HARDWOODS DISTRIBUTION INC.

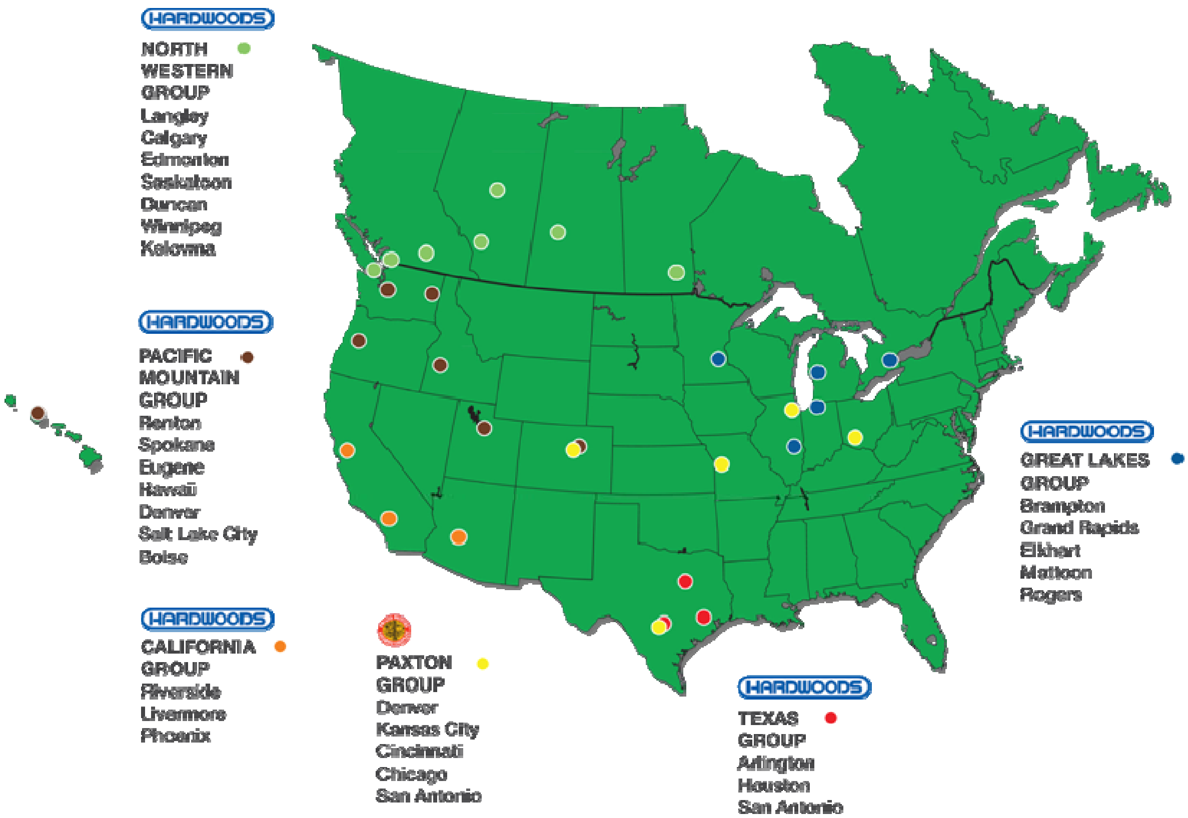
2011

Annual Report

To Shareholders

Hardwoods Distribution Inc.

Hardwoods Distribution Inc. ("Hardwoods" or "the Company") was established on July 1, 2011 with the conversion of the Hardwoods Distribution Income Fund to a publicly-traded, dividend paying corporation. The Company is listed on the Toronto Stock Exchange and trades under the symbol HWD. Hardwoods is one of North America's largest wholesale distributors of hardwood lumber and related sheet good and specialty wood products. Including our new Paxton business group, acquired in September 2011, we operate a network of 30 distribution centres in the US and Canada:



Demand for products made from hardwood comes from multiple sectors of the North American economy, including new home construction, renovation, commercial 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.

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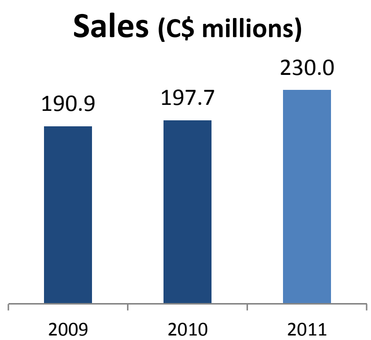
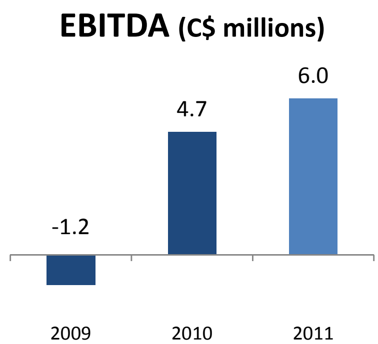
To Our Shareholders

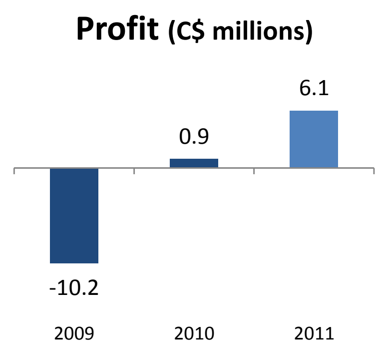
We achieved profitable growth in 2011 as we pursued our business strategy, investing in new markets, products and sales personnel, and improving results from our existing operations.

Our acquisition of the Frank Paxton Lumber Company on September 19, 2011 was a highlight of the year and is already proving accretive. Paxton is a respected remanufacturer and distributor of premium hardwood lumber, millwork and architectural sheet goods, with five US branches located in Chicago, Cincinnati, Denver, Kansas City and San Antonio. These branches also provide custom architectural millwork predominantly to commercial and institutional customers. During the three and a half months we operated this business in 2011, Paxton contributed revenues of $13.6 million and a net positive EBITDA contribution of $0.2 million, even after accounting for $0.2 million of transaction costs.

Importantly, our existing operations also boosted performance in 2011, with strong organic sales and EBITDA growth, particularly from our US distribution centres. Overall, we generated our best revenue, EBITDA and profit results in three years, and we have now achieved seven consecutive quarters of improving sales performance.







These are significant achievements in light of market conditions. In the US market, home building, remodeling and commercial construction activity fell short of forecasters' expectations, resulting in closures and production cutbacks among secondary manufacturers, including some of the largest component and cabinet manufacturers in the US. In Canada, the residential construction sector posted modest gains, but secondary manufacturers continued to be hurt by a stronger Canadian dollar, which limits their ability to compete in the US market. Prices for hardwood lumber and panels were flat or slightly weaker than a year ago.

Our improving financial performance in the midst of lackluster market conditions provides clear evidence that our business strategy is working. Launched in late 2010, our strategy focuses on three key objectives:

Increasing Our End-Market Diversification - We are actively targeting the commercial and institutional construction markets as we work to achieve greater end-market diversification. Customers in these sectors make significant use of hardwood in applications ranging from office, restaurant, school and hospital interiors, to hotel lobbies, and retail point-of-purchase displays. They have also been generally less affected by the economic downturn than residential construction customers, reflecting the different dynamics in these markets.

During 2011, we fine-tuned our product offering and hired experienced sales representatives to help us build our customer base. The Paxton acquisition provided further momentum by bringing us an established base of commercial and institutional construction customers, along with a line of architectural millwork products and capabilities targeted to them. As a result of our strategies, commercial accounts represented the majority of new accounts opened during the year and were an important contributor to our sales growth.

Leveraging Our Import Program - Hardwoods boasts one of the most successful lines of import products in the industry thanks to a long-term strategy of identifying top-notch manufacturers, working closely with them to create high-quality, differentiated products, branding these products, and providing strong support for them. As an example, our line of Dragon Ply plywood has built a reputation for quality, consistency and exceptional value, and attracts an ever-larger following of customers each year. During 2011, we continued to grow our import sales as we introduced our proprietary products to existing and new customers, including customers of the Paxton business. We also continued to refine our import program with the addition of new vendors and improved freight routes.

Expanding Into High-Potential Geographic Markets - We were successful in identifying and making our move into larger North American markets that have significant growth potential, but where we previously had little or no representation. Thanks to the Paxton acquisition we have gained a strong presence in Kansas City, Cincinnati and Chicago, all of which have a sizeable base of secondary manufacturers, and we have expanded our presence in San Antonio and Denver. In other regions, our success in attracting industry experienced sales staff within high potential geographic markets is also helping us win additional market share and contributing to our stronger results.

Looking Ahead

Moving into 2012, we expect to continue improving our performance as we fully integrate the Paxton business and begin to expand our presence in our new geographic and end-use markets. While our outlook on market conditions remains cautious, we are confident of our ability to grow our business with added market share.

Financially, the Company is in excellent shape with a conservative financial position at the end of 2011 and $21 million of unused debt capacity available to finance future growth. Having completed our conversion to a corporation, we are also able to move forward under a more simplified business structure.

Overall our future looks promising. We have demonstrated that we can grow and succeed in challenging conditions and when a sustained economic recovery takes hold, we believe we will be well positioned to capitalize on it.

Based on our improving performance and our positive outlook, our Directors initiated a quarterly dividend in 2011, declaring total dividends of $0.04 per share in the second half of the year. Since the year end we have declared an additional quarterly dividend of $0.02 per share to be paid on April 30, 2012, to unitholders of record on April 20, 2012. It is a real pleasure to be providing this tangible return to you, our investors. We thank you for your continued confidence in Hardwoods, and we look forward to continuing to reward your trust in us in the year ahead.

Lance R. Blanco

President and Chief Executive Officer

Management’s Discussion and Analysis

March 9, 2012

This management’s discussion and analysis (“MD&A”) has been prepared by Hardwoods Distribution Inc. (“HDI” or the “Company”), formerly Hardwoods Distribution Income Fund (the “Fund”), as of March 9, 2012. This MD&A should be read in conjunction with the audited consolidated financial statements and accompanying notes (“Audited Financial Statements”) of the Company for the years ended December 31, 2011 and 2010. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with International Financial Reporting Standards (“IFRS”), including IFRS 1 “First Time Adoption of IFRS.” For comparative purposes, all financial amounts related to the quarters ended March 31, 2010, June 30, 2010, September 30, 2010, and for the quarter and year ended December 31, 2010, have been restated in accordance with IFRS. For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

In this MD&A, references to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, where interest is defined as net finance costs as per the consolidated statement of comprehensive income. In addition to profit or loss, we consider EBITDA to be a useful supplemental measure of a company’s ability to meet debt service and capital expenditure requirements, and we interpret trends in EBITDA as an indicator of relative operating performance.

EBITDA is not an earnings measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. Investors are cautioned that EBITDA should not replace profit or loss or cash flows (as determined in accordance with IFRS) as an indicator of our performance. Our method of calculating EBITDA may differ from the methods used by other issuers. Therefore, our EBITDA may not be comparable to similar measures presented by other issuers. For a reconciliation between EBITDA and profit or loss as determined in accordance with IFRS, please refer to the discussion of Results of Operations described in section 3.0 of this report.

This MD&A includes the following sections:

1.0 Executive Summary

1.1 Overview

The 2011 fiscal year brought a number of significant developments for Hardwoods, including our conversion from an income trust to a publicly traded corporation. The conversion was undertaken in response to changes to the taxation of income trusts which became effective January 1, 2011 and which made the income trust form of structure less advantageous for us. Concurrent with this move, we acquired the former non-controlling interest in our business at a discounted exchange ratio of 0.3791 common shares per exchangeable unit held by the non-controlling interest. Moving forward as Hardwoods Distribution Inc., we now own 100% of our underlying operating businesses, compared to 80% previously, and we are now operating with a corporate structure we believe is more beneficial for our shareholders in the long term.

Following our conversion to a corporation, our Directors instituted a quarterly dividend based on our improving financial performance and our positive outlook for the business. We declared dividends of $0.02 per share in the third and fourth quarters, and have since declared a dividend of $0.02 per share to be paid on April 30, 2012, to unitholders of record on April 20, 2012.

On September 19, 2011 we acquired the assets of the Frank Paxton Lumber Company ("Paxton") for $13.7 million. Paxton is a leading remanufacturer and distributor of premium hardwood lumber, millwork and architectural sheet goods, with five branches located in Chicago Illinois, Cincinnati Ohio, Denver Colorado, Kansas City Missouri and San Antonio Texas. The acquisition supported our business strategy by providing an immediate entry into three high-potential geographic markets where we did not previously have a presence, and by increasing our access to commercial and institutional markets through Paxton's expertise in architectural millwork. In addition, we have gained an expanded customer base for our existing lines of high-quality import products.

We financed the Paxton acquisition entirely with debt, taking advantage of our strong balance sheet to maximize accretion for our shareholders. Our financial position remains conservative even after making these changes with $66.8 million of net current assets financed by just $19.8 million of bank indebtedness at December 31, 2011. In May 2011, we renewed and extended the term of our revolving credit facility in the United States, and concurrent with the Paxton acquisition we increased the maximum available borrowing to US$30 million. In December

2011, we renewed and extended the term of our $15 million revolving credit facility in Canada. In both cases, we negotiated better rates and more flexible covenants.

Market conditions remained challenging in 2011 with a stronger Canadian dollar reducing the value of our US sales and continued weakness in the US economy limiting growth in hardwood demand. While combined single family and multi-family housing starts in the US climbed 3.4% to 606,900 starts in 2011, this was below industry expectations. The US non-residential construction sector had a weak start to the year, but ultimately posted modest gains on a year-over-year basis. However, remodeling activity declined as persistently high unemployment and concerns about the economy weakened consumer confidence. Secondary wood products manufacturers continued to be impacted by the weakness in demand, and many cabinet and wood component companies scaled back production during the year.

In Canada, market demand remained relatively flat in 2011, with modest growth in residential housing starts partially offset by weak demand from secondary manufacturers

On the supply side, hardwood lumber production climbed approximately 7.1% in the first half of 2011 according to the Hardwood Lumber Review, before falling off in the second half as weak demand failed to support the increased production levels. On average, pricing for hardwood lumber was flat to slightly weaker in 2011 compared to 2010, while pricing for panel products was predominantly flat.

Despite these challenges, Hardwoods' financial performance strengthened in 2011. Total sales increased 16.4%, gross profit was up by 18.2% and EBITDA grew 27.4% compared to 2010. Our improvement in EBITDA reflects our stronger sales and margin performance, and the acquisition of Paxton in September of 2011. Paxton contributed $0.2 million of EBITDA (net of $0.2 million of one-time transactions costs incurred to complete the acquisition) to our 2011 results. In addition to the incremental EBITDA provided by Paxton, comparison of our year-over-year EBITDA results is also impacted by one-time costs related to our conversion to a corporation in 2011, and the absence of a recovery from a lawsuit in the prior year period. Excluding these three items, the underlying improvement in Hardwoods business performance measured on an adjusted EBITDA basis is an increase of 46.3% year-over-year as outlined in the following table.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	Year ended December 31, 2011	Year ended December 31, 2011	$ Increase (Decrease)	% Increase (Decrease)
EBITDA as reported	$ 5,969	$ 4,687	$ 1,282	27.4%
Add (deduct):				
Corporate conversion expenses	571	-		
Proceeds received from litigation settlement	-	(320)		
Paxton EBITDA, net of one-time acquisition transaction costs	(151)	-		
Adjusted EBITDA	$ 6,389	$ 4,367	$ 2,022	46.3%

Given the weakness in market conditions, we believe most of our sales and EBITDA gains can be attributed to successful implementation of our business strategy. Our strategy focuses on increasing our end-market diversification with a stronger focus on the commercial and institutional construction markets; leveraging our import program to grow sales and build market share; and increasing our market share in larger, high-potential geographic markets.

Consistent with our practice of continually reviewing and optimizing our branch network, we closed our satellite branch in Red Deer, Alberta in December 2011. Sales personnel from the Red Deer branch were reassigned to our other branches and we are continuing service to customers in the Red Deer market through our existing branches in Edmonton and Calgary.

1.2 Outlook

Looking forward, we anticipate that the North American economy will continue to experience a slow recovery with very gradual improvement in the US residential construction markets and moderately stronger gains in non-residential construction markets. In Canada, growth in the domestic economy shows signs of slowing as global economic events reduce consumer confidence and the stronger Canadian dollar negatively impacts secondary manufacturers. Accordingly we anticipate only modest improvement from this market in 2012.

Given our expectation of continuing weak market conditions, we will continue to rely on our market expansion strategy to achieve growth and enhance profits. Specifically we will seek to:

- Further strengthen our presence in the commercial and institutional construction markets, including leveraging Paxton's products and capabilities to make a broader range of products available to customers in these sectors.
- Leverage our successful import program by continuing to seek out attractive new products and introducing our branded lines of import products to Paxton's base of customers.

- Solidify and further expand our presence in the large and promising new geographic markets we have entered via the Paxton acquisition, as well as target additional growth in selected existing markets.

We anticipate that operating expenses will increase further in 2012 as we implement our market expansion strategies, support increased sales activity and integrate the Paxton business. Key priorities in 2012 will be to complete the integration of the Paxton operations and to continue executing our business strategy, while tightly managing the business. We will also continue to seek out acquisition opportunities that further increase shareholder value.

2.0 Background

2.1 Company Overview

Hardwoods Distribution Inc. is a publicly traded company that holds, indirectly, a 100% ownership interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP (collectively, "Hardwoods" or the "Business"). The Company was formed in order to convert Hardwoods Distribution Income Fund (the "Fund") from an income trust structure to a corporation. The Fund was converted to a corporation by way of a plan of arrangement effective July 1, 2011.

Pursuant to the conversion, all outstanding units of the Fund held by unitholders were exchanged for common shares of Hardwoods Distribution Inc. on a one-for-one basis. All of the Class B limited partner units in the Fund's operating subsidiaries, which represented a 20% equity interest in Hardwoods and were held by the former owners of the Business, were exchanged for common shares of Hardwoods Distribution Inc. on the basis of 0.3793 common shares per Class B limited partner unit. As a result of these arrangements, Hardwoods Distribution Inc. owns 100% of Hardwoods, whereas previously the Fund owned 80% of the Business. The Fund has been wound up into HDI. Hardwoods Distribution Inc. is listed on the Toronto Stock Exchange and trades under the symbol HWD.

2.2 Business and Industry Overview

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, 2011 we operated 30 distribution facilities located in 16 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.

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 non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Our sheet goods and lumber are complementary product lines that are key products used by our customers in the manufacture of their end-use 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, remanufacturing materials to customer specifications where required, selling 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.

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.

The majority 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 hardwood 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.

3.0 Results of Operations

3.1Years Ended December 31, 2011 and December 31, 2010

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	For the year Ended December 31, 2011	For the year Ended December 31, 2010	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 230,019	$ 197,655	$ 32,364	16.4%
Sales in the US (US$)	*148,365*	*114,532*	*33,833*	29.5%
Sales in Canada	*83,271*	*79,653*	*3,618*	4.5%
Gross profit	40,620	34,357	6,263	18.2%
Gross profit %	*17.7%*	*17.4%*		
Operating expenses	(35,653)	(30,808)	4,845	15.7%
Profit from operating activities	4,967	3,549	1,418	40.0%
Add: Depreciation	1,002	1,138	(136)	-12.0%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 5,969	$ 4,687	$ 1,282	27.4%
Add (deduct):				
Depreciation	(1,002)	(1,138)	136	12.0%
Net finance cost	(569)	(1,028)	459	44.6%
Income tax recovery (expense)	1,667	(1,584)	3,251	205.2%
Profit for the period	$ 6,065	$ 937	$ 5,128	547.3%
Basic profit per share/unit	$ 0.40	$ 0.07		
Fully diluted profit per share/unit	0.39	0.06		
Average Canadian dollar exchange rate for one US dollar	0.989	1.030		

Sales

For the twelve months ended December 31, 2011, we increased total sales to $230.0 million, up 16.4% from $197.7 million in 2010. This performance improvement reflects a 19.4% increase in underlying sales activity, partially offset by a 3.0% decrease in sales due to the negative impact of a stronger Canadian dollar on foreign exchange conversion of our US-based sales.

The 19.4% increase in underlying sales was led by sales growth of US$33.8 million from our US operations. Approximately US$13.7 million of this US growth was provided by our new Paxton operations, acquired on September 19, 2011. The remaining US$20.1 million increase in sales reflects organic growth of 17.5% achieved by our US operating regions as we implemented our market expansion strategies. Introduced in late 2010, these new strategies focus on increasing our end-market diversification, continuing to leverage our import program, and selectively adding qualified sales representatives to our staff.

Sales in Canada increased by $3.6 million or 4.5% in 2011 compared to the prior year. Our Canadian operations also benefited from execution of our market expansion strategies, albeit at more modest growth rates. Canada has been a more stable market for hardwoods demand throughout the recent economic downturn.

Gross Profit

Gross profit for the year ended December 31, 2011 was $40.6 million, an increase of $6.3 million, or 18.2%, from $34.4 million in 2010. The improvement in gross profit primarily reflects the higher sales, but also the achievement of a higher gross profit margin during 2011. As a percentage of sales, gross profit increased to 17.7%, compared to 17.4% in 2010, reflecting product mix changes and lower inventory writedowns in 2011 compared to 2010. We view a gross profit margin of 17% to 18% as appropriate given competitive conditions at this point in the business cycle.

Operating Expenses

Operating expenses were $35.7 million in 2011, compared to $30.8 million the prior year, an increase of $4.8 million. The higher operating costs reflect an additional $2.6 million in operating costs from the acquired Paxton operations, $1.9 million in increased personnel and other operating costs incurred to support our market expansion strategies, and $0.8 million in non-recurring transactions costs related to our conversion to a corporation and our acquisition of Paxton. In addition, a $0.3 million litigation expense recovery that was received in the 2010 period was not repeated in the 2011 period. The increase in costs was partially offset by the $0.8 million positive impact of a stronger Canadian dollar on the conversion of expenses at our US operations. As a percentage of sales, 2011 operating expenses were 15.5% of sales, compared to 15.6% in 2010.

EBITDA

For the year ended December 31, 2011, we recorded EBITDA of $6.0 million, an increase of $1.3 million, or 27.4%, from $4.7 million in 2010. The increase in EBITDA reflects the $6.3 million increase in gross profit, partially offset by the $4.9 million increase in operating expenses before depreciation.

Excluding the impact of the Paxton acquisition and some non-recurring items (as outlined in section 1.1 of this report), adjusted EBITDA increased to $6.4 million in 2011 compared to $4.4 million in 2010, a 46.3% improvement in our underlying business performance.

Net Finance Income (Cost)

(in thousands of Canadian dollars)		Year ended December 31, 2011		Year ended December 31, 2010		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(537)	$	(709)	$	(172)
Amortization of deferred finance cost		(214)		(177)		37
Accretion of finance lease obligation		(91)		(94)		(3)
Change in fair value of non-controlling interest		(546)		(464)		82
Foreign exchange losses		-		(161)		(161)
Total finance expense		(1,388)		(1,605)		(217)
Finance income:						
Imputed interest on employee loans receivable		17		22		(5)
Interest on trade receivables and customer notes		487		555		(68)
Foreign exchange gain		315		-		315
Total finance income		819		577		242
Net finance cost	$	(569)	$	(1,028)	$	459

Net finance cost was $0.6 million in 2011, compared to a net finance cost of $1.0 million in 2010. As shown above, the $0.5 million change in net finance income primarily reflects two items: the $0.2 million decrease in interest on bank indebtedness, and a $0.5 million change in foreign exchange gains/losses between the periods.

The decrease in interest on bank indebtedness in 2011 compared to 2010 reflects lower interest rates paid on borrowings as a result of favorable renewals of our credit facilities during the year.

The change in foreign exchange gains/losses primarily relates to the impact of changes in the Canadian/US dollar exchange rate on translation for reporting purposes of intercompany debt held by, or with, our subsidiaries. During the year ended December 31, 2011, a weakening of the Canadian dollar resulted in a foreign exchange gain of $0.3 million on this intercompany debt. In contrast, the Canadian dollar strengthened during the comparative period in 2010 and resulted in a foreign exchange loss of $0.2 million.

Income Tax Recovery (Expense)

We recorded an income tax recovery of $1.7 million in 2011. This primarily reflects a $3.8 million deferred income tax recovery arising as a result of restructuring activities that occurred during the third quarter of 2011, including the exchange of the non-controlling interest described in section 2.1 of this report and financing transactions undertaken as part of the Paxton acquisition. This was partially offset by a $1.9 million utilization of future tax assets to offset taxable income generated during the period, and by $0.2 million of current income tax expense incurred during the year.

In the comparative 2010 period, we recorded an income tax expense of $1.6 million, primarily reflecting the use of future tax assets to offset taxable income generated during the period.

Profit for the Period

Profit increased to $6.1 million in 2011, from $0.9 million in 2010. This $5.1 million improvement reflects the $1.3 million increase in EBITDA, a $0.1 million decrease in depreciation, a $0.5 million decrease in net finance cost, and the $3.3 million increase in income tax recovery.

3.2 Three Months Ended December 31, 2011 and December 31, 2010

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)							
		For the three months Ended December 31, 2011		For the three months Ended December 31, 2010		$ Increase (Decrease)	% Increase (Decrease)
Total sales	$	63,899	$	46,392	$	17,507	37.7%
Sales in the US (US$)		*43,888*		*27,230*		*16,658*	61.2%
Sales in Canada		*19,350*		*18,826*		*524*	2.8%
Gross profit		11,315		7,689		3,626	47.2%
Gross profit %		*17.7%*		*16.6%*			
Operating expenses		(10,707)		(8,265)		2,442	29.5%
Profit from operating activities		608		(576)		1,184	-205.6%
Add: Depreciation		333		237		96	40.5%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$	941	$	(339)	$	1,280	-377.6%
Add (deduct):							
Depreciation		(333)		(237)		(96)	-40.5%
Net finance cost		(512)		(442)		(70)	-15.8%
Income tax recovery (expense)		(446)		38		(484)	1273.7%
Loss for the period	$	(350)	$	(980)	$	630	64.3%
Basic loss per share/unit	$	(0.02)	$	(0.07)			
Fully diluted loss per share/unit		(0.02)		(0.07)			
Average Canadian dollar exchange rate for one US dollar		0.981		1.0395			

Sales

For the three months ended December 31, 2011, total sales increased to $63.9 million, from $46.4 million during the same period in 2010. This $17.5 million or 37.7% increase reflects a 40.0% increase in underlying sales activity, partially offset by a 2.3% decrease in sales due to the negative impact of a stronger Canadian dollar.

In the fourth quarter of 2011, sales activity at our US operations, as measured in US dollars, increased $16.7 million compared to the same period last year. Sales from the Paxton business, acquired in September 2011, accounted for US$11.6 million of this sales growth. The remaining $5.1 million of US sales growth was generated by Hardwoods existing US branch network, reflecting the success of our market expansion strategies as described in section 1 of the MD&A. Sales in Canada increased by $0.5 million, or 2.8%, in the three months ended December 31, 2011 compared to the same period in the prior year.

Gross Profit

Gross profit for the fourth quarter increased to $11.3 million, from $7.7 million in the fourth quarter of 2010. The increase in gross profit primarily reflects higher sales, as well as an increase in gross profit margin. As a percentage of sales, gross profit increased to 17.7% in the three months ended December 31, 2011, from 16.6% in the same period in 2010. The lower gross profit margin realized in the fourth quarter of 2010 included certain valuation writedowns and other adjustments made to year-end inventory which were not repeated in the current year period.

Operating Expenses

Operating expenses increased $2.4 million to $10.7 million in the fourth quarter of 2011, from $8.3 million during the same period in 2010. Incremental expenses related to the newly acquired Paxton operations were the most significant factor in this increase. As a percentage of sales, operating expenses for the three months ended December 31, 2011 were 16.8% of sales, compared to 17.8% in the same period in 2010.

EBITDA

For the three months ended December 31, 2011, we recorded EBITDA of $0.9 million, compared to an EBITDA loss of $0.3 million during the same period in 2010. The $1.3 million increase in EBITDA reflects the $3.6 million increase in gross profit, partially offset by a $2.4 million increase in operating expenses before depreciation.

Income Tax Recovery (Expense)

Income tax expense for the three months ended December 31, 2011 was $0.4 million, comprised of $0.1 million of current taxes for estimated state taxes payable for the period, and $0.3 million utilization of future tax assets to offset taxable income generated during the period. In the comparative 2010 period, we recorded an income tax recovery of $38,000 against a small taxable loss generated during the period.

Loss for the Period

Loss for the three months ended December 31, 2011 was $0.4 million, compared to a loss of $1.0 million in 2010. The $0.6 million decrease in loss primarily reflects the $1.3 million increase in EBITDA, partially offset by a $0.1 million increase in depreciation expense, a $0.1 million increase in net finance expense, and a $0.5 million increase in income tax expense.

4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Total sales	$ 63,899	$ 57,372	$ 56,718	$ 52,030	$ 46,392	$ 50,559	$ 52,206	$ 48,498
Profit (loss)	$ (350)	$ 5,605	$ 1,511	$ (701)	$ (980)	$ (147)	$ 1,495	$ 569
Basic profit (loss) per share or unit	$ (0.02)	$ 0.37	$ 0.10	$ (0.05)	$ (0.07)	$ (0.01)	$ 0.10	$ 0.04
Fully diluted profit (loss) per share or unit	$ (0.02)	$ 0.36	$ 0.10	$ (0.05)	$ (0.07)	$ (0.01)	$ 0.10	$ 0.04
EBITDA	$ 941	$ 1,928	$ 2,542	$ 558	$ (339)	$ 1,399	$ 2,387	$ 1,240

The preceding table 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, changes in the carrying value of deferred income tax assets (which occurred in the three months ended September 30, 2011), and changes in the fair value of the non-controlling interest liability prior to July 1, 2011.

4.2 Annual Financial Information

(in thousands of dollars except per unit amounts)	Year ended December 31, 2011	Year ended December 31, 2010	Year ended December 31, 2009(1)
Total sales	$ 230,019	$ 197,655	$ 190,923
Profit (loss)	6,065	937	(10,240)
Basic profit (loss) per share/unit	0.40	0.07	(0.71)
Fully diluted profit (loss) per share/unit	0.39	0.06	(0.71)
Total assets	99,034	76,150	74,270
Total long-term financial liabilities	589	148,789	9,164
EBITDA	5,969	4,687	(1,154)
Dividends/distributions per share/unit relating to the period:			
Public shareholders/unitholders	$ 0.040	$ -	$ -
Retained interest unitholders	$ -	$ -	$ -
Dividends/distributions per share/unit	$ 0.040	$ -	$ -

(1) Year ended December 31, 2009 figures have not been restated to reflect the adoption of International Financial Reporting Standards

5.0 Liquidity and Capital Resources

5.1 Cash Flows from Operating, Investing and Financing Activities

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	Year ended December 31			Three months ended December 31		
	2011	2010	$ Change	2011	2010	$ Change
Cash provided by (used by) operating activities before changes in non-cash working capital	$ 8,157	$ 5,119	$ 3,038	$ 1,035	$ (65)	$ 1,100
Changes in non-cash working capital	(5,619)	(7,914)	2,295	2,640	4,633	(1,993)
Net cash provided by (used in) operating activities	2,538	(2,795)	5,333	3,675	4,568	(893)
Net cash provided by (used in) investing activities	(13,639)	872	(14,511)	(77)	81	(158)
Net cash provided by (used in) financing activities	11,450	1,503	9,947	(3,532)	(4,809)	1,277
Increase (decrease) in cash	349	(420)	769	66	(160)	226
Cash, beginning of period	43	463	(420)	326	203	123
Cash, end of period	$ 392	$ 43	$ 349	$ 392	$ 43	$ 349

Net cash provided by (used in) operating activities

For the year ended December 31, 2011, cash provided by operating activities was $2.5 million, compared to cash used in operating activities of $2.8 million during the same period in 2010. The $3.0 million increase in cash provided by operating activities, before changes in non-cash working capital, primarily reflects the $1.3 million increase in EBITDA discussed in section 3.1 of this report, and a $1.8 million cash receipt of an income tax refund received in the first quarter of 2011. Investments in non-cash working capital were $2.3 million lower in 2011 than in 2010. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2011, cash provided by operating activities decreased to $3.7 million, from $4.6 million during the same period in 2010. The $1.1 million increase in cash provided by operating activities before changes in non-cash working capital primarily reflects the $1.3 million increase in EBITDA discussed in section of 3.2 of this report. In addition, investment in non-cash working capital was higher by $2.0 million in the fourth quarter of 2011 compared to the same period in the prior year. An analysis of changes in working capital is provided in section 5.2 of this report.

Net cash provided by (used in) investing activities

Net cash used in investing activities increased by $14.5 million in 2011 compared to 2010. The increase is primarily attributed to the $13.7 million business acquisition of Paxton which occurred in the third quarter of 2011.

Prior to the Paxton acquisition, our capital expenditures were typically low as we leased all of our buildings and contracted out all freight delivery services. Capital expenditures that were made were principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Between 2007 and 2011, capital expenditures were lower than normal, reflecting the closure of 11 branch locations in response to weak economic conditions. These closures freed up additional forklift capacity and reduced our need to purchase replacement forklift equipment. We also decreased many of our discretionary cash outlays for capital items during this period as we emphasized cost reduction and cash conservation. As a result, our total capital expenditures amounted to just $0.1 million in the year ended December 31, 2010, and $0.4 million in 2011.

We also lease automobiles for the use of outside sales representatives and certain managers. For the year ended December 31, 2011, principle payments on automobile finance lease obligation were $0.7 million (2010 - $0.8 million).

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.

Our acquisition of Paxton on September 19, 2011 will increase our future maintenance capital expenditure needs. Unlike other Hardwoods distribution operations, the Paxton business requires ongoing investment in moulders and other light remanufacturing equipment. Paxton also buys trailers and leases tractor units for use in delivery of product to customers, whereas other Hardwoods operations contract out this freight delivery service to third-party carriers. We anticipate that additional annual capital expenditure requirements of approximately $0.5 million will be associated with maintaining the productive capacity of the Paxton business.

Net cash provided by financing activities

Net cash provided by financing activities increased by $9.9 million and $1.3 million respectively in the year and three months ended December 31, 2011, compared to the same periods in 2010. These increases primarily reflect increased bank indebtedness as we supported sales growth with higher working capital investment. We also increased borrowing to fund the Paxton acquisition which occurred in the third quarter of 2011.

5.2 Working Capital

Our business requires an ongoing investment in working capital, which we consider to be comprised of accounts receivable, inventory, and prepaid expenses, partially offset by provisions and short-term credit provided by suppliers in the form of accounts payable and accrued liabilities. We had working capital of $67.6 million at December 31, 2011, compared to $51.5 of working capital at December 31, 2010, with most of the increase attributable to the value of accounts receivable and inventory that we purchased with the Paxton acquisition, along with increased investment in accounts receivable and inventory to support our growth in sales.

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 twelve months and three months ended December 31, 2011 and 2010 is provided below.

(in thousands of Canadian dollars) Source (use) of funds	Year ended December 31, 2011	Year ended December 31, 2010	Three months ended December 31, 2011	Three months ended December 31, 2010
Accounts receivable	$ (2,237)	$ (2,457)	$ 4,295	$ 3,552
Inventory	(5,110)	(4,436)	969	2,470
Prepaid expenses	(121)	(290)	(67)	(249)
Provisions	(444)	85	(360)	369
Accounts payable and accrued liabilities	2,293	(816)	(2,197)	(1,509)
Decrease (increase) in non-cash operating working capital	$ (5,619)	$ (7,914)	$ 2,640	$ 4,633

Continued compliance with financial covenants under our credit facilities is important to ensure that we have adequate financing available to meet our working capital requirements. The terms of our revolving credit facilities are addressed in section 5.3 of this report.

5.3 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)				
		As at December 31, 2011		As at December 31, 2010
Cash and cash equivalents	$	(392)	$	(43)
Bank indebtedness		19,794		6,745
Net Debt	$	19,402	$	6,702
Shareholders' equity/Unitholders' deficit		71,899		(83,557)
Fund unit liability		-		144,366
Total Capitalization	$	91,301	$	67,511
Net debt to total capitalization		21.3%		9.9%

The Company considers its capital to be bank indebtedness (net of cash), shareholder's equity, and, prior to conversion of the Fund to a corporation, the Fund unit liability. As shown above, our net debt balance increased by $12.7 million to $19.4 million at December 31, 2011, from $6.7 million at December 31, 2010. This increase in net debt primarily reflects the use of our bank lines to finance the $13.7 million acquisition of Paxton. Overall net debt compared to total capitalization stood at 21.3% as of December 31, 2011, compared to 9.9% at December 31, 2010.

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, and in the case of the Canadian credit facility, to also make capital contributions to our US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is, from time-to-time, limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Company. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at December 31, 2011 is provided in the following table. In the fourth quarter of 2011 we renewed our Canadian credit facility which provided our Canadian operating subsidiary with committed revolving credit extending to August 7, 2016.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	$15 million	$ 30.5 million (US$30 million)
Credit facility expiry date	August 7, 2016	May 26, 2015
Available to borrow	$ 11.8 million	$ 28.5 million (US$ 28.0 million)
Credit facility borrowings	$ 4.9 million	$ 14.1 million (US$ 13.9 million)
Unused credit facility available	$ 6.9 million	$ 14.4 million (US$ 14.1 million)
Financial covenants:		
	Covenant does not apply when the unused credit facility available exceeds $2.0million, which it did at December 31, 2011	Covenant does not apply when the unused credit facility available exceeds US$2.5million, which it did at December 31, 2011

The terms of the agreements with our lenders provide that distributions from our subsidiaries cannot be made in the event that our subsidiaries are not compliant with their financial covenants, which would in turn restrict the ability of the Company to pay dividends to its shareholders. As shown in the preceding table, our operating subsidiaries were compliant with all required credit ratios as at December 31, 2011. Accordingly there were no restrictions on dividends 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 2016 and May 2015, respectively. We do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn on our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and our cash generating capacity going forward. When making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities. We do not target a specific financial leverage amount. We believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy.

5.4 Contractual Obligations

The table below sets forth our contractual obligations as at December 31, 2011. These obligations relate to leases on various premises and automobiles, and become due in the fiscal years indicated.

(in thousands of Canadian dollars)						
Total	2012	2013	2014	2015	2016	2017 and thereafter
$ 19,108	$ 5,954	$ 5,003	$ 4,204	$ 2,638	$ 1,224	$ 85

5.5 Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

5.6 Financial Instruments

Financial assets include cash and cash equivalents, current and long-term receivables and income taxes recoverable which are measured at amortized cost. Financial liabilities include bank indebtedness, accounts payable and accrued liabilities, and finance lease obligations which are measured at amortized cost. The carrying values of our 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 and finance lease obligations are not expected to differ materially from carrying value given the interest rates being charged. The carrying values of the credit facilities approximate their fair values due to the existence of floating market based interest rates.

5.7 Share Data

As at March 9, 2012 we had 16,095,343 common shares issued and outstanding. In addition at March 9, 2012 we had 104,856 performance share grants and 219,442 restricted share grants outstanding under the terms of our long-term incentive plan. The performance and restricted shares can be settled in common shares of the Company issued from treasury, shares purchased by us in the market, or in an amount of cash equal to the fair value of our common shares, or any combination of the foregoing. The restricted and performance shares vest over periods of up to three years and we intend to issue common shares from treasury to settle these obligations as they vest. The number of common shares to be issued to settle the performance share grants will be dependent upon the Company's financial performance over the vesting period.

5.8 Dividends

In the fourth quarter of 2011, we declared a quarterly dividend of $0.02 per share, which was paid on January 31, 2012 to shareholders of record as at January 20, 2012. On March 9, 2012 we declared a quarterly dividend of $0.02 per share, payable on April 30, 2012 to shareholders of record as at April 20, 2012.

6.0 Related Party Transactions

Related parties refers to affiliates of the previous owners of the Business who retained up until July 1, 2011, a 20% interest in Hardwoods through ownership of Class B Hardwoods LP units and Class B Hardwoods USLP units, respectively, and who subsequent to July 1, 2011 retain an interest in the Company's common shares and who continue to have representation on our board of directors. For the year ended December 31, 2011, sales of $0.3 million were made to related parties, and the subsidiaries of the Company purchased $0.1 million from related parties. These sales and purchases took place at prevailing market prices.

7.0 Critical Accounting Estimates & Adoption of Changes in Accounting Policies

7.1 Critical Accounting Estimates

The preparation of financial statements in accordance with IFRS 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.

Deferred 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 us. These estimates and assumptions can have a material impact upon the amount of deferred income tax assets and liabilities that we recognize.

Fair Value of Non-Controlling Interest: Prior to conversion of the Fund to a corporation, we were required to estimate the fair value of the non-controlling interest liability at each reporting date. Estimating the value of the non-controlling interest required significant judgment, and we considered, amongst other things, the value of Fund Units as traded on the Toronto Stock Exchange, and the relative economic interests of non-controlling interests compared with Fund Units, including the terms of the subordination arrangements that were in place with the non-controlling interest. As the changes in fair value determined at each reporting date were recorded in profit or loss for the period, our estimates of fair value may have a material impact upon the Fund's reported profit or loss.

Allocation of Purchase Price related to the Acquisition of Paxton: The acquisition of Paxton is accounted for as a business combination, which requires the consideration paid to be allocated to the identifiable assets acquired at their relative fair values. The assumptions made in determining the fair value of the assets acquired may impact the allocation of the purchase price in the financial statements.

7.2 Adoption of New Accounting Standards

Effective January 1, 2011 Canadian publicly listed entities were required to prepare their financial statements in accordance with IFRS. Due to the requirement to present comparative financial information, the effective transition date is January 1, 2010. The Audited Financial Statements include in Note 20 reconciliations of the previously disclosed comparative period financial statements prepared in accordance with Canadian generally accepted accounting principles reconciled to IFRS.

We note that the standard-setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies that we have selected. The impact of any new

IFRS standards or interpretations will be evaluated as they are drafted and published. New standards and interpretations that have been identified but have yet to be adopted are:

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9 - *Financial Instruments,* which is the first step in its project to replace IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 establishes the measurement and classification of financial assets. Under IFRS 9, financial assets are measured either at fair value through earnings or at amortized cost if certain conditions are met. The effective date of this standard is January 1, 2015, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2015. We are currently evaluating the impact of IFRS 9 on our financial statements.

IFRS 10 – Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 – *Consolidated Financial Statements*. The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. The adoption of IFRS 10 is not expected to have a significant impact on our consolidated financial statements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12 – *Disclosure of Interests in Other Entities*. The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. We are currently evaluating the impact of IFRS 12 on our financial statements.

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13 – *Fair Value Measurement*. The objective of IFRS 13 is to define fair value, set out in a single IFRS framework for measuring fair value, and establish disclosure requirements regarding fair value measurements. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. We are currently evaluating the impact of IFRS 13 on our financial statements.

8.0 Risks and Uncertainties

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of in our Annual Information Form dated March 9, 2012 which is available to readers along with other disclosure information at www.sedar.com.

9.0 Disclosure Controls and Procedures and Internal Control over Financial Reporting

Our management, under the supervision of the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), is responsible for establishing and maintaining adequate disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"). Any systems of DC&P and ICFR, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to information required to be disclosed and financial statement preparation and presentation.

Our management has limited the scope of its design and testing of DC&P and ICFR to exclude controls, policies and procedures of Paxton, which we acquired on September 19, 2011. For the year ended December 31, 2011, Paxton accounted for $13.7 million of our consolidated revenues. Paxton accounted for $0.2 million of our income before discontinued operations and extraordinary items and $0.1 million of our net income for the year ended December 31, 2011, net of transactions costs associated with completing the acquisition. As at December 31, 2011, Paxton accounted for $10.1 million of our current assets, $4.0 million of our non-current assets, $0.5 million of our current liabilities and nil of our non-current liabilities.

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, we carried out an evaluation of the effectiveness of our DC&P as of December 31, 2011. The evaluation was carried out under the supervision of, and with the participation of the CEO and

CFO. Based on this evaluation, the CEO and CFO concluded that our DC&P were effective as of December 31, 2011.

As required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, we carried out an evaluation of the effectiveness of our ICFR as of December 31, 2011. 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 this evaluation, the CEO and CFO concluded that our ICFR were effective as of December 31, 2011.

There have been no changes in our ICFR during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our ICFR.

10.0 Note Regarding Forward Looking Information

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

The forward-looking information in this MD&A includes, but is not limited to: our belief that given the weakness in market conditions, most of our sales and EBITDA gains can be attributed to successful implementation of our business strategy; that we anticipate that the North American economy will continue to experience a slow recovery with very gradual improvement in the US residential construction markets and moderately stronger gains in non-residential construction markets; our belief that in Canada, growth in the domestic economy shows signs of slowing as global economic events reduce consumer confidence and the stronger Canadian dollar negatively impacts secondary manufacturers, such that we anticipate only modest improvement from this market in 2012; that given our expectation of continuing weak market conditions, we will continue to rely on our market expansion strategy to achieve growth and enhance profits; that we anticipate that operating expenses will increase further in 2012 as we implement our market expansion strategies, support increased sales activity and integrate the Paxton business; that our key priorities in 2012 will be to complete the integration of the Paxton operations and to continue executing our business strategy, while tightly managing the business;

our intention to continue to seek out acquisition opportunities that further increase shareholder value; our estimate that at least 50% of our products are used in new residential construction, in the form of cabinets, mouldings, custom finishing, and home furniture, and that 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; our belief that 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; our belief we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment; our perspective that our acquisition of Paxton will increase our future maintenance capital expenditure needs; that we anticipate additional annual capital expenditure requirements of approximately $0.5 million will be associated with maintaining the productive capacity of the Paxton business; that 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 2016 and May 2015, respectively; that we do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity; that the amount of bank debt that will actually be drawn on our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and our cash generating capacity going forward; that when making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities; that we do not target a specific financial leverage amount; and that we believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy.

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.

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. 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 Company 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 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 Directors. 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 Company.

Lance R. Blanco
President and Chief Executive Officer

Independent Auditor's Report

To the Shareholders of Hardwoods Distribution Inc.

We have audited the accompanying consolidated financial statements of Hardwoods Distribution Inc., which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010, and January 1, 2010, the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years ended December 31, 2011 and December 31, 2010, 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 International Financial Reporting Standards, 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 consolidated financial position of Hardwoods Distribution Inc. as at December 31, 2011, December 31, 2010, and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants
March 9, 2012

Vancouver, Canada

HARDWOODS DISTRIBUTION INC.

Consolidated Statements of Financial Position
(Expressed in thousands of Canadian dollars)

	Note	December 31, 2011	December 31, 2010	January 1, 2010
Assets				
Current assets:				
Cash		$ 392	$ 43	$ 463
Accounts receivable	7	33,263	26,656	25,585
Income taxes recoverable		7	1,820	2,286
Inventories	8	39,015	27,441	23,901
Prepaid expenses		902	768	878
Total current assets		73,579	56,728	53,113
Non-current assets:				
Long-term receivables	7	1,394	1,515	1,883
Property, plant and equipment	9	6,483	2,444	2,567
Deferred income taxes	15	17,556	15,463	17,417
Intangible asset		22	-	-
Total non-current assets		25,455	19,422	21,867
Total assets		$ 99,034	$ 76,150	$ 74,980
Liabilities				
Current liabilities:				
Bank indebtedness	10	$ 19,794	$ 6,745	$ 4,564
Accounts payable and accrued liabilities		5,474	3,098	4,035
Income taxes payable		50	41	94
Provisions	11	90	301	385
Finance lease obligation	12	817	733	885
Dividend payable	5	321	-	-
Total current liabilities		26,546	10,918	9,963
Non-current liabilities:				
Provisions	11	7	240	474
Finance lease obligation	12	582	722	267
Non-controlling interests	13	-	3,197	2,733
Long term incentive plan liability	14(b)	-	264	-
Fund Units	14(a)	-	144,366	144,100
Total non-current liabilities		589	148,789	147,574
Total liabilities		27,135	159,707	157,537
Shareholders' equity/Unitholders' deficit				
Share capital	14(a)	44,061	-	-
Contributed surplus		105,097	-	-
Deficit		(76,196)	(81,620)	(82,557)
Accumulated other comprehensive loss		(1,063)	(1,937)	-
Shareholders' equity/Unitholder's deficit		71,899	(83,557)	(82,557)
Total shareholders' equity and liabilities		$ 99,034	$ 76,150	$ 74,980

The accompanying notes are an integral part of these consolidated financial statements.

Approved on behalf of the board of directors:

(Signed) GRAHAM M. WILSON Director **(Signed) TERRY M. HOLLAND** Director

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2011 and 2010

	Note		2011		2010
Sales		$	230,019	$	197,655
Cost of sales			(189,399)		(163,298)
Gross profit			40,620		34,357
Operating expenses:					
Selling and distribution			(27,570)		(24,268)
Administration			(7,240)		(6,857)
Other (expense) recovery			(843)		317
			(35,653)		(30,808)
Profit from operating activities			4,967		3,549
Finance expense	16		(1,388)		(1,605)
Finance income	16		819		577
Net finance costs			(569)		(1,028)
Profit before income taxes			4,398		2,521
Income tax recovery (expense):					
Current	15		(158)		(104)
Deferred	15		1,825		(1,480)
			1,667		(1,584)
Profit for the year			6,065		937
Other comprehensive income (loss):					
Exchange differences translating foreign operations			874		(1,937)
Total comprehensive income (loss) for the period		$	6,939	$	(1,000)
Basic profit per share/unit	14(c)	$	0.40	$	0.07
Diluted profit per share/unit	14(c)	$	0.39	$	0.06

The accompanying notes are an integral part of these consolidated financial statements.

HARDWOODS DISTRIBUTION INC.

Consolidated Statements of Changes in Shareholders' Equity
(Expressed in thousands of Canadian dollars)

Years ended December 31, 2011 and 2010

	Note	Share capital	Contributed surplus	Accumulated other comprehensive loss - translation reserve	Deficit	Total
Balance at January 1, 2010		$ -	$ -	$ -	$ (82,557)	$ (82,557)
Profit for the year			-	-	937	937
Translation of foreign operations		-	-	(1,937)	-	(1,937)
Balance at December 31, 2010		$ -	$ -	$ (1,937)	$ (81,620)	$ (83,557)
Shares issued on conversion	14(a)	$ 43,759	$ 104,573	$ -	$ -	$ 148,332
Transferred from LTIP liability July 1, 2011	14(b)	-	436	-	-	436
Share based compensation expense since July 1, 2011		-	357	-	-	357
Share-based compensation tax adjustment		-	33	-	-	33
Shares issued pursuant to LTIP since July 1, 2011		302	(302)	-	-	-
Profit for the year		-	-	-	6,065	6,065
Dividends declared		-	-	-	(641)	(641)
Translation of foreign operations		-	-	874	-	874
Balance at December 31, 2011		$ 44,061	$ 105,097	$ (1,063)	$ (76,196)	$ 71,899

The accompanying notes are an integral part of the consolidated financial statements.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2011 and 2010

	Note	2011	2010
Cash flows from operating activities:			
Profit for the year		$ 6,065	$ 937
Adjustments for:			
Depreciation	9	1,002	1,138
Gain on sale of property, plant and equipment	9	(81)	(109)
Non-cash employee incentive program	14(b)	750	531
Income tax (recovery) expense		(1,667)	1,584
Net finance costs		569	1,028
Interest received		487	555
Interest paid		(636)	(791)
Income taxes paid		(141)	(77)
Income tax refunds received		1,809	323
		8,157	5,119
Changes in non-cash working capital:			
Accounts receivable		(2,237)	(2,457)
Inventories		(5,110)	(4,436)
Prepaid expenses		(121)	85
Provisions		(444)	(290)
Accounts payable and accrued liabilities		2,293	(816)
		(5,619)	(7,914)
Net cash provided by (used in) operating activities		2,538	(2,795)
Cash flow from financing activities:			
Increase in bank indebtedness		12,471	2,265
Principle payments on finance lease obligation		(702)	(762)
Dividends paid to shareholders	5	(319)	-
Net cash provided by financing activities		11,450	1,503
Cash flow from investing activities:			
Additions to property, plant and equipment		(379)	(106)
Proceeds on disposal of property, plant and equipment		112	220
Business acquisition	4	(13,693)	-
Payments received on long-term receivables		321	758
Net cash provided by (used in) investing activities		(13,639)	872
Increase (decrease) in cash		349	(420)
Cash, beginning of period		43	463
Cash, end of period		$ 392	$ 43

The accompanying notes are an integral part of the consolidated financial statements.

1. Nature of operations and the Arrangement:

Hardwoods Distribution Inc. (the "Company") is incorporated under the Canada Business Corporations Act. The Company is the successor to Hardwoods Distribution Income Fund (the "Fund") following the completion of the conversion of the Fund (the "Reorganization") from an income trust structure by way of a court-approved plan of arrangement under the Canada Business Corporation Act on July 1, 2011 (the "Arrangement").

Pursuant to the Arrangement holders of units of the Fund received common shares ("Common Shares") of the newly created corporation, Hardwoods Distribution Inc., on a one-for-one basis. Concurrently with the Arrangement, holders of the Special Voting Units of the Fund and corresponding Class B limited partner units of Hardwoods Specialty Products LP and Hardwoods Specialty Products USLP (together the "Exchangeable Units") directly or indirectly exchanged each Exchangeable Unit for 0.3793 Common Shares of the Company. Upon completion of the Arrangement, the Company holds all the assets previously held by the Fund and wholly owns Hardwoods Specialty Products LP and Hardwoods Specialty Products USLP. Hardwoods Specialty Products LP and Hardwoods Specialty Products USLP are the primary operating entities of the Company in Canada and the US, respectively. As a result of the Arrangement, the Company became the sole unitholder of the Fund's outstanding Units. On July 1, 2011 the Fund was dissolved and all of its assets were transferred to, and all of its liabilities were assumed by, the Company as the Fund's sole unitholder on that date.

The Arrangement resulted in the Company having 15,970,514 Common Shares issued and outstanding as of July 1, 2011, and the Common Shares trading on the Toronto Stock Exchange under the symbol "HWD." The Company's principal office is located at #306, 9440 202nd Street, Langley, British Columbia V1M 4A6. Taken together, Hardwoods Specialty Products LP and Hardwoods Specialty Products USLP operate a network of 30 distribution centers in Canada and the US engaged in the wholesale distribution of hardwood lumber and related sheet goods and specialty products.

The Reorganization has been accounted for on a continuity of interest basis and accordingly, the consolidated financial statements reflect the financial position, results of operations and cash flows as if the Company had always carried on the business formerly carried on by the Fund, with all assets and liabilities transferring to the Company at their respective carrying values on July 1, 2011. Costs of $0.6 million associated with the Reorganization have been expensed as incurred and are included in other expenses in the statement of comprehensive income.

Information herein with respect to Hardwoods Distribution Inc. includes information in respect of the Fund prior to completion of the Reorganization to the extent applicable unless the context otherwise requires. In addition, references to "common shares" and "shares" should be read as references to "units" for periods prior to July 1, 2011.

2. Basis of preparation:

(a) Statement of compliance:

These consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. These are the Company's first consolidated annual financial statements prepared in accordance with IFRS and IFRS 1, First Time Adoption of International Financial Reporting Standards ("IFRS 1"), has been applied. The preparation of these consolidated financial statements resulted in changes to the accounting policies adopted by the Company in its previous annual financial statements, which were prepared under Canadian generally accepted accounting principals ("GAAP") as issued by the Canadian Institute of Chartered Accountants. An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Company is explained in note 20 to these consolidated financial statements.

The consolidated financial statements were authorized for issue by the Board of Directors on March 9, 2012.

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis, except for the non-controlling interest's exchangeable unit liability and long-term incentive plan liability which were recorded in the statement of financial position at their estimated fair value until July 1, 2011.

(c) Functional and presentation currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information presented in the financial statements, with the exception of per share/unit amounts, has been rounded to the nearest thousand.

(d) Use of estimates and judgment:

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual amounts may differ from the estimates applied in the preparation of these financial statements.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

2. Basis of preparation (continued):

(d) Use of estimates and judgment (continued)

Information about significant areas of estimation uncertainty and critical judgments in applying policies that have the most significant effect on the amounts recognized in the consolidated financial statements is included in the following notes:

- Note 4 – the estimate of fair values and pro forma sales and profitability associated with the Frank Paxton business acquisition;
- Note 7 – the determination of the allowance for credit loss;
- Note 11 – the determination and measurement of provisions and contingencies;
- Note 12 – the determination and measurement of finance lease obligations;
- Note 13 – the valuation of the non-controlling interest exchangeable units; and
- Note 15 – the valuation of deferred income taxes and utilization of tax loss carry forwards.

3. Significant accounting policies:

The significant accounting policies that have been used in the preparation of these consolidated financial statements are summarized below. These accounting policies have been applied consistently by the Company and its subsidiaries to all periods presented in these financial statements and in preparing the opening IFRS statement of financial position at January 1, 2010, as required by IFRS 1.

(a) Principles of consolidation:

These consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

Wholly owned subsidiaries of the Company are Hardwoods Specialty Products ULC, Hardwoods LP, Hardwoods GP, Hardwoods USLP, Hardwoods USGP, Paxton Hardwoods LLC, and Hardwoods Specialty Products (Washington) Corp.

On January 1, 2012 Hardwoods Specialty Products ULC amalgamated with the Company.

(b) Foreign currencies:

Foreign currency transactions

Foreign currency transactions are translated into the respective functional currencies of the Company and its subsidiaries, using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate in effect at the financial statement date. The foreign currency gain or loss on monetary items is the difference between the amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in the foreign currency translated at the exchange rate at the end of the period. Such exchange gains or losses arising from translation are recognized in profit and loss for the reporting period.

3. Significant accounting policies (continued):

(b) Foreign currencies (continued):

Translation of foreign operations for consolidation

For purposes of consolidation, the assets and liabilities of foreign operations with functional currencies other than the Canadian dollar are translated to Canadian dollars using the rate of exchange in effect at the financial statement date. Revenue and expenses of the foreign operations are translated to Canadian dollars at exchange rates at the date of the transactions with the average exchange rate for the period being used for practical purposes. Foreign currency differences resulting from translation of the accounts of foreign operations are recognized directly in other comprehensive income and are accumulated in the translation reserve as a separate component of shareholders equity.

Gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are consider in substance to form part of the net investment in a foreign operation and are recognized directly in other comprehensive income in the cumulative amount of foreign currency translation differences.

When a foreign operation is disposed of, the amount of the associated translation reserve is fully transferred to profit or loss.

(c) Segment reporting:

Operating segments are based on the information about the components of the entity that management uses to make decisions about operating matters. The subsidiaries of the Company engage in one main business activity, hence operating segment information is not provided. Geographical segment information is provided by country of operations in note 17.

(d) Revenue recognition:

Revenue from the sale of hardwood lumber, sheet goods and specialty products is measured by reference to the fair value of consideration received or receivable by the operating subsidiaries of the Company, excluding taxes, rebates, and trade discounts. Revenue is recognized when persuasive evidence exists that the Company has transferred to the buyer the significant risks and rewards of ownership of the goods supplied, recovery of the consideration is probable and the revenue and associated costs can be measured reliably. Significant risks and rewards are generally considered to be transferred when the customer has taken undisputed delivery of the goods.

(e) Finance costs and income:

Finance cost is primarily comprised of interest of the Company’s operating line of credit, changes in the fair value of the non-controlling interest’s exchangeable units prior to July 1, 2011, and the unwinding of the discount on the Company’s finance lease obligations. Finance costs also include the amortization of costs incurred to obtain credit facilities in Canada and the United States. Interest on bank indebtedness and accretion of the lease obligation is expensed using the effective interest method. Deferred finance costs are amortized on a straight-line basis over the term of the related credit facility as an effective interest rate method is not practicable given the revolving debt balances. The change in fair value of the non-controlling interest units was expensed in the period in which they were incurred.

3. Significant accounting policies (continued):

(e) Finance costs and income (continued):

Finance income is comprised of interest earned on cash balances, imputed interest income on employee loans receivable, and interest charged and received or receivable on trade accounts receivable and notes receivable from customers. Finance income is recognized as it accrues using the effective interest method.

Foreign exchange gains and losses are reported on a net basis as either finance income or finance expense.

(f) Inventories:

Inventories are measured at the 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. Net realizable value is the estimated selling price in the ordinary course of business less any applicable selling expenses

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.

(g) Property, plant and equipment:

Items of property, plant and equipment are carried at acquisition cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Depreciation is provided at straight-line rates sufficient to depreciate the cost of the assets over their estimated useful lives less estimated residual value as follows:

Assets	Estimated useful life
Furniture and equipment	3 to 10 years
Mobile equipment	up to 15 years
Leased vehicles	Over the term of the lease
Leasehold improvements	Over the term of the lease

Leased assets are depreciated over the lease term unless the useful life is shorter than the lease term. If a component of an asset has a useful life that is different from the remainder of the asset, then that component is depreciated separately.

Depreciation methods, material residual value estimates and estimates of useful lives are reviewed at each financial year end and updated as required.

Gains or losses arising on the disposal of property, plant and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss at the time of the disposal.

3. Significant accounting policies (continued):

(h) Impairment:

Non-Financial assets

The carrying values of the Company's non-financial assets are reviewed at each reporting date to assess whether there is any indication of impairment. If any such indication is present, then the recoverable amount of the assets is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purposes of impairment testing, assets are grouped at the lowest levels that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit and loss. Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment charge is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Company on terms that the Company would not consider otherwise, or indications that a debtor or issuer will enter bankruptcy.

The Company considers evidence of impairment for financial assets, and in particular receivables, at both a specific asset and collective level.

All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics. In assessing collective impairment of receivables, management considers the aging of receivables, the nature and extent of security held, historical trends of default, and current economic and credit conditions to estimate impairments.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

3. Significant accounting policies (continued):

(h) Impairment (continued)

Financial assets (continued)

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss is recognized. For financial assets measured at amortized cost, this reversal is recognized in profit or loss.

(i) Financial instruments:

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

Financial assets and financial liabilities are measured initially at fair value plus transactions cost, except for financial assets and financial liabilities carried at fair value through profit or loss, which are measured initially at fair value.

The classification and measurement of the Company's financial instruments is disclosed in note 6 of these consolidated financial statements.

Cash and cash equivalents

The Company 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.

Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition these are measured at amortized cost using the effective interest method, less provision for impairment. Discounting is omitted where the effect of discounting is immaterial.

Individual receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Impairment of trade receivables are presented within "selling and distribution expenses".

Loans receivable consist of notes from customers discounted using the effective interest method, and loans to employees for relocation costs, also discounted. Interest revenue on these loans is recognized within "finance income".

3. Significant accounting policies (continued):

(i) Financial instruments (continued):

Financial liabilities

Loans and payables are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. After initial recognition these liabilities are measured at amortized cost using the effective interest method, less provision for impairment. Discounting is omitted where the effect of discounting is immaterial. The revolving bank line of credit is not discounted; rather, actual interest accrued based on the daily balances is recorded each month.

(j) Income taxes:

Income tax expense comprises current and deferred tax and is recognized in profit and loss. Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of the previous years.

Deferred tax is recognized by the Company and its subsidiaries in respect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss; differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and taxable differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset only when the Company has a legally enforceable right and intention to set off current tax assets and liabilities from the same taxation authority.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(k) Leases:

Automobile leases for which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments and a lease obligation is recorded equal to the present value of the minimum lease payments.

Subsequent to initial recognition, the leased asset is accounted for in accordance with the accounting policy applicable to that asset. Minimum lease payments made under finance leases are apportioned between finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

3. Significant accounting policies (continued):

(k) Leases (continued):

Other leases are operating leases and as such the leased assets are not recognized in the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(l) Provisions and contingent liabilities:

Provisions are recognized in the statement of financial position when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

The Company's provisions include amounts related to the settlement of litigation and onerous contracts where the expected benefits to be derived from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

(m) Basic and diluted profit per Share/Unit:

The Company presents basic and diluted profit per share/unit data for its outstanding common shares/units. Basic profit per share/unit attributable to shareholders is calculated by dividing profit by the weighted average number of common shares/units outstanding during the reporting period. Diluted profit per unit is determined by adjusting the profit attributable to common shareholders/unitholders and the weighted average number of common shares/units outstanding for the effects of all dilutive potential common shares/units.

(n) Share based compensation:

The Company has a share based long-term incentive plan as described in note 14(b). The Company is accounting for the Restricted Shares and Performance Shares as employee equity settled awards whereby the compensation cost is determined based on the grant date fair value and is recognized as an expense with a corresponding increase to contributed surplus in equity over the period that the employees unconditionally become entitled to payment. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met.

Prior to July 1, 2011 the Fund accounted for Restricted Units and Performance Units as cash settled awards with an expense and corresponding liability being recorded based on the fair value of the share-based awards at each reporting date being recognized over the period that the employees unconditionally became entitled to payment.

3. Significant accounting policies (continued):

(o) New standards and interpretations yet to be adopted:

The following summarizes relevant new standards and interpretations that are effective for future annual periods.

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9 - *Financial Instruments*, which is the first step in its project to replace IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 establishes the measurement and classification of financial assets. Under IFRS 9, financial assets are measured either at fair value through earnings or at amortized cost if certain conditions are met. The effective date of this standard is January 1, 2015, but early adoption is permitted. The Company will apply this standard to its financial statements beginning on January 1, 2015. The Company is currently evaluating the impact of IFRS 9 on its financial statements.

IFRS 10 – Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 – *Consolidated Financial Statements*. The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The effective date of this standard is January 1, 2013, but early adoption is permitted. The Company will apply this standard to its financial statements beginning on January 1, 2013. The adoption of IFRS 10 is not expected to have a significant impact on the Company's consolidated financial statements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12 – *Disclosure of Interests in Other Entities*. The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The effective date of this standard is January 1, 2013, but early adoption is permitted. The Company will apply this standard to its financial statements beginning on January 1, 2013. The Company is currently evaluating the impact of IFRS 12 on its financial statements..

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13 – *Fair Value Measurement*. The objective of IFRS 13 is to define fair value, set out in a single IFRS framework for measuring fair value, and establish disclosure requirements regarding fair value measurements. The effective date of this standard is January 1, 2013, but early adoption is permitted. The Company will apply this standard to its financial statements beginning on January 1, 2013. The Company is currently evaluating the impact of IFRS 13 on its financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

4. Business acquisition:

On September 19, 2011 a subsidiary of the Company purchased certain assets of Frank Paxton Lumber Company ("Paxton") with the intention to continue operations of the business. Paxton is a US based remanufacturer and distributor of hardwood lumber, millwork and sheet goods, with branch operations in San Antonio, Denver, Cincinnati, Kansas City and Chicago. The Company purchased the trade accounts receivable, inventory, and property, plant and equipment of Paxton for cash consideration of $13.7 million (US$13.9 million) and hired Paxton's employees to continue operating the business. As part of the agreement certain accounts receivable totaling $0.2 million not subsequently collected were returned to the seller with the amount recorded at December 31, 2011 as a short term other receivable.

The acquisition has been accounted for as a business combination. The allocation of the purchase price to identified assets acquired is as follows:

Trade accounts receivable	$	3,972
Inventory		5,769
Property, plant and equipment		3,931
Intangible asset		21
Cash paid		13,693
Receivable adjustment		(179)
Net investment	$	13,514

Costs associated with the acquisition of $0.2 million have been expensed as incurred and are included in other expenses in the statement of comprehensive income.

As part of the acquisition, buildings have been leased from the previous owner at market rates. Liabilities were not assumed with the exception of equipment and truck leases, which are classified as operating leases. The lease obligations at the date of acquisition were as follows:

Minimum lease payments due	Within one year	One to five years	After five years	Total
Buildings	$ 1,048	$ 4,193	$ -	$ 5,241
Equipment and vehicles	86	67	-	153

Had the acquisition occurred on January 1, 2011 management estimates that the Company's consolidated sales would have been $280.2 million and profit would have been $7.1 million for the year ended December 31, 2011. Included in these consolidated financial statements for the period from September 19 to December 31, 2011 for Paxton are sales of $13.6 million and profit of $0.1 million.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Capital management:

The Company'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 Company considers its capital to be bank indebtedness (net of cash) and shareholders' equity or Fund unit liability and net deficit attributable to Unitholders. The Company's capitalization is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Cash	$ (392)	$ (43)	$ (463)
Bank indebtedness	19,794	6,745	4,564
Fund unit liability	-	144,366	144,100
Net deficit attributable to unitholders	-	(83,557)	(82,557)
Shareholders' equity	71,899	-	-
Total capitalization	$ 91,301	$ 67,511	$ 65,644

The terms of the Company's US and Canadian credit facilities are described in note 10. The terms of the agreements with the Company's lenders provide that distributions cannot be made by its subsidiaries in the event that its subsidiaries do not meet certain credit ratios. The Company's operating subsidiaries were compliant with all required credit ratios under the US and Canadian credit facilities as at December 31, 2011, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Dividends are one way the Company manages its capital. Dividends are declared having given consideration to a variety of factors including the outlook for the business and financial leverage. There were no changes to the Company's approach to capital management during the year ended December 31, 2011.

A cash dividend of $0.02 per common share was paid to shareholders on October 31, 2011. On November 7, 2011 Hardwoods Distribution Inc. declared a cash dividend of $0.02 per common share to shareholders of record as of January 20, 2012. The dividend was paid to shareholders on January 31, 2012. On March 9, 2012 Hardwoods Distribution Inc. declared a cash dividend of $0.02 per common share to shareholders of record as of April 20, 2012 to be paid on April 30, 2012.

6. Financial instruments:

Financial instrument assets include cash and cash equivalents, current and long-term receivables, and income taxes recoverable, which are designated as loans and receivables and measured at amortized cost. Non-derivative financial instrument liabilities include bank indebtedness, accounts payable, accrued liabilities, finance lease obligation and prior to conversion of the Fund to a corporation, the Fund unit liability and associated long term incentive plan liability. 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.

6. Financial instruments (continued):

Fair values of financial instruments

The carrying values of cash and cash equivalents, accounts receivable, income tax recoverable, and accounts payable accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of long-term receivables and finance lease obligations are not expected to differ materially from their respective carrying values, given the interest rates being charged. The carrying values of the credit facilities approximate their fair values due to the existence of floating market based interest rates. The fair value of these non-derivative financial assets and liabilities has been estimated based on the present value of future cash flows, discounted at a market rate of interest at the reporting date.

The fair value of the Fund Unit liability at December 31, 2010, based on the quoted market price of the Fund Units was $34.0 million (January 1, 2010 - $28.8 million).

Derivative financial instruments

The Fund's non-controlling interest exchangeable unit liability (note 13) was recorded at fair value each reporting period, until their conversion to shares of the Company on July 1, 2011 (notes 1 and 14). The fair value was determined based on quoted market prices of the Fund's units adjusted to reflect the impact of the subordination arrangement in effect.

Financial risk management:

The Board of Directors of the Company and its subsidiaries has the overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, 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 Company'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 Company's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Company.

The Company 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 Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's current and long-term receivables from its customers. Cash held at banks, employee housing loans and security deposits also present credit risk to the Company. The carrying value of these financial assets, which total $35.1 million at December 31, 2011, represents the Company's maximum exposure to credit risk.

6. Financial instruments (continued):

Financial risk management (continued):

(*i*) Credit risk (continued):

Trade accounts receivable:

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The Company is exposed to credit risk in the event it is unable to collect in full amounts receivable from its customers. The Company employs established credit approval practices and engages credit attorneys when appropriate to mitigate credit risk. It is the Company'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 Company may choose to transact with a customer on a cash-on-delivery basis. The Company's largest individual customer balance amounted to 7.4% (2010 – 8.1%) of trade accounts receivable and customer notes receivable at December 31, 2011. No one customer represents more than 2.5% of sales.

More detailed information regarding management of trade accounts receivable is found in note 7 to these consolidated financial statements.

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 Company 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 5%-18%.

Security deposits:

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

6. Financial instruments (continued):

Financial risk management (continued):

(*ii*) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company'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 Company's reputation. At December 31, 2011, in Canada, a subsidiary of the Company had a revolving credit facility of up to $15.0 million. In the US, a subsidiary of the Company had a revolving credit facility of up to $30.5 million (US$30.0 million). These credit facilities can be drawn down to meet short-term financing requirements, including fluctuations in non-cash working capital. The amount made available under the revolving credit facilities from time to time is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Company, as well as by continued compliance with credit ratios and certain other terms under the credit facilities. At December 31, 2011 the Canadian and U.S. credit facilities had $6.9 million and $14.4 million (US$14.1 million), respectively, of additional borrowing capacity.

The Company's accounts payable and accrued liabilities are subject to normal trade terms and have contracted materialities that will result in payment in the following quarter. The undiscounted contractual maturities of finance lease obligations is presented in note 12 to these financial statements.

(*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 Company's net earnings or value of its holdings of financial instruments.

Interest rate risk:

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

Based upon December 31, 2011 bank indebtedness balance of $19.8 million, a 1% increase or decrease in the interest rates charged would result in decrease or increase to annual net earnings by approximately $198,000.

6. Financial instruments (continued):

Financial risk management (continued):

(*iii*) Market risk (continued):

Currency risk:

As the Company conducts business in both Canada and the United States it is exposed to currency risk. Most of the hardwood lumber sold by the Company in Canada is purchased in U.S. dollars from suppliers in the United States. Although the Company 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 Company's financial statements and cause its earnings to fluctuate. Changes in the costs of hardwood lumber purchased by the Company 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 Company for distribution to its Shareholders.

At December 31, 2011 the Company's Canadian subsidiaries primary exposure to foreign denominated working capital financial instruments was in relation to accounts receivable from U.S. customers (2011 - US$0.2 million, 2010 – US$0.2 million), income taxes recoverable (2011 - nil, 2010 – US$1.9 million), and accounts payable to U.S. suppliers (2011 - $0.3 million, 2010 – US$0.2 million).

Based on the Company's exposure to foreign denominated financial instruments, the Company 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, 2011 by approximately $0.1 million (2010 - $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 Company's Canadian subsidiaries exposure to foreign denominated financial instruments as at December 31, 2011 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 Company's U.S. subsidiaries nor is it intended to estimate the potential impact changes in currency rates would have on the Company's sales and purchases.

Commodity price risk:

The Company 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 Company's selling prices to customers.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Accounts receivable:

The following is a breakdown of the Company's current and long term receivables and represents the Company's principal exposure to credit risk.

	December 31, 2011	December 31, 2010	January 1, 2010
Trade accounts receivable - Canada	$ 10,561	$ 10,555	$ 9,756
Trade accounts receivable - United States	24,226	17,726	16,117
Sundry receivable	148	200	203
Current portion of long-term receivables	1,158	413	919
	36,093	28,894	26,995
Less:			
Allowance for credit loss	2,830	2,238	1,410
	$ 33,263	$ 26,656	$ 25,585
Long-term receivables:			
Employee housing loans	$ 368	$ 375	$ 450
Customer notes	1,753	1,088	1,834
Security deposits	431	465	518
	2,552	1,928	2,802
Less:			
Current portion, included in accounts receivable	1,158	413	919
	$ 1,394	$ 1,515	$ 1,883

The aging of trade receivables was:

	December 31, 2011	December 31, 2010	January 1, 2010
Current	$ 20,977	$ 16,791	$ 14,557
Past due 31 - 60 days	7,174	5,460	5,283
Past due 61 - 90 days	2,676	2,059	2,181
Past due 90+ days	3,960	3,971	3,852
	$ 34,787	$ 28,281	$ 25,873

The Company determines its allowance for credit loss based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectable are written off. The total allowance at December 31, 2011 was $2.8 million (December 31, 2010 - $2.2 million; January 1, 2010 - $1.4 million). The amount of the allowance is considered sufficient based on the past experience of the business, the security the Company has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Accounts receivable (continued):

The change in the allowance for credit loss can be reconciled as follows:

	2011	2010
Balance as at January 1	$ 2,238	$ 1,410
Additions during the period	1,072	1,788
Changes due to currency rate fluctuations	64	(102)
Use during the period	(544)	(858)
Balance as at December 31	$ 2,830	$ 2,238

Bad debt expense, net of recoveries, for the year ended December 31, 2011 was $1.4 million which equates to 0.6% of sales (year ended December 31, 2010 – $2.0 million, being 1.0% of sales).

8. Inventories:

	December 31, 2011	December 31, 2010	January 1, 2010
Lumber	$ 13,469	$ 9,868	$ 8,224
Sheet goods	19,346	13,270	12,171
Specialty	3,497	2,307	2,099
Goods in-transit	2,703	1,996	1,407
	$ 39,015	$ 27,441	$ 23,901

Inventory related expenses are included in the consolidated statement of comprehensive income as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Inventory write-downs	$ 720	$ 977
Cost of inventory sold	$ 181,256	$ 156,665
Other cost of sales	8,143	6,633
Total cost of sales	189,399	163,298

(Tabular amounts expressed in thousands of Canadian dollars)

9. Property, plant and equipment:

	Leased vehicles	Machinery and equipment	Mobile equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2010	$ 2,456	$ 2,095	$ 3,225	$ 786	$ 8,562
Additions	1,476	61	-	13	1,550
Disposals	(1,416)	(137)	(134)	(2)	(1,689)
Adjustments:					
Foreign currency translation	(82)	(63)	(112)	(12)	(269)
Balance at December 31, 2010	2,434	1,956	2,979	785	8,154
Additions	767	3,660	513	132	5,072
Disposals	(698)	(62)	(45)	(166)	(971)
Adjustments:					
Foreign currency translation	33	124	57	5	219
Balance at December 31, 2011	$ 2,536	$ 5,678	$ 3,504	$ 756	$ 12,474
Accumulated depreciation					
Balance at January 1, 2010	$ 1,180	$ 1,685	$ 2,394	$ 736	$ 5,995
Depreciation during period	706	189	205	38	1,138
Disposals	(974)	(133)	(133)	(3)	(1,243)
Adjustments:					
Foreign currency translation	(31)	(53)	(85)	(11)	(180)
Balance at December 31, 2010	881	1,688	2,381	760	5,710
Depreciation during period	663	196	115	28	1,002
Disposals	(536)	(59)	(37)	(166)	(798)
Adjustments:					
Foreign currency translation	14	24	34	5	77
Balance at December 31, 2011	$ 1,022	$ 1,849	$ 2,493	$ 627	$ 5,991
Net book value:					
January 1, 2010	$ 1,276	$ 410	$ 831	$ 50	$ 2,567
December 31, 2010	1,553	268	598	25	2,444
December 31, 2011	1,514	3,829	1,011	129	6,483

(Tabular amounts expressed in thousands of Canadian dollars)

9. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the year ended December 31, 2011 was $1.0 million (year ended December 31, 2010 - $1.1 million) and is included in the statement of comprehensive income as follows:

	2011	2010
Selling and distribution	$ 884	$ 1,018
Cost of sales	85	-
Administration	33	120
	$ 1,002	$ 1,138

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2011 was a net gain of $81,403 (2010 - $109,680) and is included in the statement of comprehensive income as follows:

	2011	2010
Selling and distribution	$ 81	$ 100
Administration	-	9
Gain on sale of property, plant and equipment	$ 81	$ 109

10. Bank indebtedness:

	December 31, 2011	December 31, 2010	January 1, 2010
Checks issued in excess of funds on deposit	$ 922	$ 282	$ 1,077
Credit facility, Hardwoods LP	4,943	548	1,945
Credit facility, Hardwoods USLP (December 31, 2011 - US$13,692; December 31, 2010 - US$6,162; January 1, 2010 - US$1,844)	13,929	6,129	1,938
Deferred finance fees	-	(214)	(396)
	$ 19,794	$ 6,745	$ 4,564

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”).

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 the Hardwoods LP partnership units held by subsidiaries of the Company. 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 Company.

10. Bank indebtedness (continued):

The Hardwoods LP Credit Facility, which was extended to August 7, 2016 during the fourth quarter of 2011, provides financing up to $15.0 million. During the three month period ended September 30, 2011, Hardwoods USLP amended its credit facility in conjunction with the Paxton acquisition, increasing the maximum borrowing available under the credit facility from US$25 million to US$30 million. The Hardwoods USLP credit facility has a four year term with a maturity date of May 26, 2015. Each facility is payable in full at maturity. Both Hardwoods Credit Facilities are revolving credit facilities which Hardwoods may terminate at any time without prepayment penalty. 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. 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. Certain identified accounts receivable and inventories are excluded from the calculation of the amount available under the Credit Facility. Hardwoods LP is required to maintain a fixed charge coverage ratio (calculated as the ratio of EBITDA less cash taxes less capital expenditures less distributions, divided by interest plus principal payments on capital lease obligations) of not less than 1.1 to 1. However, this covenant does not apply so long as the unused availability under the credit line is in excess of $2.0 million. At December 31, 2011, the Hardwoods LP credit facility had $6.9 million of available 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 55% of the book value of inventories (with certain accounts receivable and inventory being excluded). Hardwoods USLP is required to maintain a fixed charge coverage ratio (calculated as EBITDA less cash taxes less capital expenditures, divided by interest plus distributions) of 1.0 to 1. This covenant of the Hardwoods USLP Credit Facility does not need to be met however when the unused availability under the credit facility is in excess of US$2.5 million. At December 31, 2011, the Hardwoods USLP credit facility had unused availability of $14.4 million (US$14.1 million).

The average annual interest rates paid in respect of bank indebtedness for the year ended December 31, 2011 were 3.84% and 3.55% (2010 – 4.79% and 5.88%) for the Hardwoods LP and Hardwoods USLP credit facilities, respectively. In addition, standby fees of 0.25% and 0.25% (2010 – 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)

11. Provisions:

		Legal		Onerous contracts		Total
Balance at January 1, 2010	$	203	$	656	$	859
Provisions made during the period		150		-		150
Provisions used during the period		(53)		(415)		(468)
Balance at December 31, 2010		300		241		541
Provisions made during the period		150		-		150
Provisions used during the period		(400)		(194)		(594)
Balance at December 31, 2011	$	50	$	47	$	97
Non-current	$	-	$	7	$	7
Current		50		40		90
	$	50	$	47	$	97

Legal

The Company and its subsidiaries are subject to legal proceedings that arise in the ordinary course of its business. Provisions for legal costs are related to employee severance and product liability issues. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for or insured, would be material in relation to the Company's consolidated financial statements.

Onerous contracts

Due to the closure of some branches before the expiry of the lease the Company has a legal obligation to pay the monthly lease until the expiry date. The Company has mitigated the obligation by sub-leasing the properties. The Company has made provision for the net lease cost in the case that the sub-lease does not cover the entire obligation. The full expense was recognized in profit/loss in the period of the branch closure and subsequently the related liability is being reduced over the life of the obligation as cash payments are made. The liability is measured at the present value of the expected net cost of the remaining term of the contract.

Decommissioning

The Company and its subsidiaries are not obligated in any material way for decommissioning or site restoration.

(Tabular amounts expressed in thousands of Canadian dollars)

12. Leases:

(a) Finance leases as lessee:

Subsidiaries of the Company lease vehicles with terms ranging from 18 to 50 months. Hardwoods LP guarantees a residual value under the terms of the leases in Canada, and any difference between the amount realized and the guaranteed residual value is either paid to or paid by Hardwoods LP. In the US the lease payments cover the full capitalized cost over the term of the lease, and any proceeds from the sale of the vehicle are paid to Hardwoods USLP. The Company and its subsidiaries have determined that these vehicle leases are considered finance leases and are recorded on the statement of financial position.

Finance lease liabilities are payable as follows:

Minimum lease payments due	Within one year	One to five years	Total
December 31, 2011:			
Future minimum lease payments	$ 880	$ 607	$ 1,487
Interest	63	25	88
Present value of minimum payments	$ 817	$ 582	$ 1,399
December 31, 2010:			
Future minimum lease payments	$ 806	$ 758	$ 1,564
Interest	73	36	109
Present value of minimum payments	$ 733	$ 722	$ 1,455
January 1, 2010:			
Future minimum lease payments	$ 928	$ 283	$ 1,211
Interest	43	16	59
Present value of minimum payments	$ 885	$ 267	$ 1,152

The present value of the lease payments is calculated using the interest rate implicit in the lease.

(b) Operating leases as lessee:

The Company's subsidiaries are obligated under various operating leases, including building and trucking equipment leases that require future minimum rental payments as follows:

Minimum lease payments due	Within one year	One to five years	After five years	Total
Minimum lease payments due:				
December 31, 2011	$ 4,962	$ 12,281	$ 42	$ 17,285
Minimum sublease revenue receivable:				
December 31, 2011	133	147	-	280

(Tabular amounts expressed in thousands of Canadian dollars)

12. Leases (continued):

(b) Operating leases as lessee (continued):

Minimum lease payments recognized as an expense during the year ended December 31, 2011 amount to $4.5 million (2010 - $4.1 million). Sublease payments received during the year ended December 31, 2011 were $0.6 million (2010 - $0.6 million) and are recognized as a reduction to selling and distribution costs on the statement of comprehensive income.

The Company's operating lease agreements do not contain any contingent rent clauses. Some operating building lease agreements contain renewal options but none contains any restrictions regarding distributions, further leasing or additional debt. Renewal options are reviewed regularly by management.

13. Non-controlling interests:

Prior to completion of the Arrangement on July 1, 2011 (note 1), the previous owners of the business had 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. In accordance with the Arrangement described in Note 1 the owners of the Class B LP Units and Class B USLP Units agreed to exchange their units for 0.3793 Common Shares of the Company per outstanding unit.

For accounting purposes up to the conversion to a corporation, the non-controlling interest exchangeable Units, being the Class B LP Units and the Class B USLP Units, were considered a liability as the Units to be issued by the Fund in an exchange were themselves a puttable financial instrument. The non-controlling interest exchangeable Units included an embedded derivative, being the ability of the non-controlling interest to convert the exchangeable Units to full participating Fund Units. The Fund chose not to separate the embedded derivative and is instead recorded the non-controlling interest exchangeable unit liability at its estimated fair value as at the reporting dates.

The fair value of the non-controlling interest exchangeable unit liability was estimated to be as follows:

	December 31, 2011	December 31, 2010	January1, 2010
Non-controlling interest exchangeable unit liability	$ -	$ 3,197	$ 2,733

Changes in the fair value of the above noted liability were recorded in the statement of comprehensive income as part of net finance expense (note 16). The fair value of $3.7 million at June 30, 2011 was transferred to share capital upon conversion to shares of the Company.

(Tabular amounts expressed in thousands of Canadian dollars)

14. Shares and Fund Units (continued):

(a) Share capital

At December 31, 2011, the authorized share capital of the Company comprised an unlimited number of common shares without par value ("Shares").

Prior to the Arrangement the Fund had issued 14,604,085 Units with a carrying value of $144.6 million. The Fund Units were classified as a liability under IFRS in accordance with IAS 32, Financial Instruments: Presentation. This classification is a result of the Units being puttable instruments as the holder had the option to redeem the Units for amounts based on the market prices at the time of redemption and the Units had a contractual obligation requiring delivery of income to the unitholders. The Fund recorded the liability at the fair value of the Units at the inception of the liability and recorded the amounts subsequent to initial recognition on an amortized cost basis. Direct expenses associated with the initial issuance of the Fund Units, totaling $10.6 million, were expensed as a financing cost at the date of issuance.

On July 1, 2011 the Fund Units were converted on a one-to-one basis to common shares in the Company and are now recorded as Share Capital at the fair market value on the date of conversion being $43.7 million, with the difference of $104.6 million between the carrying value of the Fund Unit liability and the fair value of the shares issued being recorded in contributed surplus.

A continuity of the Shares and Fund Unit liability is as follows:

	Shares	Units		Total
Balance at January 1, 2010	-	14,410,000	$	144,100
Issued pursuant to long term incentive plan	-	113,858		266
Balance at December 31, 2010	-	14,523,858		144,366
Issued pursuant to long term incentive plan	-	80,227		222
Converted to Common Shares	-	(14,604,085)		(144,588)
Common shares at fair value as of July 1, 2011	14,604,085	-		40,015
Class B units converted to Common Shares	1,366,429	-		3,744
Issued pursuant to long term incentive plan	124,829	-		302
Balance at December 31, 2011	16,095,343	-	$	44,061

14. Shares and Fund Units (continued):

(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. Upon conversion to a corporation on July 1, 2011 the LTIP plan was continued with references to Units being replaced by common shares.

The LTIP is comprised of Restricted Shares and Performance Shares. Each Restricted Share will entitle the holder to be issued the number of Shares of the Company designated in the grant agreement for that Restricted Share. Shares issuable pursuant to Restricted Share grants will vest and be issued on the date or dates determined by the Company'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 Share was granted. Each Performance Share will entitle the holder to be issued the number of Shares designated in the grant agreement for the Performance Share 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. Shares issuable pursuant to Performance Shares 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 Share was granted.

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

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

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

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

(Tabular amounts expressed in thousands of Canadian dollars)

14. Shares and Fund Units (continued):

(b) Long Term Incentive Plan (continued):

For the period prior to July 1, 2011, in accordance with the IFRS 2, Share-based Payment, the Fund was required to classify its Restricted Units and Performance Units as cash settled awards as they converted into Units of the Fund which were redeemable at the holder's option. The amount of compensation cost was measured each period end based on the current market price of the Fund's Units and the expense was recognized each period during the requisite service period based on the estimated number of awards that were 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 were considered probable of achievement.

Post-conversion to a corporate entity, the LTIP awards can be settled in common shares of the Company, and as such, the Company has reclassified the LTIP shares as an equity-settled share based award, as the Company has no stated intent and no past practice of settling in cash. The Company has accounted for the changes to the LTIP as a modification of the LTIP awards. The fair value of the LTIP liability at July 1, 2011, being the date of the modification, was transferred to contributed surplus. The compensation cost from July 1, 2011 onwards is based on the fair value of the awards at grant date and will be recorded over the remaining vesting periods.

A continuity of the LTIP Shares/Units outstanding is as follows:

	Performance Units/Shares	Restricted Units/Shares
Balance at January 1, 2010	-	-
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
LTIP Units issued during the period	24,631	116,558
LTIP Units settled by exchange for free-trading Common shares	(80,227)	(124,829)
Balance at December 31, 2011	104,856	219,442

As of March 31, 2011, 80,227 Performance Units became fully vested and were settled by the issuance of Fund Units with a fair value of $0.2 million. On December 31, 2011, 124,829 Restricted Units/Shares became fully vested and were settled by the issuance of Company Shares with a fair value of $0.3 million

Non-cash compensation expense amount of $749,655 was recorded for the year ended December 31, 2011 (2010 – $530,887).

(Tabular amounts expressed in thousands of Canadian dollars)

14. Shares and Fund Units (continued):

(c) Weighted average shares

The calculation of basic and fully diluted profit per share is based on the profit for the year of $6.1 million (2010 – $0.9 million). The weighted average number of common shares / units outstanding in each of the reporting periods was as follows:

	2011	2010	
Issued ordinary shares/units at January 1	14,523,858	14,410,000	
Effect of shares/units issued during the year:			
Pursuant to long-term incentive plan	60,853	311	
Pursuant to conversion of Class B unitholders	683,215	-	
Weighted average common shares / units (basic)	15,267,926	14,410,311	
Effect of dilutive securities:			
Long term incentive plan	340,034	40,927	
Weighted average common shares / units (diluted)	15,607,960	14,451,238	1

15. Income taxes:

	2011	2010
Current tax expense	$ (158)	$ (104)
Deferred tax recovery (expense)	1,825	(1,480)
	$ 1,667	$ (1,584)

Under current income tax regulations, subsidiaries of the Company are subject to income taxes in Canada and the United States. The applicable statutory rate in Canada for the year ending December 31, 2011 is 27.1% (2010 – 28.5%) and in the United States is 39.4% (2010 – 39.4%). Historically the majority of the Company's tax expense arose from its US subsidiaries, and as such the company reconciles its consolidated income tax expense to the statutory rate applicable in the United States.

(Tabular amounts expressed in thousands of Canadian dollars)

15. Income taxes (continued):

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

	2011	2010
Profit before income tax	$ 4,398	$ 2,521
Statutory rate	39.4%	39.4%
Computed tax expense at statutory rate	$ (1,733)	$ (993)
Effect of lower tax rates in Canada and other rate changes	185	105
Non-deductible expenses	(252)	(266)
Corporate conversion and internal restructuring	3,787	(301)
State tax	(55)	(71)
Adjustment to non-controlling interest not subject to tax	(215)	(182)
Other	(50)	124
Income tax recovery (expense)	$ 1,667	$ (1,584)

The tax effect of temporary differences that give rise to significant portions of the deferred income tax assets and liabilities is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Deferred tax assets:			
Accounts receivable	$ 1,079	$ 663	$ 437
Accounts payable and provisions	133	171	207
Inventory	599	387	290
Employee housing loans	39	36	44
Finance lease obligations	463	395	309
Goodwill	11,634	13,684	15,927
Tax loss carry forwards and future interest deductions	3,809	4,123	3,766
Financing charges and other	170	158	215
	17,926	19,617	21,195
Deferred tax liabilities:			
Prepaid expenses	(101)	(48)	(45)
Property, plant and equipment	(269)	(292)	(60)
Investment in Hardwoods USLP	-	(3,814)	(3,673)
	(370)	(4,154)	(3,778)
Deferred tax asset	$ 17,556	$ 15,463	$ 17,417

At December 31, 2011, subsidiaries of the Company have operating loss carry forwards for income tax purposes of approximately $12.9 million in Canada and US$1.3 million in the United States that may be utilized to offset future taxable income. These losses, if not utilized expire between 2014 and 2030.

(Tabular amounts expressed in thousands of Canadian dollars)

15. Income taxes (continued):

At December 31, 2011 the Company and its Canadian subsidiaries have capital losses of approximately $23.4 million (2010 - $23.4 million), and suspended capital losses of approximately $44.2 million (2010 - $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. The deferred income tax asset of $8.5 million (2010 - $8.5 million) associated with these capital losses has not been recorded because it is not probable that future taxable capital gains will be generated to utilize the benefit.

16. Finance income and expense:

	Note	Year ended December 31, 2011	Year ended December 31,2010
Finance expense:			
Interest on bank indebtedness	10	$ 537	$ 709
Amortization of deferred finance cost	10	214	177
Accretion of finance lease obligation	12	91	94
Change in fair value of non-controlling interest	13	546	464
Foreign exchange losses		-	161
Total finance expense		1,388	1,605
Finance income:			
Imputed interest on employee loans receivable	7	17	22
Interest on trade receivables and customer notes	7	487	555
Foreign exchange gains		315	-
Total finance income		819	577
Net finance costs		$ 569	$ 1,028

(Tabular amounts expressed in thousands of Canadian dollars)

17. Segment reporting:

Information about geographic areas is as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Revenue from external customers:		
Canada	$ 83,271	$ 79,653
United States	146,748	118,002
	$ 230,019	$ 197,655

	December 31, 2011	December 31, 2010	January 1, 2010
Non-current assets:			
Canada	$ 8,855	$ 8,340	$ 9,350
United States	16,600	11,082	12,517
	$ 25,455	$ 19,422	$ 21,867

18. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are analyzed below.

	Year ended December 31, 2011	Year ended December 31, 2010
Wages, salaries, and benefits	$ 18,211	$ 14,586
Pensions - defined contribution plans	498	443
LTIP Share/Unit compensation	750	531
	$ 19,459	$ 15,560

Employee benefit expenses are included in the consolidated statement of comprehensive income as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Cost of sales	$ 412	$ -
Selling and distribution	15,265	12,337
Administration	3,782	3,223
	$ 19,459	$ 15,560

18. Employee remuneration (continued):

(b) Pensions:

Hardwoods USLP and Paxton Hardwoods LLC maintain defined contribution 401(k) retirement savings plans (the "USLP Plan" and the "Paxton 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, 2011, Hardwoods USLP contributed and expensed $237,934 (US$240,556) (year ended December 31, 2010 - $218,345 (US$211,924)) in relation to the USLP Plan. The assets of the Paxton Plan are held and related investment transactions are executed by the Plan's Trustee, PNC Bank, and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2011, Hardwoods USLP contributed and expensed $18,587(US$18,792) in relation to the Paxton 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, 2011, Hardwoods LP contributed and expensed $241,177 (year ended December 31, 2010 - $204,621) in relation to the LP Plan.

19. Related party transactions:

The Company's related parties include Sauder Industries Limited (SIL) (note 13), key management, and post-employment benefit plan for the employees of the Company's subsidiaries.

(a) Transactions with SIL:

For the year ended December 31, 2011, sales of $271,389 (year ended December 31, 2010 - $435,792) were made to affiliates of SIL, and the Company's subsidiaries made purchases of $84,263 (year ended December 31, 2010 - $120,107) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

(Tabular amounts expressed in thousands of Canadian dollars)

19. Related party transactions (continued):

(b) Transactions with key management personnel:

Key management of the Company includes members of the Board of Directors, the President, Chief Financial Officer, and regional Vice Presidents. Key management personnel remuneration includes the following expenses:

		Year ended December 31, 2011		Year ended December 31, 2010
Short-term employee benefits:				
Salaries and benefits including bonuses	$	1,691	$	1,718
Company car		35		46
LTIP Share/Unit compensation		405		294
Total remuneration	$	2,131	$	2,058

The Company offers housing loans to employees required to relocate. Key management had no loans outstanding at either December 31, 2011 or December 31, 2010.

During the year ended December 31, 2011, the Company paid $0.4 million (year ended December 31, 2010 - $0.1 million) to former key management personnel under the term of non-compete and consulting arrangements.

(c) Transactions with post-employment benefit plans:

The defined contribution plan referred to in note 18(b) is a related party to the Company. The Company's transactions with the pension scheme include contributions paid to the plan, which are disclosed in note 18(b). The Company has not entered into other transactions with the pension plan, neither has it any outstanding balances at the reporting dates under review.

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20. Explanation of transition to IFRS:

The accounting policies set out in note 3 have been consistently applied in preparing the financial statements for year ended December 31, 2011 and the comparative year ended December 31, 2010 and in the preparation of an opening IFRS statement of financial position at January 1, 2010 (the Company's date of transition).

Adjustments on transition to IFRS

In preparing its opening IFRS statement of financial position and the comparative year ended December 31, 2010, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Company's financial position and financial performance is set out in the following tables and the accompanying notes thereto.

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Reconciliation of Consolidated Statement of Financial Position at January 1, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets				
Current assets:				
Cash		$ 463	$ -	$ 463
Accounts receivable		25,585	-	25,585
Income taxes recoverable		2,286	-	2,286
Inventories		23,901	-	23,901
Prepaid expenses		878	-	878
Total current assets		53,113	-	53,113
Non-current assets:				
Long-term receivables		1,883	-	1,883
Property, plant and equipment	e	1,291	1,276	2,567
Deferred financing costs	h	396	(396)	-
Deferred income taxes	i	17,587	(170)	17,417
Total non-current assets		21,157	710	21,867
Total assets		$ 74,270	$ 710	$ 74,980
Liabilities				
Current liabilities:				
Bank indebtedness	h	$ 4,960	$ (396)	$ 4,564
Accounts payable and accrued liabilities	g	4,988	(953)	4,035
Income taxes payable	g	-	94	94
Provisions	g	-	385	385
Finance lease obligation	e	-	885	885
Total current liabilities		9,948	15	9,963
Non-current liabilities:				
Deferred gain on sale leaseback	d	416	(416)	-
Provisions	g	-	474	474
Finance lease obligation	e	-	267	267
Non-controlling interests	c	8,748	(6,015)	2,733
Fund Units	b	-	144,100	144,100
Total non-current liabilities		9,164	138,410	147,574
Total liabilities		19,112	138,425	157,537
Net Assets (Deficit) Attributable to Unitholders				
Fund Units	b	133,454	(133,454)	-
Deficit	k	(60,198)	(22,359)	(82,557)
Accumulated other comprehensive loss	a	(18,098)	18,098	-
Total net assets (deficit) attributable to unitholders		55,158	(137,715)	(82,557)
Total net assets (deficit) and liabilities		$ 74,270	$ 710	$ 74,980

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Reconciliation of Consolidated Statement of Financial Position at December 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets				
Current assets:				
Cash		$ 43	$ -	$ 43
Accounts receivable		26,656	-	26,656
Income taxes recoverable		1,820	-	1,820
Inventories		27,441	-	27,441
Prepaid expenses		768	-	768
Total current assets		56,728	-	56,728
Non-current assets:				
Long-term receivables		1,515	-	1,515
Property, plant and equipment	e	891	1,553	2,444
Deferred financing costs	h	214	(214)	-
Deferred income taxes	i	15,594	(131)	15,463
Total non-current assets		18,214	1,208	19,422
Total assets		$ 74,942	$ 1,208	$ 76,150
Liabilities				
Current liabilities:				
Bank indebtedness	h	$ 6,959	$ (214)	$ 6,745
Accounts payable and accrued liabilities	g	3,680	(582)	3,098
Income taxes payable	g	-	41	41
Provisions	g	-	301	301
Finance lease obligation	e	-	733	733
Total current liabilities		10,639	279	10,918
Non-current liabilities:				
Deferred gain on sale leaseback	d	320	(320)	-
Provisions	g	-	240	240
Finance lease obligation	e	-	722	722
Non-controlling interests	c	8,744	(5,547)	3,197
Long term incentive plan liability	j	-	264	264
Fund Units	b,j	-	144,366	144,366
Total non-current liabilities		9,064	139,725	148,789
Total liabilities		19,703	140,004	159,707
Net Assets (Deficit) Attributable to Unitholders				
Fund Units	b	133,653	(133,653)	-
Contributed surplus	j	198	(198)	-
Deficit	k	(59,242)	(22,378)	(81,620)
Accumulated other comprehensive loss	a	(19,370)	17,433	(1,937)
Net assets (deficit) attributable to unitholders		55,239	(138,796)	(83,557)
Total net assets (deficit) and liabilities		$ 74,942	$ 1,208	$ 76,150

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Reconciliation of the Consolidated Statement of Comprehensive Income for the year ended December 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Sales		$ 197,655	$ -	$ 197,655
Cost of sales		(163,298)	-	(163,298)
Gross profit		34,357	-	34,357
Expenses:				
Selling and distribution	e,f	-	(24,268)	(24,268)
Administration	f,j	-	(6,857)	(6,857)
Other	f	-	317	317
Sales and administration	f	(29,740)	29,740	-
Depreciation	f	(431)	431	-
Deferred financing costs	f	(177)	177	-
Amortization of deferred gain	d	76	(76)	-
Interest	f	(709)	709	-
Foreign exchange losses	f	(161)	161	-
		(31,142)	334	(30,808)
Finance expense	c,e,f	-	(1,605)	(1,605)
Finance income	f	-	577	577
Net finance expense		-	(1,028)	(1,028)
Non-controlling interest	c	(643)	643	-
Profit before income taxes		2,752	(51)	2,521
Income tax expense:				
Current		(104)	-	(104)
Deferred	d,e	(1,512)	32	(1,480)
		(1,616)	32	(1,584)
Profit for the year		956	(19)	937
Other comprehensive loss:				
Exchange differences translating foreign operations		(1,272)	(665)	(1,937)
Total comprehensive loss for the year		$ (316)	$ (684)	$ (1,000)
Basic profit per Unit		$ 0.07	$ 0.00	$ 0.07
Diluted profit per Unit		0.07	(0.01)	0.06

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(a) IFRS 1 "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"):

IFRS 1 generally requires that first-time adopters retrospectively apply all effective IFRS standards and interpretations in effect as at the reporting date. IFRS-1 also provides for certain optional exemptions and mandatory exceptions to this general principle. The Fund has made the following elections under IFRS 1:

(*i*) The Company has elected under IFRS 1 not to apply IFRS 3 "Business Combinations" retrospectively to business combinations that occurred prior to January 1, 2010 (the date of transition to IFRS). Accordingly, the Company has continued with the same accounting treatment of previous business combinations under Canadian GAAP.

(*ii*) The Company has elected under IFRS 1 not to apply IAS 21 "The Effects of Changes in Foreign Exchange Rates" to the cumulative translation differences that arose prior to the date of transition to IFRS. The cumulative translation differences that existed for foreign subsidiaries at the date of transition to IFRS have been deemed to be nil and the amount recorded at December 31, 2009 under Canadian GAAP was transferred to deficit. Gains or losses on a subsequent disposal of foreign operations will exclude translation differences that arose before the date of transition to IFRS.

The effect of this election is to increase deficit and decrease accumulated other comprehensive loss by $18.1 million at January 1, 2010 and December 31, 2010 as compared to amounts reported under previous Canadian GAAP.

(b) Previously under Canadian GAAP, the Fund's Units were classified as equity instruments. In Accordance with IAS 32, "Financial Instruments: Presentation" ("IAS 32"), the Units are classified as a long-term liability as the Units are considered puttable financial instruments as the holder has the option to redeem the Units for amounts related to market prices at the time of the redemption and the Units impose an obligation requiring delivery of income to the unitholders. Certain exceptions provided in IAS 32 allow some puttable instruments to be classified as equity under IFRS, however these conditions are much more restrictive than previous Canadian GAAP. The Units did not meet the exceptions in IAS 32 for equity presentation, as there was a contractual obligation to distribute taxable income to unitholders on an annual basis.

The Company has made the following two accounting policy elections with respect to these Units:

(i) it has not separated the income distribution stream as an embedded derivative as it is considered to be dependent on a non-financial variable specific to a party to the contract, and

(ii) it has elected to treat the distribution stream based on income as a floating rate financial instrument.

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

(b) (continued):

As a result the Company has recorded the liability at the cash amount originally exchanged for the Units, being $144.4 million. The effect of classification of the Units as a long-term liability is to reduce Unitholders' equity and increase long-term liabilities by $144.1 million at January 1, 2010 and at December 31, 2010 as compared to amounts reported under previous Canadian GAAP. The Company has transferred $10.6 million of related Unit issuance costs previously netted against the Unitholders' equity balance to deficit as a financing cost expensed prior to the IFRS adoption date.

Consistent with the classification of the units as a liability, distributions paid to Unitholders are considered a financing cost in the statement of comprehensive income. As no distributions were paid during the year ended December 31, 2010, there is no impact to the comparative statement of comprehensive income. As the Units are treated as a floating rate liability, any changes in the distributions based on changes to income levels are expensed in the period in which they occur.

(c) Prior to July 1, 2011, the Company's non-controlling interest was in the form of exchangeable Class B units that, under certain conditions, could be converted into Units of the Fund. In accordance with IAS 32, if the instruments to be received on exchange are themselves puttable instruments, or instruments that impose an obligation to deliver a pro rata share of the net assets of the entity on liquidation, the exchangeable instruments are themselves considered a financial liability. As the Units were themselves considered a liability, the non-controlling interest's exchangeable units were also considered a liability. As the non-controlling interest was previously presented in the statement of financial position as a liability there is no difference in classification arising from the transition to IFRS.

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

(c) (continued):

As described in note 13, the non-controlling interest's exchangeable units are measured at fair value at each financial statement date and the difference is recorded as a gain or loss in the net finance cost section of the consolidated statement of comprehensive income. The impact resulting from the change in measurement of the non-controlling interest is as follows:

	Year ended December 31, 2010
Consolidated statement of comprehensive income	
Decrease in non-controlling interest share of net income	$ 643
Increase in finance expense	(464)
Increase in comprehensive income	$ 179

	January 1, 2010	December 31, 2010
Consolidated statement of financial position		
Decrease in non-controlling interest	$ (6,015)	$ (5,547)
Decrease in deficit	$ 6,015	$ 5,547

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

(d) During the year ended December 31, 2005, a subsidiary of the Company sold a building and related land to an unrelated third party and subsequently leased back the facilities. Canadian GAAP required the gain on the sale to be deferred and amortized in proportion to the rental payments. IFRS requires the gain on the sale to be recognized in income when the sale is made at fair market value and the leaseback is classified as an operating lease. The Company has determined that under IFRS the gain on sale would have been recognized in its entirety in 2005.

The impact arising from the transition to IFRS is summarized as follows:

		Year ended December 31, 2010
Consolidated statement of comprehensive income		
Decrease in other income – amortization of deferred gain	$	(76)
Decrease in deferred income tax expense		25
Decrease in comprehensive income	$	(51)

		January 1, 2010		December 31, 2010
Consolidated statement of financial position				
Decrease in deferred gain on sale leaseback	$	(416)	$	(320)
Decrease in deferred income tax asset		131		101
Decrease in deficit	$	285	$	219

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(e) Under previous Canadian GAAP, leases of automobiles used by the Company's sales people were considered operating leases. Upon assessment of IAS 17 "Leases", the Company has concluded that the automobile leases are finance leases, primarily because the gains or losses from the fluctuation in the fair value of the automobiles residual values accrue to the Company and its subsidiaries as a result of a residual value guarantee included in the lease agreement.

The effect of this change in classification has resulted in the Company's subsidiaries recording a finance lease obligation and increasing its property, plant and equipment to reflect the depreciated value of the automobiles. Furthermore, the statement of comprehensive income now includes depreciation expense related to the automobiles and finance costs related to the lease obligation, as compared to an operating lease expense which had been previously recorded as a selling and distribution expense.

The impact arising from the change is summarized as follows:

	Year ended December 31, 2010
Consolidated statement of comprehensive income	
Increase (decrease) in selling and distribution:	
Decrease in operating lease expense	$ 911
Increase in amortization expense	(707)
Decrease in gain on leased automobiles	(131)
Decrease in expense related to leased automobiles	73
Increase in finance costs	(94)
Decrease in deferred income tax expense	7
Decrease in comprehensive income	$ (14)

	January 1, 2010	December 31, 2010
Consolidated statement of financial position		
Increase in property, plant and equipment	$ 1,276	$ 1,553
Increase in capital lease obligation:		
Current portion	885	733
Long-term portion	267	722
Decrease in deferred income tax asset	(39)	(30)
Decrease in deficit	85	68

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(f) Management has elected to present the consolidated statement of comprehensive income according to the expenses functional classification. Previously under Canadian GAAP, the sales and administrative expenses were presented together. Under IFRS, these categories have been separated and expenses such as employee expenses and benefits (note 18) and amortization (note 9) have been allocated between these functional categories. Furthermore expenses related to deferred finance costs, interest and foreign exchange losses were reclassified to finance expense and interest income from employee loan receivables, trade receivables and customer notes previously netted against sales and administration costs were reclassified to finance income.

(g) In accordance with IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", management of the Company reviewed its assessments relating to provisions for legal proceedings based on the probability-weighted average of the possible outcomes. There is no change to provisions at January 1, 2010 or December 31, 2010.

Other provisions and income taxes payable that were previously included in accounts payable and accrued liabilities have been separately disclosed on the IFRS statement of financial position. The impact of these reclassifications is as follows:

	January 1, 2010	December 31, 2010
Consolidated statement of financial position		
Decrease in accounts payable and accrued liabilities	$ (953)	$ (582)
Reclassified to provisions:		
Current portion	385	301
Long-term portion	474	240
Reclassified to income taxes payable	94	41

(h) In accordance with IAS 32, deferred finance costs that were directly incurred in attaining revolving credit facilities by subsidiaries of the Company are to be netted against the associated bank indebtedness. Under previous Canadian GAAP, such charges were shown as a long-term asset. This reclassification has no impact on the Company's deficit.

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(i) The above changes increased (decreased) the deferred income tax asset as follows based on a tax rate of 39.4% in the US and 26% in Canada:

	Note	January 1, 2010	December 31, 2010
Decrease to the deferred tax asset arising from:			
Elimination of deferred gain on sale lease-back financing charges	d	131	101
Recognition of finance lease obligation and corresponding adjustment to property, plant and equipment	e	39	30
Decrease in deferred tax asset		$ (170)	$ (131)

(j) In accordance with IFRS 2, “Share-based Payment”, the Company is required to classify its Restricted Units and Performance Units, issued under the Company’s LTIP, as a liability as compared to equity (contributed surplus) under previous Canadian GAAP. In addition, unlike Canadian GAAP, the LTIP liability is remeasured each period end based on the current market price of the Company’s units.

The impact arising from the transition to IFRS is summarized as follows:

	Year ended December 31, 2010
Consolidated statement of comprehensive income	
Increase in administration expense	$ (134)

(Tabular amounts expressed in thousands of Canadian dollars)

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(j) (continued):

	January 1, 2010	December 31, 2010
Consolidated statement of financial position		
Increase in long term incentive plan liability	$ -	$ 264
Increase in Fund Unit liability	-	68
Decrease in contributed surplus	-	(198)
Increase in deficit	$ -	$ (134)

(k) The above noted changes decreased (increased) deficit (each net of related tax) as follows:

	Note	January 1, 2010	December 31, 2010
Reclassification of cumulative currency differences	a	$ (18,098)	$ (18,098)
Unit issuance costs	b	(10,646)	(10,646)
Fair value non-controlling interest	c	6,015	5,547
Deferred gain on sale leaseback	d	285	219
Finance leases	e	85	68
LTIP compensation	j	-	(134)
CTA on adjustment items		-	666
Increase in deficit		(22,359)	(22,378)

(l) The following table is a reconciliation of the change in classification of cash flows arising from the transition to IFRS for the year ended December 31, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Net cash used in operating activities	$ (3,402)	$ 802	$ (2,600)
Net cash provided by financing activities	2,265	(940)	1,325
Net cash provided by investing activities	717	138	855

The adjustments to the cash flow classification arise as a result of the presentation of the Company's automobile leases as finance leases. In accordance with the Company's lease classification, the principle repayments on the automobile leases are presented as a financing activity.

Corporate Information

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President, Grawil Consultants Inc.

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Chair & CEO, Sauder Industries

William Sauder
Executive VP, Sauder Industries

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