million decrease in amortization expense, a $1.4 million reduction in non-cash foreign currency losses, and a $6.8 million decrease in income tax expense. These gains were partially offset by a $0.1 million increase in interest expense and a $2.9 million decrease in recovery from the non-controlling interest.

3.2 Three Months Ended December 31, 2010 and December 31, 2009

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

	For the three months Ended December 31, 2010	For the three months Ended December 31, 2009
Total sales	$ 46,392	$ 41,577
Sales in the US (US$)	*27,230*	*22,987*
Sales in Canada	*18,826*	*17,500*
Gross profit	7,689	7,636
Gross profit %	*16.6%*	*18.4%*
Selling and administrative expenses	(8,006)	(10,057)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ (317)	(2,421)
Add (deduct):		
Amortization	(90)	(198)
Interest	(167)	(152)
Non-cash foreign currency losses	(117)	(171)
Non-controlling interest	138	590
Income tax (expense) recovery	10	1,808
Net loss for the period	$ (543)	$ (544)
Basic and fully diluted loss per Class A Unit	$ (0.04)	$ (0.04)
Average Canadian dollar exchange rate for one US dollar	1.0131	1.0571

Sales

For the three months ended December 31, 2010, sales increased to $46.4 million, from $41.6 million during the same period in 2009. This 11.6% improvement reflects a 14.5% increase in underlying sales activity, partially offset by a 2.9% decrease in sales due to the negative effect of a stronger Canadian dollar. Fourth quarter sales activity at our US operations (as measured in US dollars) was up 18.5%, while sales in Canada increased by 7.6%. As described in section 2.0 of this MD&A, overall economic conditions remained fragile, but improved over the course of

2010. This translated into improved demand for hardwood products, which in turn, contributed to the year-over-year increase in fourth quarter sales results. The fourth quarter is historically a seasonally slower sales period for our business.

Gross Profit

Gross profit for the three months ended December 31, 2010 increased to $7.7 million, a $0.1 million increase from $7.6 million during the same period in 2009. The increase in gross profit reflects higher sales, partially offset by weaker gross profit margin. As a percentage of sales, gross profit declined to 16.6%, from 18.4% in the same period in 2009. The change in gross margin percentage reflects continued competitive pressure, and certain valuation writedowns and other adjustments made to year-end inventory.

Selling and Administrative Expenses

During the fourth quarter, we reduced S&A expenses by $2.1 million to $8.0 million, from $10.1 million during the same period in 2009. The most significant area of cost savings was a $1.6 million year-over-year reduction in bad debt. The positive impact of the stronger Canadian dollar on conversion of S&A expenses at our US operations accounted for $0.3 million of the S&A reductions. As a percentage of sales, fourth quarter 2010 S&A expenses were 17.3% of sales, compared to 24.2% in 2009.

EBITDA

For the three months ended December 31, 2010, we recorded an EBITDA loss of $0.3 million, compared to an EBITDA loss of $2.4 million during the same period in 2009. The $2.1 million increase in EBITDA reflects the $2.1 million decrease in S&A expenses.

Non-controlling Interest

The non-controlling interest generated a $0.1 million contribution to earnings in the fourth quarter of 2010, comprised of NCI's interest in the pre-tax loss for the period. In the comparable period in 2009, the non-controlling interest contributed a $0.6 million increase to earnings, comprised of NCI's interest in the pre-tax loss for that period, as well as an adjustment to NCI to reflect the value of subordinated distributions that could no longer be recovered by the Class B Units under the terms of the Fund's subordination feature.

Income Tax Recovery (Expense)

An income tax expense of $10,000 was recorded in the fourth quarter of 2010, comprised of estimated state income taxes payable for the period. By comparison, an income tax recovery of $1.8 million was recorded in the fourth quarter of 2009, primarily related to changes in tax law enacted by the US Congress as part of its economic stimulus plan at that time. The tax law changes enabled us to carry back an additional two years of tax losses from one of our US subsidiaries.

Net Loss

We recorded a net loss of $0.5 million in the fourth quarter of 2010, compared to a net loss of $0.5 million during the same period in 2009. This reflects the $2.1 million increase in EBITDA and the $0.1 million decrease in amortization expense, partially offset by the $0.5 million decrease in recovery from NCI and the $1.8 million decrease in income tax recovery.

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, 2010	Year ended December 31, 2009	3 months ended December 31, 2010	3 months ended December 31, 2009
Net cash provided by (used in) operating activities	$ (3,402)	$ 10,247	$ 4,452	$ 1,380
Increase (decrease) in non-cash operating working capital	7,553	(10,291)	(4,614)	(1,885)
Cash flow from operations before changes in non-cash operating working capital	4,151	(44)	(162)	(505)
Capital expenditures	(74)	(95)	(37)	-
Distributable Cash	$ 4,077	$ (139)	$ (199)	$ (505)
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	-	-	-	-
Total Units	$ -	$ -	$ -	$ -
Weighted average outstanding units and per unit amounts:				
Class A Units outstanding	14,410,312	14,410,000	14,411,238	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,812	18,012,500	18,013,738	18,012,500
Distributable Cash per Total Units	$ 0.226	$ (0.008)	$ (0.011)	$ (0.028)
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	$ -	$ -	$ -	$ -
Total Units	$ -	$ -	$ -	$ -
Payout ratio (2)	0.0%	0.0%	0.0%	0.0%

	March 23, 2004 to December 31, 2010
Cumulative since inception:	
Distributable Cash	79,555
Distributions relating to the period	66,754
Payout ratio (2)	83.9%

[1] 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, 2010 balance sheet.

[2] Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

In 2010, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of $4.1 million, or $0.226 per unit. In the fourth quarter of 2010 the Fund and its subsidiaries generated negative total Distributable Cash available to Class A and Class B Unitholders of $0.2 million, or $0.011 per unit. No distributions were made related to the years ended December 31, 2010 and 2009.

On November 3, 2008, the Trustees of the Fund suspended monthly cash distributions until such time as market conditions strengthened and the Fund's financial performance stabilized. Although the Fund has generated $4.1 million in Distributable Cash in 2010, cumulative Distributable Cash since distributions were suspended nine fiscal quarters ago has been much weaker at just $2.2 million. Trustees will look for indications of a sustainable and predictable return of the Fund's cash generation capability before any decision is taken to reinstate distributions to unitholders. The Trustees will also consider the need to invest in additional working capital in order to support sales growth. Since its initial public offering on March 23, 2004, the Fund has paid $66.8 million in distributions, representing 83.9% of Distributable Cash generated since its inception.

When distributions are declared by Trustees of the Fund, they are paid 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.

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, 2010	Year ended December 31, 2009	3 months ended December 31, 2010	3 months ended December 31, 2009
Net cash provided by (used in) operating activities	$ (3,402)	$ 10,247	$ 4,452	$ 1,380
Capital expenditures	(74)	(95)	(37)	-
Standardized Distributable Cash	$ (3,476)	$ 10,152	$ 4,415	$ 1,380
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	-	-	-	-
Total Units	$ -	$ -	$ -	$ -
Weighted average outstanding units and per unit amounts:				
Class A Units outstanding	14,410,312	14,410,000	14,411,238	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,812	18,012,500	18,013,738	18,012,500
Standardized Distributable Cash per Total Units	$ (0.193)	$ 0.564	$ 0.245	$ 0.077
Distributions per Total Units	$ -	$ -	$ -	$ -
Standardized payout ratio (2)	0.0%	0.0%	0.0%	0.0%

	March 23, 2004 to December 31, 2010
Cumulative since inception:	
Standardized Distributable Cash	89,836 (3)
Distributions relating to the period	66,754
Standardized Payout ratio (2)	74.3%

[1] 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, 2010 balance sheet.
[2] Payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.
[3]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 looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. As a result, management believes that our historical measure of Distributable Cash, which excludes the impact of changes in non-cash working capital, is a better measure for determining our operating performance.

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

Selected Unaudited Consolidated Financial Information
(in thousands of dollars)

	Year ended December 31, 2010	Year ended December 31, 2009	3 months ended December 31, 2010	3 months ended December 31, 2009
Standardized Distributable Cash	$ (3,476)	$ 10,152	$ 4,415	$ 1,380
Increase (decrease) in non-cash operating working capital	7,553	(10,291)	(4,614)	(1,885)
Distributable Cash	$ 4,077	$ (139)	$ (199)	$ (505)

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, 2010 and 2009 is provided below.

(in thousands of Canadian dollars)

Source (use) of funds	12 months ended December 31, 2010	12 months ended December 31, 2009	3 months ended December 31, 2010	3 months ended December 31, 2009
Accounts receivable	$ (2,414)	$ 3,842	$ 3,620	$ 5,773
Income taxes recoverable	355	(223)	(22)	(2,125)
Inventory	(4,436)	4,355	2,470	(866)
Prepaid expenses	85	74	126	174
Accounts payable and accrued liabilities	(1,143)	2,243	(1,580)	(1,071)
Decrease (increase) in non-cash operating working capital	$ (7,553)	$ 10,291	$ 4,614	$ 1,885

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. Between 2007 and 2010 we closed a total of 10 branch locations in response to weak economic conditions. These closures have freed up additional forklift capacity and reduced our need to purchase replacement forklift equipment. We also generally decreased our discretionary cash outlays for capital items during this period as we shifted our focus to cost reduction and cash conservation. As a result, our total capital expenditures amounted to just $74,000 in 2010. Despite the reduced spending on capital expenditures, we believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment.

In addition to maintaining the productive capacity of our property, plant and equipment, we also manage the productive capacity of our 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. In response to the lengthy market downturn, we have downsized our distribution infrastructure, closing a total of nine branches in 2008 and 2009. In December of 2010 we closed an additional branch location in Las Vegas, Nevada, as discussed in section 2.0 of this report. We believe these reductions are appropriate to better match our productive capacity to current market demand.

Selected Unaudited Consolidated Financial Information

	December 31, 2010	December 31, 2009	December 31, 2008	December 31, 2007	December 31, 2006
Number of distribution centres in operation	26	27	29	36	36
Total square footage of distribution centres	0.9 million s.f.	1.0 million s.f.	1.1 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. The total number of employees increased by 13 in 2010, primarily reflecting the addition of more sales representatives in order to bolster our sales capability in targeted markets.

Selected Unaudited Consolidated Financial Information

	December 31, 2010	December 31, 2009	December 31, 2008	December 31, 2007	December 31, 2006
Number of employees	172	159	190	236	252
Annual sales per employee ($ millions)	1.1	1.2	1.3	1.4	1.4

4.5 Utilization of Distributable Cash

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Year ended December 31, 2010	Year ended December 31, 2009	3 months ended December 31, 2010	3 months ended December 31, 2009
Distributable Cash	$ 4,077	$ (139)	$ (199)	$ (505)
Cash Distributions paid in the period	-	-	-	-
Distributable Cash retained (shortfall)	$ 4,077	$ (139)	$ (199)	$ (505)
Decrease (increase) in non-cash operating working capital	(7,553)	10,291	4,614	1,885
Decrease (increase) in long-term receivables	758	1,545	58	743
Decrease (increase) in deferred financing fees	-	(345)	-	(26)
Proceeds from disposal of property, plant and equipment	33	57	(1)	15
Decrease (increase) in bank indebtedness, net of cash	$ (2,685)	$ 11,409	$ 4,472	$ 2,112

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, 2010, the Fund generated Distributable Cash of $4.1 million and paid no cash distributions. We increased our investment in non-cash operating working capital by $7.6 million, primarily in the form of additional inventory and accounts receivable. We generated additional cash by decreasing our investment in long-term receivables by $0.8 million, and through the disposal of property, plant and equipment for a return of $33,000. Combined, these actions increased our bank indebtedness (net of cash) by $2.7 million in 2010.

For the three months ended December 31, 2010, the Fund generated negative Distributable Cash of $0.2 million and paid no cash distributions. We decreased our investment in non-cash operating working capital by $4.6 million during the quarter, reflecting the seasonality of the business, and reduced our investment in long-term receivables by $58,000. Taking these factors together, the Fund decreased its bank indebtedness (net of cash) by $4.5 million in the fourth quarter of 2010.

4.6 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	As at December 31, 2010		As at December 31, 2009	
Cash and cash equivalents	$	(43)	$	(463)
Bank indebtedness		6,959		4,960
Net Debt		6,916		4,497
Unitholders' Equity		55,239		55,158
Total Capitalization	$	62,155	$	59,655
Net debt to total capitalization		11.1%		7.5%

During the 12 months ended December 31, 2010, the Fund increased its net debt by $2.7 million. The impact of a stronger Canadian dollar (as at December 31, 2010 compared to December 31, 2009) on the conversion of our US dollar bank line reduced our debt by $0.3 million. Taken together, the Fund's net debt balance increased by $2.4 million to $6.9 million at December 31, 2010, from $4.5 million at December 31, 2009. Overall net debt compared to total capitalization stood at 11.1% as of December 31, 2010, compared to 7.5% at December 31, 2009.

We have independent credit facilities in both Canada and the U.S. These facilities may be drawn down to meet short-term financing requirements such as fluctuations in non-cash working capital. Our Canadian credit facility can also be drawn down to make capital contributions to the Fund's US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is 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 as at December 30, 2010 is provided in the following table.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	$15 million	$24.9 million (US$25 million)
Credit facility expiry date	August 7, 2012	September 30, 2011
Available to borrow	$11.7 million	$ 15.7 million (US$15.9 million)
Credit facility borrowings	$ 0.5 million	$ 6.1 million (US$ 6.2 million)
Unused credit facility available	$11.2 million	$ 9.6 million (US$ 9.7 million)
Financial covenants:		
a. (EBITDA - Cash Taxes - Capital Expenditures) / Interest (1)		
Covenant minimum	1.1	
Covenant actual	23.0	
b. Minimum Trailing EBITDA covenant		Covenant does not apply when the unused credit facility available exceeds US$4.0 million, which it did as at December 31, 2010

[1] EBITDA and Interest calculated on a trailing twelve month basis in accordance with the terms of the Canadian credit facility.

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 30, 2010, and accordingly, there were no restrictions on distributions arising from non-compliance with financial covenants.

Our debt management strategy is to roll and renew (as opposed to repay and retire) our revolving credit facilities in Canada and the US when they expire in August 2012 and September 2011, respectively. Discussions are presently underway with respect renewal or replacement of our US credit facility which expires in September of this year. Based upon such discussions, we do not anticipate any difficulties in renewing or securing replacement financing for this credit facility. 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 and cyclical needs of the business, and the 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. Our focus has been on cash conservation and maximizing liquidity until such time as market conditions and the Fund's financial performance and cash generating performance have stabilized. 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, 2010. 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	2011	2012	2013	2014	2015	2016 and thereafter
$ 16,342	$ 5,195	$ 4,136	$ 3,199	$ 2,540	$ 1,221	$ 51

4.8 Off-Balance Sheet Arrangements

The Fund has no off-balance sheet arrangements.

5.0 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, 2010, 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.

6.0 Critical Accounting Estimates and Adoption of Changes in Accounting Policies

6.1 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.

Future Income Taxes: 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 estimates and assumptions can have a material impact upon the amount of future income tax assets and liabilities that we recognize.

6.2 Adoption of New Accounting Standards

On January 1, 2011, International Financial Reporting Standards ("IFRS") replaced 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 will affect the Fund's reported financial position and results of operations. It may also affect certain business functions. We have utilized an IFRS changeover plan to assist us with this process. Key elements of the changeover plan we used include:

Year	Key Activities
2008	Completed IFRS education and training with our accounting staff. Identified an IFRS project manager. Determined the intended use of outside consultants. Analyzed differences between our current accounting policies and IFRS.
2009	Made preliminary selections of IFRS accounting policies. Identified one-time elective exemptions available on initial IFRS adoption. Identified the information required to deliver the preliminary selections of IFRS accounting policies. Identified system changes (accounting, policies, procedures, information technology) required to get that information. Developed a master conversion plan for changes identified. Automated and tested data collection. Identified and addressed the impact of changes IFRS makes to our business drivers, including debt covenants, incentive plans, and management reporting, budgeting, and other items.
2010	Calculated impacts of IFRS adoption on our financial statements at transition date and collected information on adjustments related to 2010 comparatives. Commenced IFRS accounting to provide comparative figures for 2011 IFRS startup date. Prepared IFRS communication plan for stakeholders. Linked IFRS to CEO/CFO certification processes and updated certification documentation relating to internal controls over financial reporting and disclosure controls.
2011	Commence IFRS reporting.

While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement, and disclosures. While the effects of IFRS have not yet been finalized, the Fund has identified a number of key areas that will be impacted, including:

- Under IFRS, the Fund units meet the definition of a liability as they impose an obligation on the Fund to distribute taxable income to unitholders. The liability at January 1, 2010 will be recorded at the fair value of the Units at the inception of the liability, being $144.1 million. Direct expenses associated with the initial issuance of the Fund Units, totaling $10.6 million, will be expensed retroactively as a financing cost at the date of issuance, increasing the deficit;

- The exchangeable Fund units held by the non-controlling interest are considered a liability as the units to be issued by the Fund in an exchange are themselves a puttable financial instrument. The non-controlling interest exchangeable units include an embedded derivative, being the ability of the non-controlling interest to convert the exchangeable units to full participating Fund units. The Fund has chosen not to separate the embedded derivative and will instead record the non-controlling interest exchangeable unit liability at its estimated fair value as at each reporting date. Fluctuations in the estimated fair value of the Class B units will be recorded in income during each period. We are currently working on an assessment of the fair value of the Class B units and expect the non-controlling interest amount recognized in the statement of financial position will be reduced, with a corresponding increase to deficit, at January 1, 2010;

- The Fund is required to classify its Long Term Incentive Plan Units as a liability under IFRS. The amount of compensation cost is remeasured each period end based on the current market price of the Fund's units and the expense is recognized each period during the requisite service period based on the estimated number of awards that are expected to vest and in the case of Performance Units, based on the estimated number of Units to be issued provided that the performance conditions are considered probable of achievement;

- At the IFRS balance sheet transition date, the Fund has elected under IFRS 1 to reduce to nil cumulative translation differences that exist related to translation of self sustaining foreign subsidiaries. The effect is to decrease the balance of accumulated other comprehensive loss by $18.1 million at January 1, 2010, and make a corresponding increase to deficit;

- Subsidiaries of the Fund lease vehicles for employee use. Under IFRS such leases are classified as capital leases, rather than operating leases as accounted for under current Canadian GAAP. The effect at January 1, 2010 is to increase property, plant and equipment by $1.3 million, and to record a lease obligation liability of $1.4 million with the difference increasing deficit. Amortization on the property, plant and equipment and finance costs associated with the lease obligation will be recorded in earnings as compared to an operating lease expense;

- The deferred gain on sale-leaseback of land and building on the balance sheet will be transferred to Unitholders' deficit at January 1, 2010. The effect is a $0.4 million decrease to liabilities and deficit on January 1, 2010;

- To the extent applicable, corresponding future income tax impacts of the above noted adjustments will also be recorded.

In addition, financial statement presentation changes and additional disclosure requirements are anticipated under IFRS. Such changes will be fully disclosed in our March 31, 2011 interim consolidated financial statements. The adoption of IFRS is not expected to have a material impact on the Fund's reported cash flows or business drivers. Day-to-day business operations are not expected to be impacted by the transition to IFRS, consequently design of most internal controls will not change. For those areas above that have been identified as key areas to be impacted, some new procedures have been identified, which will be documented and subsequently tested for internal control purposes. No material changes are anticipated to be required to the Fund's information technology systems as a result of the implementation of IFRS.

The accounting standards under IFRS continue to evolve and future changes or interpretations could result in the identification of new financial impacts not previously noted or could require a revision to the financial statement impacts noted above. The impacts of conversion to IFRS is still in the process of being finalized and reviewed by our auditors, and thus it is possible that further differences may be identified prior to the release of our March 31, 2011 interim consolidated financial statements.

7.0 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 28, 2011, which is available to readers at www.sedar.com.

8.0 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, 2010. 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 this evaluation, the CEO and CFO concluded that the Fund’s disclosure controls and procedures were effective as of December 31, 2010.

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, 2010. 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, 2010.

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, 2010 which materially affected, or are reasonably likely to materially affect, the Fund’s ICFR.

9.0 Selected Financial Information

9.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2010	Q3 2010	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Total sales	$ 46,392	$ 50,559	$ 52,206	$ 48,498	$ 41,577	$ 46,435	$ 49,489	$ 53,422
Net earnings	$ (543)	$ 263	$ 822	$ 414	$ (544)	$ (11,072)	$ (491)	$ 1,867
Basic and fully diluted earnings (loss) per Class A Unit	$ (0.04)	$ 0.02	$ 0.06	$ 0.03	$ (0.04)	$ (0.77)	$ (0.03)	$ 0.13
EBITDA	$ (317)	$ 1,391	$ 2,374	$ 1,169	$ (2,421)	$ 543	$ (192)	$ 916
Distributable Cash	$ (199)	$ 1,259	$ 2,055	$ 962	$ (505)	$ 230	$ (569)	$ 705
Total distributions to Class A and Class B Units	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

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 future income tax assets which may not be recoverable due to the continued downturn in results at our US operations (which occurred in the three months ended September 30, 2009), and other factors.

9.2 Annual Financial Information

(in thousands of dollars except per unit amounts)	Year ended December 31, 2010	Year ended December 31, 2009	Year ended December 31, 2008	Year ended December 31, 2007	Year ended December 31, 2006
Total sales	$ 197,655	$ 190,923	$ 256,301	$ 331,765	$ 362,528
Net earnings (loss)	956	(10,240)	(36,243)	15,619	3,637
Basic and fully diluted earnings (loss) per Class A Unit	0.07	(0.71)	(2.52)	1.08	0.25
Total assets	74,895	74,270	103,350	173,727	198,404
Total long-term financial liabilities	9,064	9,164	13,652	34,187	37,372
EBITDA	4,617	(1,154)	5,918	21,260	21,821
Distributable Cash	4,077	(139)	4,968	17,281	16,748
Distributions per Unit relating to the period:					
Class A Units	$ -	$ -	$ 0.525	$ 0.857	$ 0.921
Class B Units	$ -	$ -	$ -	$ -	$ -
Total Units	$ -	$ -	$ 0.420	$ 0.686	$ 0.736

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.

Lance R. Blanco
President and Chief Executive Officer

Independent Auditors' Report

To the Unitholders of Hardwoods Distribution Income Fund

We have audited the accompanying consolidated financial statements of Hardwoods Distribution Income Fund, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations and deficit, comprehensive loss, accumulated other comprehensive loss, and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Hardwoods Distribution Income Fund as at December 31, 2010 and 2009, and the consolidated results of operations and its consolidated cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants
Vancouver, Canada

March 28, 2011

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

December 31, 2010 and 2009

	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	$ 43	$ 463
Accounts receivable (note 6(b))	26,656	25,585
Income taxes recoverable	1,820	2,286
Inventory (note 5)	27,441	23,901
Prepaid expenses	768	878
	56,728	53,113
Long-term receivables (note 6(b))	1,515	1,883
Property, plant and equipment (note 7)	891	1,291
Deferred financing costs	214	396
Future income taxes (note 11)	15,594	17,587
	$ 74,942	$ 74,270
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 8)	$ 6,959	$ 4,960
Accounts payable and accrued liabilities	3,680	4,988
	10,639	9,948
Deferred gain on sale-leaseback of land and building	320	416
Non-controlling interests (note 9)	8,744	8,748
Unitholders' equity:		
Fund Units (note 10)	133,653	133,454
Contributed surplus (note 10)	198	-
Deficit	(59,242)	(60,198)
Accumulated other comprehensive loss	(19,370)	(18,098)
	55,239	55,158
Commitments (note 13)		
Contingencies (note 17)		
	$ 74,942	$ 74,270

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 Operations and Deficit
(Expressed in thousands of Canadian dollars, except per unit amounts)

Years ended December 31, 2010 and 2009

	2010	2009
Sales	$ 197,655	$ 190,923
Cost of sales	163,298	156,441
Gross profit	34,357	34,482
Expenses (income):		
Selling and administrative	29,740	35,636
Amortization:		
Plant and equipment	431	795
Deferred financing costs	177	159
Deferred gain on sale-leaseback of land and building	(76)	(84)
Interest	709	586
Foreign exchange losses	161	1,553
	31,142	38,645
Income (loss) before non-controlling interests and income taxes	3,215	(4,163)
Non-controlling interests (note 9)	(643)	2,347
Income (loss) before income taxes	2,572	(1,816)
Income tax expense (recovery) (note 11):		
Current	104	(1,896)
Future	1,512	10,320
	1,616	8,424
Income (loss) for the year	956	(10,240)
Deficit, beginning of year	(60,198)	(49,958)
Deficit, end of year	$ (59,242)	$ (60,198)
Basic and diluted earnings (loss) per Unit	$ 0.07	$ (0.71)
Weighted average number of Units outstanding	14,410,312	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statements of Comprehensive Loss
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2010 and 2009

	2010	2009
Net income (loss) for the year	$ 956	$ (10,240)
Other comprehensive loss:		
Unrealized losses on translation of self-sustaining foreign operations	(1,272)	(3,374)
Comprehensive loss	$ (316)	$ (13,614)

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

Years ended December 31, 2010 and 2009

	2010	2009
Accumulated other comprehensive loss, beginning of year	$ (18,098)	$ (14,724)
Other comprehensive loss	(1,272)	(3,374)
Accumulated other comprehensive loss, end of year	$ (19,370)	$ (18,098)

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, 2010 and 2009

	2010	2009
Cash flows provided by (used in) operating activities:		
Net income (loss) for the year	$ 956	$ (10,240)
Items not involving cash:		
Amortization	608	954
Imputed interest income on employee loans	(22)	(158)
Non-cash employee compensation	397	-
Deferred gain on sale-leaseback of land and building	(76)	(84)
Gain on sale of property, plant and equipment	(28)	(42)
Unrealized foreign exchange losses	161	1,553
Non-controlling interests	643	(2,347)
Future income taxes	1,512	10,320
	4,151	(44)
Change in non-cash operating working capital (note 12)	(7,553)	10,291
Net cash provided by (used in) operating activities	(3,402)	10,247
Cash flows provided by (used in) financing activities:		
Bank indebtedness	2,265	(11,031)
Deferred financing fees	-	(345)
Net cash provided by (used in) financing activities	2,265	(11,376)
Cash flows provided by (used in) investing activities:		
Additions to property, plant and equipment	(74)	(95)
Proceeds on disposal of property, plant and equipment	33	57
Long-term receivables, net	758	1,545
Net cash provided by investing activities	717	1,507
Increase (decrease) in cash	(420)	378
Cash, beginning of year	463	85
Cash, end of year	$ 43	$ 463
Supplemental information:		
Interest paid	$ 685	$ 586
Income taxes paid	77	207
Income tax refunds received	323	-
Transfer of accounts receivable to long-term customer notes receivable, being a non-cash transaction	-	685

See accompanying notes to consolidated financial statements.

1. Nature 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 of Units and acquired an 80% interest in a hardwood lumber and sheet goods distribution business in North America (the "Business") from affiliates of Sauder Industries Limited ("SIL"). The Fund holds, indirectly, 80% of the outstanding limited partnership units of Hardwoods Specialty Products LP ("Hardwoods LP") and Hardwoods Specialty Products US LP ("Hardwoods USLP"), limited partnerships established under the laws of the Province of Manitoba and the state of Delaware, respectively.

2. Significant accounting policies:

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

(a) Basis of presentation:

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

(b) Cash and cash equivalents:

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

(c) Accounts receivable:

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

(d) Inventory:

Inventory is valued at 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 rebates and supplier trade discounts are accounted for as a reduction of the cost of the related inventory and are earned when inventory is sold.

2. Significant accounting policies (continued):

(e) Property, plant and equipment (continued):

Property, plant and equipment is stated at cost less accumulated amortization. During the year ended December 31, 2010 management performed an annual review of amortization policies and as a result increased the estimated useful life of certain mobile equipment. The change in estimate is being applied prospectively. 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	up to 15 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 credit facility.

(g) Impairment of long-lived assets:

Long-lived assets, including property, plant and equipment, 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.

(h) 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.

(i) 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):

(i) 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 does not 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.

(j) 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.

(k) 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 as a proxy for the exchange rates prevailing at the transaction dates. 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 income for the period.

(l) Unit based compensation:

The Fund has a unit based long-term incentive compensation plan which is described in Note 10(b). The Fund is accounting for the Restricted Units and Performance Units as employee equity settled awards whereby the compensation cost is determined at the grant date and recognized over the service period using graded vesting amortization. The amount of compensation cost recognized each period during the requisite service period is based on the estimated number of awards that are expected to vest and in the case of Performance Units, based on the estimated number of Units to be issued provided that the performance conditions are considered probable of achievement.

2. Significant accounting policies (continued):

(m) 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), and for Long Term Incentive Units. The if-converted method assumes conversion of convertible securities, taking into account performance contingencies, at the beginning of the reporting period (or at the time of issuance, if later).

(n) 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 estimate include the estimate of useful lives of property, plant and equipment, determination of the allowance for doubtful accounts for accounts receivable, future income taxes and amounts of accrued liabilities. Actual amounts may differ from the estimates applied in the preparation of these financial statements.

(o) Comparative figures:

Certain comparative figures have been reclassified to conform with the presentation adopted in the current period.

3. Adoption of new accounting standards:

Effective January 1, 2011, 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 and the transition from Canadan GAAP to IFRS will be applicable for the Fund's first quarter 2011 financial statement when the Fund will prepare both current and comparative financial information in accordance with IFRS. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement, and disclosures. The Fund has identified key areas which will be impacted, including:

- The deferred gain on sale-leaseback of land and building on the balance sheet will be transferred to Unitholders' deficit at January 1, 2010. The effect will be a decrease to liabilities and a decrease to deficit;
- At the IFRS balance sheet transition date, January 1, 2010, the Fund will elect under IFRS 1 to reduce to nil cumulative translation differences that exist related to translation of self sustaining foreign subsidiaries. The effect is to decrease to nil the balance of accumulated other comprehensive loss with a corresponding increase to deficit;
- Subsidiaries of the Fund lease vehicles for employee use. Under IFRS such leases have been determined to be capital leases, rather than operating leases as is currently the case. The effect is to increase property, plant and equipment, and to record a lease obligation liability. Amortization on the property, plant and equipment and finance costs associated with the lease obligation will be recorded in earnings as compared to an operating lease expense;

(Tabular amounts expressed in thousands of Canadian dollars)

3. Adoption of new accounting standards (continued):

- Under IFRS, the Fund units meet the definition of a liability. The effect is to reduce Unitholders' equity, and increase Fund unit liability;
- The exchangeable Class B units held by the non-controlling interest are considered a liability as the units to be issued by the Fund in an exchange are themselves a puttable financial instrument The Fund will record the non-controlling interest as a liability at its estimated fair value at each reporting date. Fluctuations in the estimated fair value of the Class B units will be recorded in income during each period. The effect will be to decrease the carrying value of the non-controlling interest at the January 1, 2010 transition date with a corresponding reduction to the deficit.;
- The Fund is required to classify its Long Term Incentive Plan Units (note 10(b)) as cash settled awards and record the estimated compensation expense as a liability until such date as the obligation is settled. The amount of compensation expense is remeasured each period end based on the current market price of the Fund's units and the expense is recognized each period based on the estimated number of awards that are expected to vest. The effect will be to increase liabilities and decrease contributed surplus;
- Corresponding future income tax impacts of the above noted adjustments will also be required.

In addition, financial statement presentation changes and additional disclosure requirements are anticipated under IFRS. The adoption of IFRS is not expected to have a material impact on the Fund's reported cash flows.

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:

	2010	2009
Cash and cash equivalents	$ (43)	$ (463)
Bank indebtedness	6,959	4,960
Net debt	6,916	4,497
Unitholders' equity	55,239	55,158
Total capitalization	$ 62,155	$ 59,655

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 U.S. credit facility is subject to a minimum trailing EBITDA covenant that is only applicable in the event the U.S. subsidiary's unused credit availability falls below US $4.0 million. The Canadian credit facility is subject to a Fixed Charge Coverage Ratio ("FCCR") calculated as (EBITDA – capital expenditures – cash taxes)/(interest expense) which cannot be less than 1.1 for Hardwoods LP.

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 do not meet the above covenant requirements as well as certain additional credit ratios. The Fund's operating subsidiaries were compliant with all required credit ratios as at December 31, 2010 and 2009, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

(Tabular amounts expressed in thousands of Canadian dollars)

4. Capital disclosures:

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, 2010. 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:

	2010	2009
Lumber	$ 9,868	$ 8,224
Sheet goods	13,270	12,171
Specialty	2,307	2,099
Goods in-transit	1,996	1,407
	$ 27,441	$ 23,901

During the year ended December 31, 2010 inventory write-downs totaling $1.0 million (2009 - $2.7 million) were recorded to reduce certain inventory items to their net realizable value.

Cost of sales for the year ended December 31, 2010 were $163.3 million (2009 - $156.4 million), which included $156.7 million (2009 - $148.3 million) of costs associated with inventory. The other $6.6 million (2009 - $8.1 million) related principally to freight and other related expenses.

6. Financial instruments:

Financial assets include cash and cash equivalents, which are designated as held-for-trading and measured at fair value, current and long-term receivables, and income taxes recoverable which are designated as loans and receivables and measured at amortized cost. Financial liabilities include bank indebtedness and accounts payable and accrued liabilities. 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.

(a) Fair values of financial instruments:

The carrying values of cash and cash equivalents, accounts receivable, income taxes recoverable, accounts payable and accrued liabilities 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 carrying value. The carrying values of the credit facilities approximate their fair values due to the existence of floating market based interest rates.

(Tabular amounts expressed in thousands of Canadian dollars)

6. Financial instruments (continued):

(b) 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.

(*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. Credit risk arises principally from the Fund's receivables from its 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:

	2010	2009
Trade accounts receivable - Canada	$ 10,555	$ 9,756
Trade accounts receivable - United States	17,726	16,117
Sundry receivable	200	203
Current portion of long-term receivables	413	919
	28,894	26,995
Less: allowance for doubtful accounts	2,238	1,410
	$ 26,656	$ 25,585
Long-term receivables:		
Employee housing loans	$ 375	$ 450
Customer notes	1,088	1,834
Security deposits	465	518
	1,928	2,802
Less: current portion, included in accounts receivable	413	919
	$ 1,515	$ 1,883

(Tabular amounts expressed in thousands of Canadian dollars)

6. Financial instruments (continued):

(b) Financial risk management (continued):

(*i*) Credit risk (continued):

Trade accounts receivable:

The Fund's exposure to credit risk is influenced mainly by the 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 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. The Fund's largest individual customer balance amounted to 8.1% (2009 – 9.1%) of trade accounts receivable and customer notes receivable at December 31, 2010.

The aging of trade receivables was:

	2010	2009
Current	$ 16,791	$ 14,557
Past due 31-60 days	5,460	5,283
Past due 61-90 days	2,059	2,181
Past due 90+ days	3,971	3,852
	$ 28,281	$ 25,873

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, 2010 was $2.2 million (2009 - $1.4 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.

The change in the allowance for doubtful accounts can be reconciled as follows:

	2010	2009
Balance as at January 1	$ 1,410	$ 2,347
Additions during the period	1,788	2,774
Changes due to currency rate fluctuations	(102)	(263)
Use during the period	(858)	(3,448)
Balance as at December 31	$ 2,238	$ 1,410

6. Financial instruments (continued):

(b) Financial risk management (continued):

(*i*) Credit risk (continued):

Bad debt expense comprises additions to the allowance for doubtful accounts and the value of receivables directly written off less recoveries on accounts previously written off. Bad debt expense, net of recoveries, for the year ended December 31, 2010 was $2.0 million all of which related to trade accounts receivable. For the year ended December 31, 2009 bad debt expense was $5.2 million which included $3.4 million related to trade accounts receivable and $1.8 million to long-term receivables. For the previous five years, bad debt expense has averaged approximately 1.3% 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. Employee loans are repaid in accordance with the loan agreement. 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 security over specific property or assets. Customer notes bear market interest rates ranging from 8%-10%.

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.

(*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, 2010, in Canada, a subsidiary of the Fund had a revolving credit facility of up to $15.0 million. In the US, a subsidiary of the Fund had a revolving credit facility of up to $24.8 million (US$25.0 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, 2010 the Canadian and U.S. credit facilities had $11.2 million and $9.6 million (US$9.7 million), respectively, of additional borrowing capacity.

6. Financial instruments (continued):

(b) Financial risk management (continued):

(*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, 2010 bank indebtedness balance of $6.7 million, a 1% increase or decrease in the interest rates charged would result in decrease or increase to annual net earnings by approximately $40,000.

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. 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.

At December 31, 2010 the Fund's Canadian subsidiaries primary exposure to foreign denominated working capital financial instruments was in relation to accounts receivable from U.S. customers (US$0.2 million, (2009 – US$0.2 million)), income taxes recoverable (US$1.9 million, (2009 – US$1.9 million)), and accounts payable to U.S. suppliers ($0.2 million, (2009 – US$0.2 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 income for the year ended December 31, 2010 by approximately $0.1 million (2009 - $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, 2010 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.

(Tabular amounts expressed in thousands of Canadian dollars)

6. Financial instruments (continued):

(b) 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 in the Fund's selling prices to customers.

7. Property, plant and equipment:

December 31, 2010	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 1,956	$ 1,689	$ 267
Mobile equipment	2,979	2,381	598
Leasehold improvements	785	759	26
	$ 5,720	$ 4,829	$ 891

December 31, 2009	Cost	Accumulated amortization	Net book value
Machinery and equipment	$ 2,095	$ 1,685	$ 410
Mobile equipment	3,225	2,394	831
Leasehold improvements	786	736	50
	$ 6,106	$ 4,815	$ 1,291

8. Bank indebtedness:

	2010	2009
Checks issued in excess of funds on deposit	$ 282	$ 1,077
Credit facility, Hardwoods LP	548	1,945
Credit facility, Hardwoods USLP (December 31, 2010 - US$6,162; December 31, 2009 - US$1,844)	6,129	1,938
	$ 6,959	$ 4,960

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 (the "Credit Facilities").

8. Bank indebtedness (continued):

Each of the Credit Facilities is separate, is not guaranteed by the other partnership, and does not contain cross default provisions to the other Credit Facility. The Credit Facility made available to Hardwoods LP 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 LP Units held by a subsidiary of the Fund and SIL. The Credit Facility made available to Hardwoods USLP is secured by a first security interest in all of the present and after acquired property of Hardwoods USLP and by the USLP Units held by a subsidiary of the Fund and by SIL.

The Hardwoods LP Credit Facility has a three year term, provides financing up to $15.0 million and has a maturity date of August 7, 2012. The Hardwoods USLP Credit Facility has a three year term, provides financing of up to US$ 25.0 million and has a maturity date of September 30, 2011. Each facility is payable in full at maturity. The Hardwoods LP Credit Facility is repayable subject to prepayment penalties of $225,000 if repaid in the first 12 months of the credit facility term, $150,000 if repaid in the second 12 months of the credit facility term, and $75,000 thereafter if repaid prior to the maturity date of the credit facility. The Hardwoods USLP Credit Facility is repayable without prepayment penalties. The Credit Facilities bear interest at a floating rate based on the Canadian or US 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 on customary terms for facilities of this nature. The Credit Facilities' rates vary with the ratio of EBITDA minus capital expenditures and cash taxes, divided by interest. Commitment fees and standby charges usual for borrowings of this nature were and are payable.

The amount made available under the Credit Facility to Hardwoods LP from time to time is limited to the extent of 85% of the book value of accounts receivable and the lesser of 60% of the book value or 85% of appraised value of inventories with the amount based on inventories not to exceed 60% of the total amount to be available. Hardwoods LP is required to maintain a fixed charge coverage ratio (calculated as the ratio of EBITDA less cash taxes less capital expenditures, divided by interest) of not less than 1.1 to 1. At December 31, 2010 Hardwoods LP has $11.2 million (2009 - $11.3 million) of additional borrowing capacity.

The amount to be made available under the Credit Facility to Hardwoods USLP from time to time is limited to the extent of 85% of the book value of certain accounts receivable and 50% of the book value of inventories. Certain identified accounts receivable and inventories are excluded from the calculation of the amount available under the Credit Facility. Hardwoods USLP is required to maintain a minimum trailing EBITDA covenant until December 31, 2010, and a fixed charge coverage ratio (calculated as EBITDA less cash taxes less capital expenditures, divided by interest plus distributions) of 1.0 to 1 thereafter. These covenants of the Hardwoods USLP Credit Facility do not need to be met however when the unused availability under the credit facility is in excess of US$4.0 million. At December 31, 2010 Hardwoods USLP has $9.6 million (US$9.7 million) of additional borrowing capacity.

The average annual interest rates paid in respect of bank indebtedness for the year ended December 31, 2010 were 4.79% and 5.88% (2009 – 3.82% and 4.88%) for the Hardwoods LP and Hardwoods USLP credit facilities, respectively. In addition, standby fees of 0.5% and 0.75% (2009 – 0.5% and 0.75%) related to the unused portion of the credit facilities was charged by the banks for Hardwoods LP and Hardwoods USLP respectively.

(Tabular amounts expressed in thousands of Canadian dollars)

9. Non-controlling interests:

	2010	2009
Balance, beginning of year	$ 8,748	$ 13,080
Interest in earnings:		
Interest in earnings (loss) before taxes	643	(833)
Adjustment to non-controlling interest from subordination of Class B Unit Holders	-	(1,514)
Increase (decrease)	643	(2,347)
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	(647)	(1,985)
Balance, end of year	$ 8,744	$ 8,748

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

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

- the consolidated Adjusted EBITDA, as defined in the Subordination Agreement dated March 23, 2004, of the Fund for the 12 month period ending on the last day of the month immediately preceding such date is at least $21,300,000; and
- cash distributions of at least $29,540,000 ($2.05 per Unit) have been paid on the Units and a combined amount of cash advances or distributions of at least $7,385,000 has been paid on the Class B LP Units and Class B USLP Units, being $2.05 per combined Class B LP and Class B USLP Units (as adjusted for issuances, redemptions and repurchases of Units, LP Units and USLP Units subsequently and by converting the cash distributions or advances by Hardwoods USLP on the USLP Units at the rate of exchange used by the Fund to convert funds received by it in 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 as at December 31, 2010.

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 and as determined by the board of directors of the general partners;

9. Non-controlling interests (continued):

- 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, 2010, the amount of such deficiency was $14.8 million (2009 - $14.8 million);
  - Third, to the holders of Class B LP Units and Class B USLP Units in a combined amount for one Class B LP Unit and one Class B USLP Unit equal, on a pro-rated basis, to the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter or, if there is insufficient available cash to make advances or distributions in such amount, such lesser amount as is available;
  - Fourth, to the holders of Class B LP Units and Class B USLP Units, to the extent only that combined advances or distributions in respect of any fiscal quarter(s) during the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on one Class B LP Unit and one Class B USLP Unit were not made, or were made in amounts less, on a pro-rated basis, that the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such 12 month period, the amount of such deficiency. As of December 31, 2010, the amount of such deficiency was nil (2009 - nil); and
  - 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 (excluding Units issued or issuable pursuant to the Fund's Long Term Incentive Plan (note 10(b)). 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.

(Tabular amounts expressed in thousands of Canadian dollars)

10. Unitholders' Equity:

(a) Fund units

	Units	Amount
Balance at January 1, 2009 and December 31, 2009	14,410,000	$ 133,454
Issued pursuant to long-term incentive plan	113,858	199
Balance at December 31, 2010	14,523,858	$ 133,653

An unlimited number of Units and Special Voting Units may be created and issued pursuant to the Fund's 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. Units of the Fund are redeemable at the holders' option for amounts based on the market price of the Units at the time of redemption, subject to a maximum of $50,000 in cash redemptions by the Fund in any particular month. 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 9). Such Special Voting Units are to be cancelled on the exchange of Class B Units of Hardwoods LP and Hardwoods USLP for Units of the Fund.

(b) Long Term Incentive Plan

At the Annual General Meeting held on May 20, 2010, the Unitholders approved a long term incentive plan ("LTIP") which authorized the issuance of a maximum of 850,000 Units to qualified trustees, directors, officers, employees and consultants to align the interests of such persons with the interests of Unitholders.

The LTIP is comprised of Restricted Units and Performance Units. Each Restricted Unit will entitle the holder to be issued the number of Units of the Fund ("Units") designated in the grant agreement for that Restricted Unit. Units issuable pursuant to Restricted Unit grants will vest and be issued on the date or dates determined by the Fund's Compensation Committee and set out in the grant agreement, provided such date or dates are not later than December 31st following the third anniversary of the date the Restricted Unit was granted. Each Performance Unit will entitle the holder to be issued the number of Units designated in the grant agreement for the Performance Unit multiplied by a payout multiplier which may range from a minimum of zero to a maximum of two depending on the achievement of the defined performance criteria. Units issuable pursuant to Performance Units will be issued on the date set out in the grant agreement if the performance criteria are satisfied, provided such date is not later than December 31st following the third anniversary of the date the Performance Unit was granted.

(Tabular amounts expressed in thousands of Canadian dollars)

10. Unitholders' Equity (continued):

(b) Long Term Incentive Plan (continued)

The Units to which a grantee is entitled under a Restricted Unit or Performance Unit may, at the discretion of the Board of Directors, be settled by the Fund in Units issued from treasury, Units purchased by the Fund in the secondary market, in an amount of cash equal to the fair market value of such Units, or any combination of the foregoing.

If any Restricted Units or Performance Units granted under LTIP expire, terminate or are cancelled for any reason without the Units issuable under the Restricted Unit or Performance Unit having been issued in full, those Units will become available for the purposes of granting further Restricted Units or Performance Units under the LTIP. To the extent any Units issuable pursuant to Restricted Units or Performance Units are settled in cash or with Units purchased in the market, those Units will become available for the purposes of granting further Restricted Units or Performance Units.

The LTIP provides for cumulative adjustments to the number of Units to be issued pursuant to Restricted Units or Performance Units on each date that distributions are paid on the Units by an amount equal to a fraction having as its numerator the amount of the distribution per Unit and having as its denominator the fair market value of the Units on the trading day immediately preceding the distribution payment date. Fair market value is the weighted average price that the Units trade on the Toronto Stock Exchange for the five trading days on which the Units traded immediately preceding that date.

The LTIP provides that the number of Units issued to insiders pursuant to the plan and other Unit compensation arrangements of the Fund within a one year period, or at any one time, may not exceed 10% of the issued and outstanding Units.

During the year ended December 31, 2010, 341,572 Restricted Units and 160,452 Performance Units were granted under the terms of the LTIP with an average fair value of $1.75 per Restricted or Performance Unit. The Restricted and Performance Units vest over a three year period from the grant dates. As of December 31, 2010 113,858 of the awards were fully vested and had been settled by the issuance of Fund Units. A non-cash compensation expense and associated contributed surplus amount of $397,000 was recorded for the year ended December 31, 2010.

A continuity of the LTIP Units outstanding is as follows:

	Performance Units	Restricted Units
Balance at January 1, 2009 and December 31, 2009	-	-
LTIP Units issued during the period	160,452	341,571
LTIP Units settled by exchange for free-trading Fund Units	-	(113,858)
Balance at December 31, 2010	160,452	227,713

(Tabular amounts expressed in thousands of Canadian dollars)

10. Unitholders' Equity (continued):

(c) Contributed surplus as at December 31, 2010 is as follows:

Balance at January 1, 2009 and December 31, 2009	-
LTIP Units issued during the period	397
LTIP Units settled by exchange for free-trading Fund Units	(199)
Balance at December 31, 2010	198

11. Income taxes:

	2010	2009
Current	$ 104	$ (1,896)
Future	1,512	10,320
	$ 1,616	$ 8,424

During the year ended December 31, 2009, a subsidiary of the Fund recorded a future tax expense of $10.1 million related to the refinancing of inter-entity debt resulting from the downturn in financial results in the Fund's US operating subsidiary. The future tax expense was comprised of a reduction to the US operating loss carry forwards of a subsidiary of the Fund and a reduction in the associated tax basis in the subsidiary's investment in Hardwoods USLP.

The inter-entity refinancing noted in the preceding paragraph did not have any effect upon the management or business activities of the Fund's operating subsidiaries.

Under current income tax regulations subsidiaries of the Fund are subject to income taxes in Canada and the United States. The applicable statutory rate in Canada for the year ending December 31, 2010 is 28.5% (2009 – 30.4%) and in the United States is 39.4% (2009 – 39.4%). Historically the majority of the Fund's tax expense arose from its US subsidiaries, and as such the Fund reconciles its consolidated income tax expense to the statutory rate applicable in the United States.

Income tax expense differs from that calculated by applying the U.S. federal and state income tax rates to earnings before income taxes for the following reasons:

	2010	2009
Earnings (loss) before income tax	$ 2,572	$ (1,816)
Statutory rate	39.4%	39.4%
Computed tax expense (recovery) at statutory rate	$ 1,013	$ (716)
Effect of lower tax rates in Canada and other rate changes	(105)	(475)
Non-deductible expenses	191	206
Internal restructuring and re-financing	301	10,129
State and branch profits tax	71	228
Adjustment to non-controlling interest not subject to tax	-	(596)
Other	145	(352)
Income tax expense	$ 1,616	$ 8,424

(Tabular amounts expressed in thousands of Canadian dollars)

11. 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, 2010 is as follows:

	2010	2009
Future income tax assets:		
Accounts receivable	$ 663	$ 438
Accounts payable	165	207
Inventory	387	290
Employee housing loans	36	44
Property, plant and equipment	277	351
Goodwill	13,684	15,926
Tax loss carry forwards and future interest deductions	4,754	4,427
Deferred gain on sale-leaseback of land and building	100	131
Financing charges and other	151	200
	20,217	22,014
Future income tax liabilities:		
Prepaid expenses	(48)	(45)
Property, plant and equipment	(145)	(62)
Investment in Hardwoods USLP	(4,430)	(4,320)
	(4,623)	(4,427)
Net future income tax asset	$ 15,594	$ 17,587

At December 31, 2010, subsidiaries of the Fund have operating loss carry forwards for income tax purposes of approximately $13.0 million in Canada and US$2.0 million in the United States that may be utilized to offset future taxable income. These losses, if not utilized expire between 2014 and 2030.

At December 31, 2010 the Fund and its Canadian subsidiaries have capital losses of approximately $23.4 million (2009 - $23.4 million), and suspended capital losses of approximately $44.2 million (2009 - $44.2 million) available to offset future Canadian taxable capital gains. These capital losses arose as a result of internal restructuring and inter-entity transactions during the year ended December 31, 2009. A full valuation allowance has been recorded against the associated future income tax asset of $8.5 million (2009 - $8.5 million).

(Tabular amounts expressed in thousands of Canadian dollars)

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

	2010	2009
Source (use) of funds		
Accounts receivable	$ (2,414)	$ 3,842
Income taxes recoverable/payable	355	(223)
Inventory	(4,436)	4,355
Prepaid expenses	85	74
Accounts payable and accrued liabilities	(1,143)	2,243
Change in non-cash operating working capital	$ (7,553)	$ 10,291

CICA 1540, *Cash Flow Statements*, requires 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 years ended December 31, 2010 and December 31, 2009 no discretionary cash distributions were paid to Unitholders.

13. Commitments:

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:

2011	$ 5,195
2012	4,136
2013	3,199
2014	2,540
2015	1,221
	16,291
Thereafter	51
	$ 16,342

14. Segment disclosure:

Information about geographic areas is as follows:

	2010	2009
Revenue from external customers:		
Canada	$ 79,653	$ 75,339
United States	118,002	115,584
	$ 197,655	$ 190,923
Property, plant and equipment:		
Canada	$ 315	$ 450
United States	576	841
	$ 891	$ 1,291

15. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP Plan"). The assets of the USLP Plan are held and related investment transactions are executed by the Plan's Trustee, ING National Trust, and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2010, Hardwoods USLP contributed and expensed $218,345 (US$211,924) (2009 - $239,378 (US$209,378)) 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, 2010, Hardwoods LP contributed and expensed $204,621 (2009 - $196,561) in relation to the LP Plan.

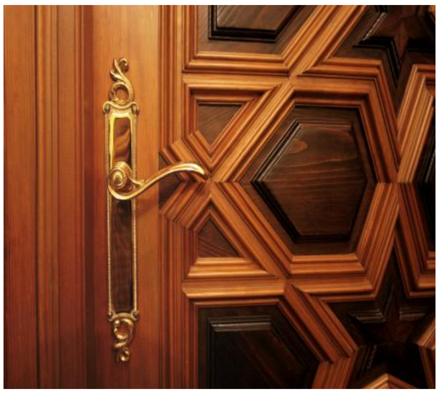
16. Related party transactions:

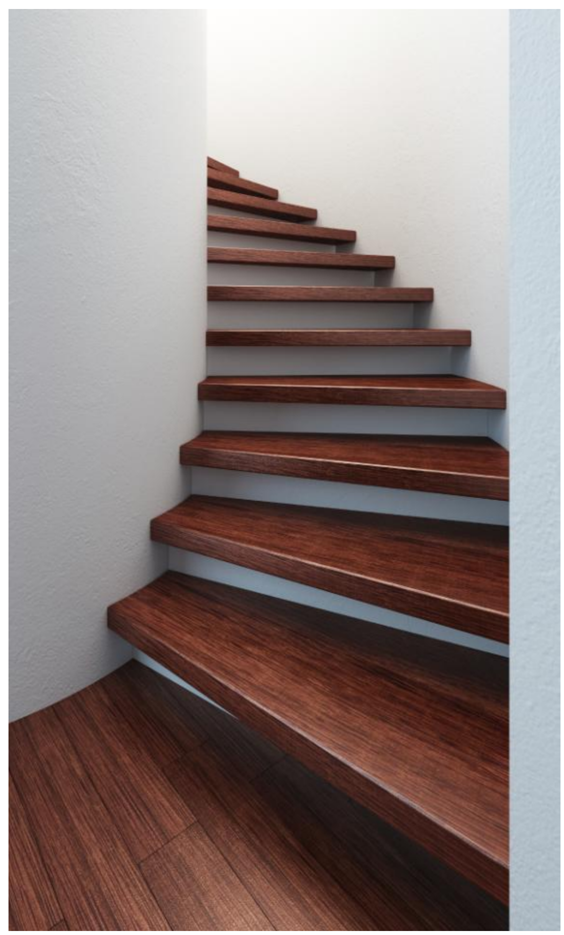
For the year ended December 31, 2010, sales of $435,792 (2009 - $448,257) were made to affiliates of SIL, and the Fund made purchases of $120,107 (2009 - $53,210) from affiliates of SIL. All sales and purchases took place at prevailing market prices.

17. Contingencies:

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

The Beauty of Hardwood





Unitholder Information

Officers

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Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California Region

Garry W. Warner
Vice President, Canada

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Trading under **HWD.UN**

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Company of Canada

HARDWOODS