HARDWOODS DISTRIBUTION INC.

2013

Annual Report

To Shareholders

HARDWOODS

Profile

Hardwoods Distribution Inc. ("Hardwoods" or "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. 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.

Our Customers: Over 4,500 customers in North America, primarily manufacturers of cabinets, mouldings, custom finishing, home furniture, 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 End-Markets: We estimate approximately 60% of the products we sell to our manufacturing customers end up in new residential construction, 20% in the commercial/institutional construction sector, and 20% in renovation/remodeling and other markets.

Our Products and Services: In 2013 our sales mix was 55% sheet good products, 38% hardwood lumber products, and 7% other specialty goods. We provide custom milling services to our customers from five of our locations in Chicago, Cincinnati, Denver, Kansas City, and San Antonio.

Our People: Over 350 dedicated employees, with a pronounced professional and entrepreneurial sales and service culture.

Our Strategy: We are focused on capturing the benefit from a steadily recovering US residential housing market. In addition to capturing market growth, our strategy is to (i) continue to leverage our established expertise in import products, which account for approximately 25% of our sales mix measured by product source; and (ii) grow our sales into commercial markets, which represent a significant demand opportunity but comprises just 20% of our total sales. We will also pursue acquisitions that complement our strategies, and we have added six new locations from acquisitions made in the past two and a half years.

Our Distribution Network: Approximately 75% of our sales are in the United States and 25% in Canada. We operate 32 distribution centres as follows:

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HARDWOODS

To Our Shareholders

2013 was an exceptional year for Hardwoods with significant growth in sales, EBITDA and profit.

We continued to build sales momentum as our market expansion strategies combined with US demand growth drove strong financial results. At $371 million, our full-year sales have now surpassed the levels we were achieving at our peak in 2005 and 2006; however, we are realizing these results on a much lower level of US housing starts. According to the US Census Bureau, US housing starts increased to 927,000 in 2013, 19% higher than in 2012, but still less than half the 2.1 million housing starts recorded in 2005.

Our financial results were bolstered by the continued strengthening of product prices during the year. Average hardwood lumber prices, as measured by the Hardwood Review Kiln Dried Lumber Price Index, were up approximately 12% over 2012 due to strong market demand. Market indices for sheet good products are not as readily observable, and sheet good pricing was variable during 2013 due to the impact of the trade case against Chinese import plywood. However, average sheet good prices in 2013 are estimated to have been up by a similar amount as hardwood lumber prices were year-over-year.

Our successful strategy of expanding our presence in the US, leveraging our import program and increasing our business with commercial customers enabled us to capitalize on improving conditions in the US. Our May 2013 acquisition of an import lumber business in Leland, North Carolina complemented this strategy. While we acquired the Leland business primarily for the direct access it gives us to international hardwood lumber producers, this well-priced acquisition also gave us a new presence on the US East Coast, nicely timed to the housing cycle. We generated approximately $2.9 million of sales from our new branch in 2013, and our entire distribution network benefited from its positive impact on our import program.

As anticipated, we successfully carried our topline gains through to the bottom line, achieving a 73.1% improvement in EBITDA and a 111.5% improvement in profit compared to 2012. We encourage you to read the Management Discussion and Analysis that follows on page 5 of this report, to learn more about our strong 2013 results and factors affecting our business.

2014 Priorities

Moving forward, we are strongly focused on capturing the continued growth potential we see in the US market. During the second half of 2013, we completed a major strategic review designed to guide our efforts. Our priorities in 2014 will be to:

1. **Leverage imports** by growing sales of our high quality proprietary import lines, supported by our established quality assurance team located in Asia, while also expanding our international sourcing capabilities to bring world-wide product solutions to our customers.

2. **Strengthen our commercial business** by capitalizing on the significant opportunities in the commercial market. In particular, we intend to grow our supply of first tier products for commercial customers and capitalize on our import capabilities to offer both domestic and off-shore product solutions to the commercial sector.

We are well positioned to pursue this strategy and to finance the ongoing growth we expect to capture in 2014 and beyond. As at December 31, 2013, our debt-to-EBITDA ratio was a conservative 1.3 times, our debt-to-capital ratio was just 23%, and we had $29.8 million of unused borrowing capacity. Accordingly, we are in a position to grow our business both organically and through well-priced acquisitions that complement our business strategy.

As a result of our strong 2013 performance, we are also able to reward our investors for their continued participation in our business. Based on our current financial position and our positive outlook, our Board of Directors has approved an increase in our quarterly dividend from 3.5 cents per share to 4.5 cents per share. The dividend will be paid on April 30, 2014, to shareholders of record as at April 18, 2014.

At the close of a successful and satisfying year, I thank you for your confidence in Hardwoods.
We look forward to continuing to build value for you in the year ahead.

Lance R. Blanco
President and Chief Executive Officer

Management's Discussion and Analysis

March 10, 2014

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of March 10, 2014. 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, 2013 and 2012. Results are reported in Canadian dollars unless otherwise stated. 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, 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 International Financial Reporting Standards ("IFRS") and does not have a standardized meaning prescribed by IFRS. Investors are cautioned that EBITDA should not replace profit 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 reconciliation between EBITDA and profit as determined in accordance with IFRS, please refer to the discussion of Results of Operations described in section 3.0 of this report.

HARDWOODS

This MD&A includes the following sections:

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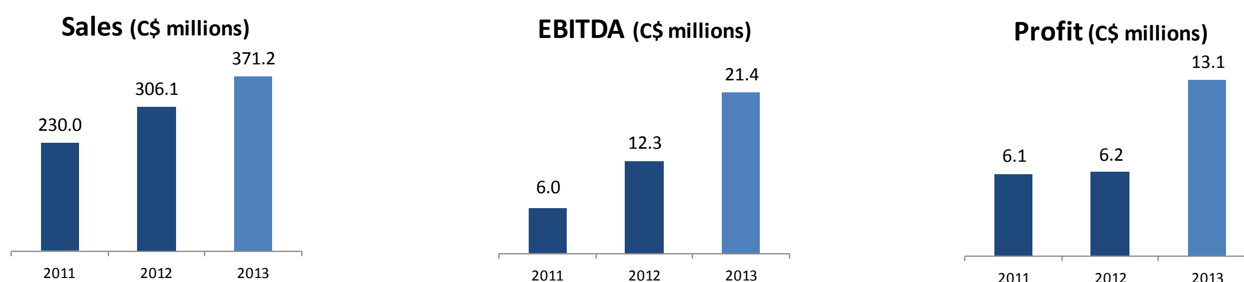
1.0 Executive Summary

1.1 Overview

Our financial performance continued to strengthen in 2013 as we capitalized on improving US market demand and stronger product prices, while successfully executing our business strategy. For the year ended December 31, 2013, our sales increased 21.3%, gross profit grew 25.7%, EBITDA climbed 73.1%, and our profit more than doubled with a 111.5% year-over-year increase.

12 Months Ended December 31:



Market Conditions

The continued recovery in the US residential construction market was a key driver of demand for our products through the year. According to the US Census Bureau, US housing starts climbed 19% to 927,000 in 2013, after increasing 28% in 2012. Given that hardwood products are typically applied at the final stages of house construction (approximately nine-to-twelve months after house construction starts), we were in a strong demand growth phase through all of 2013 and expect to remain in an upmarket through 2014.

Our US operations successfully capitalized on the increased activity levels, with sales increasing 22.8% compared to 2012. Substantially all of this growth was organic, with approximately half of the sales increase driven by higher sales volumes and the balance attributed to stronger product prices. Average hardwood lumber prices, as measured by the Hardwood Review Kiln Dried Lumber Price Index, were up approximately 12% compared to 2012, due to the strong market demand. Sheet good pricing also increased year-over-year, rising sharply in the first half due to the combination of strong demand and the imposition in the US of trade duties on hardwood panel products imported from China. Panel prices softened in the fourth quarter when the US trade case against Chinese panel imports was summarily dismissed.

In contrast to the US market, Canadian housing starts declined to 188,000 in 2013, from 215,000 a year earlier according to the Canada Mortgage and Housing Corporation. The decline was linked to the introduction of new mortgage rules, which were implemented to cool the housing market. Despite the reduction in market activity, sales from our Canadian operations increased by 8.2% compared to 2012, primarily due to higher product prices.

With sales growth in the US continuing to outpace growth in Canada, the US has become an increasingly important market for Hardwoods, accounting for 74% of 2013 sales, compared to 69% in 2012.

Profitability and Efficient Operations

Our gross profit margin increased to 18.2% in 2013, from 17.6% last year, in part due to unusually high second quarter margins which were achieved during a period of rapid product price escalation. We consider a gross margin percentage of approximately 18% to be a sustainable level for our operations under normal business conditions.

As expected, our operating expenses increased year-over-year as we supported growth in our business. As sales activity levels increase the business typically requires additional sales personnel, leased warehouse space, and trucking expenses. EBITDA as a percentage of sales increased to 5.8% in 2013, up from 4.0% the prior year.

Foreign Exchange

Late in 2013, the value of the Canadian dollar began to retreat relative to the US dollar, providing a modest benefit to our fourth quarter and full-year 2013 results. A lower Canadian dollar benefits us by (i) increasing the value of the sales and profits we generate from our US operations when translated into Canadian dollars for financial reporting purposes; (ii) increasing the selling price in Canada of US dollar denominated products sold to our Canadian customers; and (iii) improving the export-competitiveness of our Canadian industrial customers, many of whom have the capability to sell their manufactured products into the US. While the overall impact on 2013 results was not significant, a sustained reduction in the value of the Canadian value dollar would be a positive trend for our business going forward.

Balance Sheet

Financially, we continued to strengthen our balance sheet in 2013. We ended the year with net bank debt of $27.8 million, representing a conservative debt-to-total capital ratio of 23.5% and a debt-to-EBITDA ratio of just 1.3 for the year ended December 31, 2013. We also had $29.8 million of unused borrowing capacity available to us at year-end. We believe our financial position gives us the flexibility we need to continue implementing our strategy and capitalizing on growth in the US market.

1.2 Strategy

Since 2010, we have pursued a successful business strategy focused on (i) solidifying and expanding our presence in the US and in large Canadian geographic markets; (ii) leveraging our ability to source high-quality products from international markets; and (iii) strengthening our presence in the commercial and institutional construction markets.

In the latter half of 2013, we completed a major strategic review, resulting in further refinements to our growth strategy. Our focus going forward will be on the following two thrusts.

Leverage Imports

Import products have been a major growth engine for Hardwoods, currently representing approximately 25% of our sales. We have built a strong competitive advantage by working directly with overseas manufacturers to create high-quality, proprietary products that provide a strong value offering to our customers.

In 2013, we continued to grow sales of our import lines and further expanded our international sourcing capabilities. A highlight of the year was our acquisition of a hardwood lumber importer in Leland, North Carolina, which significantly improved our ability to access hardwood lumber imported directly from manufacturers. Completed in May 2013, the Leland acquisition is now providing new supply to our network of 31 other branch locations, while also giving us a new distribution presence on the East Coast of North America. As we move forward, we will continue to leverage this acquisition, while also pursuing opportunities to strengthen our import program with multi-country, multi-product sourcing.

Strengthen Commercial

Our second key strategic thrust is to expand our base of customers in the commercial and institutional sectors as we work to balance our exposure to the residential construction sector. Currently comprising approximately 25% of our sales, we view the commercial and institutional market as a significant growth opportunity for Hardwoods and we intend to become a more significant participant. To achieve our goal, we are growing our supply of first-tier quality product supply for commercial customers and capitalize on our import capabilities to offer both domestic and off-shore product solutions to the commercial sector.

1.3 Outlook

Forecasters continue to predict a multi-year strengthening trend for the US residential construction market. With approximately 75% of our business in the US, and approximately 60% of our products estimated as going into the residential construction market, we are well positioned to capitalize on the market recovery underway.

The outlook for the US repair and remodeling market is also positive with growth of over 10% forecast into 2014 by Harvard's Joint Center for Housing Studies, while indicators for commercial construction are for steady mid-single digit growth in 2014. Our outlook for the US market is strengthened by the recent dismissal of the US trade case against imported hardwood plywood panels produced in China. With trade duties eliminated and the expectation of ongoing strength in pricing for our key products, we anticipate 2014 will be a strong year for our US operations.

Our outlook for the Canadian market remains neutral, with 2014 housing starts expected to remain unchanged from 2013 levels. Growth in the Canadian renovation and commercial construction markets is expected to be in line with inflation.

Our goal in 2014 continues to be to capture the US market growth potential, both in terms of volume and pricing. With a consistent gross margin percentage and the ability to pass price increases through to our customers, our business model enables increases in volume and pricing to have a significantly positive impact on our earnings and cash flow. Our priorities will be to implement our "leverage imports and strengthen commercial" strategies, while continuing to pursue well-priced, acquisition opportunities that support our objectives.

The Board will continue to review our financial performance and assess distribution levels on a regular basis, and has increased our quarterly distribution from $0.035 to $0.045 per share commencing with the April 30, 2013 distribution. However in terms of cash utilization our primary focus in 2014 will remain on retaining the cash necessary to finance the significant market growth opportunity in the US and to keep our balance sheet strong to support strategic acquisitions.

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”). 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, 2013 we operated 32 distribution facilities located in 17 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 55% of our product mix is made up of hardwood plywood and non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Approximately 38% of our sales are of high-grade hardwood lumber. 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. The balance of our product sales, about 7%, is made up of other specialty 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 about 60% 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.

3.0 Results of Operations

3.1Years Ended December 31, 2013 and December 31, 2012

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

	For the year Ended December 31 2013	For the year Ended December 31 2012	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 371,215	$ 306,087	$ 65,128	21.3%
Sales in the US (US$)	*268,307*	*218,434*	*49,873*	22.8%
Sales in Canada	*94,912*	*87,740*	*7,172*	8.2%
Gross profit	67,616	53,810	13,806	25.7%
Gross profit %	*18.2%*	*17.6%*		
Operating expenses	(47,690)	(42,729)	4,961	11.6%
Profit from operating activities	19,926	11,081	8,845	79.8%
Add: Depreciation and amortization	1,442	1,266	176	13.9%
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 21,368	$ 12,347	$ 9,021	73.1%
Add (deduct):				
Depreciation and amortization	(1,442)	(1,266)	(176)	-13.9%
Net finance cost	(178)	(753)	575	76.4%
Income tax expense	(6,681)	(4,149)	(2,532)	-61.0%
Profit for the period	$ 13,067	$ 6,179	$ 6,888	111.5%
Basic profit per share	$ 0.80	$ 0.38		
Fully diluted profit per share	0.79	0.38		
Average Canadian dollar exchange rate for one US dollar	1.03	1.00		

Sales

For the year ended December 31, 2013, we increased total sales to $371.2 million, up $65.1 million, or 21.3%, from $306.1 million in 2012. The year-over-year sales improvement includes an 18.7% increase due to stronger underlying sales activity and higher product prices, together with a 2.6% increase due to the positive impact of a weaker Canadian dollar.

Organic growth from our existing operations accounted for approximately $62.2 million, or 96% of the sales increase. The Leland import business, which was acquired on May 31, 2013, contributed an additional $2.9 million, or 4%, of the sales growth. The Leland acquisition is discussed more fully in section 1.2 of this report.

Our sales growth came predominantly from our US operations, where sales activity increased by 22.8%, or US$49.9 million. This growth reflects higher sales volumes related to increased demand from the recovering US residential construction market. It also reflects our strategic efforts to leverage our expertise in import products and to strengthen our sales into commercial accounts, with both of these strategies yielding expanded sales in 2013. Product prices also increased and contributed to the higher sales. The increase in prices reflected the shift to higher market demand, as well as the impact of the trade case against hardwood plywood imported from China described in section 1.1 and section 8.0 of this report.

Sales in Canada increased by $7.2 million, or 8.2%, in 2013 compared to 2012. This improvement reflects higher product pricing, partially offset by weaker volume demand in Canada. As the majority of the products we sell originate in the United States, conditions that cause hardwood prices to increase in the US generally also result in higher selling prices in Canada.

Gross Profit

For the year ended December 31, 2013, gross profit climbed 25.7% to $67.6 million, from $53.8 million in 2012. This $13.8 million improvement primarily reflects increased sales together with a higher gross profit margin. As a percentage of sales, gross profit climbed to18.2%, from 17.6% in 2012. The year-over-year improvement largely reflects stronger-than-normal margins of 18.9% in the second quarter of 2013 as we sold lower-cost inventory into a rising price market. Over the longer term, we view 18% as a sustainable gross margin target for our business, while recognizing that results may fluctuate up or down based upon short-term market conditions.

Operating Expenses

Operating expenses were $47.7 million in 2013, compared to $42.7 million the prior year. The $5.0 million increase primarily reflects higher personnel and premises costs, as well as a corresponding increase in bad debt expense, as we supported the 21.3% increase in sales during the year. A weaker Canadian dollar accounted for an additional $0.9 million of the increased costs, and incremental expenses from the Leland operation acquired in May 2013 accounted for $0.5 million of the increase. As a percentage of sales, 2013 operating expenses decreased to 12.8% of sales, from 14.0% in 2012, reflecting the ability of our distribution network to efficiently accommodate sales growth.

EBITDA

For the year ended December 31, 2013, we increased EBITDA to $21.4 million, an increase of $9.0 million, or 73.1%, from $12.4 million in 2012. Our strong EBITDA result reflects the $13.8 million increase in gross profit, partially offset by the $5.0 million increase in operating expenses before depreciation.

Net Finance Cost

(in thousands of Canadian dollars)		Year ended December 31 2013		Year ended December 31 2012		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(1,016)	$	(780)	$	236
Accretion of finance lease obligation		(96)		(83)		13
Foreign exchange losses		-		(300)		(300)
Total finance expense		(1,112)		(1,163)		(51)
Finance income:						
Interest on trade receivables						
customer notes, and employee loans		375		410		(35)
Foreign exchange gain		559		-		559
Total finance income		934		410		524
Net finance cost	$	(178)	$	(753)	$	(575)

Net finance cost decreased to $0.2 million in 2013, from $0.8 million in 2012, primarily reflecting favourable changes in foreign exchange gains/losses. The decline in the value of the Canadian dollar relative to the US dollar resulted in a 2013 foreign exchange gain of $0.6 million principally on intercompany debt held by or with our subsidiaries, compared to a foreign exchange loss of $0.3 million in 2012.

The $0.9 million increase in foreign exchange gains was partially offset by higher interest on our bank indebtedness. Interest costs increased by $0.2 million in 2013, reflecting higher average borrowings on our credit facilities as we supported higher sales with increases in working capital, primarily accounts receivable and inventory.

Income Tax Expense

Income tax expense increased to $6.7 million in 2013, from $4.1 million in 2012. This increase primarily reflects higher taxable income.

Profit for the Year

Full-year profit increased to $13.1 million in 2013, from $6.2 million in 2012. The $6.9 million increase reflects the $9.0 million increase in EBITDA and the $0.6 million decrease in net finance cost, partially offset by the $2.5 million increase in income tax expense and $0.2 million increase in depreciation.

3.2 Three Months Ended December 31, 2013 and December 31, 2012

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	For the three months Ended December 31 2013	For the three months Ended December 31 2012	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 91,069	$ 74,133	$ 16,936	22.8%
Sales in the US (US$)	*64,779*	*54,227*	*10,552*	19.5%
Sales in Canada	*23,056*	*20,371*	*2,685*	13.2%
Gross profit	15,988	12,758	3,230	25.3%
Gross profit %	*17.6%*	*17.2%*		
Operating expenses	(12,168)	(10,691)	1,477	13.8%
Profit from operating activities	3,820	2,067	1,753	84.8%
Add: Depreciation and amortization	396	340	56	16.5%
Earnings before interest, taxes, depreciation and amortization (“EBITDA”)	$ 4,216	$ 2,407	$ 1,809	75.2%
Add (deduct):				
Depreciation and amortization	(396)	(340)	(56)	-16.5%
Net finance income (cost)	(75)	26	(101)	-388.5%
Income tax expense	(1,370)	(780)	(590)	-75.6%
Profit for the period	$ 2,375	$ 1,313	$ 1,062	80.9%
Basic and fully diluted profit per share	$ 0.14	$ 0.08		
Fully diluted profit per share	0.14	0.08		
Average Canadian dollar exchange rate for one US dollar	1.05	0.99		

Sales

For the three months ended December 31, 2013, total sales increased by $16.9 million to $91.1 million, from $74.1 million during the same period in 2012. The 22.8% increase includes a 17.7% increase in underlying sales activity and product prices, together with a 5.1% increase due to the positive impact of a weaker Canadian dollar.

The continued strengthening in US demand and product pricing was a significant factor in this growth. In the fourth quarter of 2013, sales activity at our US operations, as measured in US dollars, increased $10.6 million or 19.5% compared to the same period last year.

Fourth quarter sales in Canada increased by $2.7 million, or 13.2% in 2013, compared to the same period in 2012, primarily due to higher product prices.

Gross Profit

Fourth quarter gross profit increased to $16.0 million from $12.8 million during the same period in 2012. 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 was 17.6% in the fourth quarter of 2013, compared to 17.2% during the same period in 2012. Gross profit margin at 17.6% in the fourth quarter of 2013 was below our target rate of 18%. This reflects a drop in market prices for hardwood panel products in November after the trade case against Chinese import panels was dismissed, and Hardwoods experienced lowered margins as it sold higher-cost inventory

into a market with falling prices. This negative impact on gross margin was partially offset by a refund of duties paid on a portion of our import purchases made from China in 2013.

Operating Expenses

Fourth quarter operating expenses were $12.2 million in 2013, up $1.5 million from $10.7 million during the same period in 2012. Approximately $1.0 million of this increase reflects higher investments in personnel, premises and other costs to support our 22.8% increase in sales. The remaining $0.5 million reflects the impact of a weaker Canadian dollar on US operating expenses. As a percentage of sales, operating expenses for the three months ended December 31, 2013 decreased to 13.4% of sales, compared to 14.4% in the same period in 2012.

EBITDA

For the three months ended December 31, 2013, EBITDA increased to $4.2 million, from $2.4 million during the same period in 2012. The $1.8 million increase reflects the $3.2 million increase in gross profit, partially offset by the $1.5 million increase in operating expense before depreciation.

Profit for the Period

Profit for the three months ended December 31, 2013 increased to $2.4 million, from $1.3 million in 2012. The $1.1 million increase primarily reflects the $1.8 million increase in EBITDA, partially offset by a $0.6 million increase in income tax expense which arose due to higher taxable income generated in the period compared to the fourth quarter of the prior year, together with a $0.1 million increase in depreciation and a $0.1 million increase in net finance cost.

4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2013	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Total sales	$ 91,069	$ 97,546	$ 95,617	$ 86,983	$ 74,133	$ 79,862	$ 79,153	$ 72,939
Profit	2,375	3,109	4,403	3,180	1,313	1,264	2,377	1,225
Basic profit per share or unit	0.14	0.19	0.27	0.19	0.08	0.08	0.15	0.08
Fully diluted profit per share or unit	0.14	0.19	0.27	0.19	0.08	0.08	0.15	0.07
EBITDA	4,216	5,269	6,740	5,143	2,407	3,313	4,065	2,562

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 acquisitions, such as our second quarter 2013 acquisition of the import lumber business acquisition in Leland, NC, and changes to the foreign exchange rate of the Canadian and US dollar.

4.2 Annual Financial Information

(in thousands of dollars except per unit amounts)	Year ended December 31, 2013	Year ended December 31, 2012	Year ended December 31, 2011
Total sales	$ 371,215	$ 306,087	$ 230,019
Profit	13,067	6,179	6,065
Basic profit per share/unit	0.80	0.38	0.40
Fully diluted profit per share/unit	0.79	0.38	0.39
Total assets	128,264	109,335	99,034
Total long-term financial liabilities	828	567	589
EBITDA	21,368	12,347	5,969
Dividends/distributions per share/unit relating to the period:	0.14	$ 0.11	$ 0.04

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		
	2013	2012	$ Change	2013	2012	$ Change
Cash provided by operating activities before changes in non-cash working capital	$ 15,767	$ 11,151	$ 4,616	$ 2,697	$ 2,372	$ 325
Changes in non-cash working capital	(11,254)	(14,622)	3,368	13,671	2,495	11,176
Net cash provided by (used in) operating activities	4,513	(3,471)	7,984	16,368	4,867	11,501
Net cash provided by (used in) investing activities	(3,311)	298	(3,609)	6	244	(238)
Net cash provided by (used in) financing activities	(1,218)	2,875	(4,093)	(16,312)	(5,082)	(11,230)
Increase (decrease) in cash	(16)	(298)	282	62	29	33
Cash, beginning of period	94	392	(298)	16	65	(49)
Cash, end of period	$ 78	$ 94	$ (16)	$ 78	$ 94	$ (16)

Net cash provided by (used in) operating activities

For the year ended December 31, 2013, cash provided by operating activities was $4.5 million, compared to cash used in operating activities of $3.5 million during the same period in 2012. Net cash provided by operating activities, before changes in non-cash working capital, increased by $4.6 million. This primarily reflects the $9.0 million increase in EBITDA discussed in section 3.1 of this report, less a $4.0 million increase in income taxes paid in 2013, and a $0.3 million increase in net interest paid in 2013. Income taxes paid relates predominantly to our US business, as 2013 taxable income from our Canadian business was reduced by the use of tax losses available to the Canadian business. Income taxes paid increased by $4.0 million in 2013 due to higher taxable income generated by the US business, and because our US business fully utilized its remaining tax losses during 2012. With respect to the $0.3 million increase in net interest paid, this primarily reflects higher average bank indebtedness in 2013 compared to 2012 as we borrowed to invest in additional working capital required to support our 21.3% year over year increase in sales. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2013, cash provided by operating activities increased to $16.4 million, from $4.9 million during the same period in 2012. The $11.5 million increase in cash provided by operating activities primarily reflects efforts to reduce non-cash working capital, which decreased by $13.7 million in the fourth quarter of 2013, compared to a reduction of $2.5 million in the same period in 2012. 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 was $3.3 million in 2013 compared to net cash provided by investing activities of $0.3 million in 2012. The change is primarily attributed to the $3.0 million business acquisition of Leland which occurred in 2013, but was not present in the prior year period.

Our capital expenditures in 2013 were $0.9 million, compared to $0.8 million in 2012. The increase in capital expenditures primarily reflects maintenance capital investment in production equipment for the Paxton operations, which carries out light manufacturing activities, as well as customary forklift replacements arising from Hardwoods other branch operations.

Other than our five Paxton distribution centres, our capital expenditures are typically low as we lease our buildings and contract out all freight delivery services. Capital expenditures in this part of our business are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment.

Our Paxton business requires some additional 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 believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment. Ongoing maintenance capital expenditures for our operations are anticipated to be approximately $1.0 million annually.

We also lease automobiles for the use of outside sales representatives and certain managers. For the year ended December 31, 2013, principle payments on automobile finance lease obligation were $0.8 million (2012 - $0.7 million).

Net cash provided by (used in) financing activities

Net cash used in financing activities increased by $4.1 million in the year ended December 31, 2013, compared to the same period in 2012. In 2013 we increased our bank indebtedness by $3.0 million to fund the Leland acquisition, as well as increased our bank borrowings to support sales growth with higher working capital investment. In the fourth quarter ended December 31, 2013, net cash used in financing activities increased by $11.2 million compared to the same

period in 2012. This reflects a significant effort to reduce our investment in non-cash working capital in the fourth quarter of 2013 by $13.7 million, with the cash generated being used to pay down outstanding bank indebtedness. An analysis of our working capital is described in greater detail below.

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 $98.4 million at December 31, 2013, compared to $80.2 million of working capital at December 31, 2012, with most of the increase attributable to increased investment in inventory ($11.2 million) and accounts receivable ($7.6 million) 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. The fourth quarter of 2012 was an exception as we increased working capital investment in inventory to meet anticipated increases in product demand. Typically we would have made a seasonal reduction in inventory at this time of year. A summary of changes in our non-cash operating working capital during the twelve months and three months ended December 31, 2013 and 2012 is provided in the following table.

(in thousands of Canadian dollars) Source (use) of funds	**Year ended December 31, 2013**	**Year ended December 31, 2012**	**Three months ended December 31, 2013**	**Three months ended December 31, 2012**
Accounts receivable	$ (6,198)	$ (2,905)	$ 4,874	$ 6,536
Inventory	(5,366)	(12,768)	9,292	(2,845)
Prepaid expenses	(134)	(137)	322	159
Accounts payable, accrued liabilities and provisions	444	1,188	(817)	(1,355)
Increase in non-cash operating working capital	$ (11,254)	$ (14,622)	$ 13,671	$ 2,495

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, 2013		As at December 31, 2012
Cash	$	(78)	$	(94)
Bank indebtedness		27,881		24,683
Net Debt		27,803		24,589
Shareholders' equity		90,683		76,012
Total Capitalization	$	118,486	$	100,601
Net debt to total capitalization		23.5%		24.4%
Previous 12 months EBITDA	$	21,368	$	12,347
Net debt to previous 12 months EBITDA		1.3		2.0

The Company considers its capital to be bank indebtedness (net of cash) and shareholders' equity. As shown above, our net debt balance increased by $3.2 million to $27.8 million at December 31, 2013, from $24.6 million at December 31, 2012. This increase in net debt primarily reflects the use of our bank lines, along with retained cash generated by operations, to increase investment in working capital to support our sales growth as well as financing the $3.0 million Leland acquisition made during 2013. Overall net debt compared to total capitalization stood at 23.5% as of December 31, 2013, compared to 24.4% at December 31, 2012. At December 31, 2013 our ratio of net debt-to-EBITDA for the previous 12 months was 1.3 times, compared to 2.0 times at December 31, 2012. Net debt-to-EBITDA and net debt to total capitalization serve as indicators of our financial leverage, however they are not measures prescribed by IFRS and our method of calculating these measures may differ from methods used by other issuers.

We have independent credit facilities in both Canada and the U.S. Our Canadian credit facility, which has a maturity date of August 7, 2016, provides financing up to $15.0 million. On February 15, 2013, our US credit facility was amended to increase the maximum borrowing available under the credit facility to US$45 million and to extend the maturity date to May 26, 2016. On May 31, 2013, our US credit facility was further amended to increase the maximum borrowing available to US$50 million. This amendment was undertaken concurrently with the completion of the Leland acquisition. Our credit 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 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, 2013 is provided in the following table. At December 31, 2013, we had total borrowing capacity available of $29.8 million for future use, as well as to cover checks issued in excess of funds on deposit, which at December 31, 2013, amounted to $0.4 million.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Canadian Credit Facility	**US Credit Facility**
Maximum borrowings under credit facility	$15 million	$ 53.2 million (US$50 million)
Credit facility expiry date	August 7, 2016	May 26, 2016
Available to borrow	$ 14.3 million	$ 43.3 million (US$ 40.7 million)
Credit facility borrowings	$ 4.0 million	$ 23.8 million (US$ 22.4 million)
Unused credit facility available	$ 10.3 million	$ 19.5 million (US$ 18.3 million)
Financial covenants:		
	Covenant does not apply when the unused credit facility available exceeds $2.0 million, which it did at December 31, 2013	Covenant does not apply when the unused credit facility available exceeds US$2.5 million, which it did at December 31, 2013

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. This could, 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, 2013. 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 2016, 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, 2013. These obligations relate to leases on various premises and automobiles and become due in the fiscal years indicated.

(in thousands of Canadian dollars)

Total	2014	2015	2016	2017	2018	2019 and thereafter
$ 19,255	$ 6,661	$ 4,804	$ 2,706	$ 1,393	$ 1,140	$ 2,551

5.5 Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

5.6 Financial Instruments

Financial assets include cash and current and long-term receivables, which are measured at amortized cost. Financial liabilities include bank indebtedness, accounts payable and accrued liabilities, income taxes payable and finance lease obligations which are measured at amortized cost. The carrying values of our cash, accounts receivable, income taxes payable, 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 and term to maturity. 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 10, 2014 we had 16,539,378 common shares issued and outstanding. In addition at March 10, 2014 we had 30,618 performance share grants and 108,719 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

We declared a quarterly dividend of $0.035 per share in the fourth quarter of 2013, which was paid on January 31, 2014 to shareholders of record as at January 20, 2014. On March 10, 2014 we declared a quarterly dividend of $0.045 per share, payable on April 30, 2014 to shareholders of record as at April 18, 2014.

6.0 Related Party Transactions

There were no material related party transactions in the three and twelve months ended December 31, 2013 and 2012.

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.

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.

7.2 Adoption of New Accounting Policies

The Company has adopted the following new standard, including any consequential amendments to other standards, with a date of initial application of January 1, 2013:

IFRS 13, *Fair Value Measurement*

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair values measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair values as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7, Financial Instruments: Disclosures ("IFRS 7"). As a result, the Company has included additional disclosure over fair value measurements in Note 6 of the Audited Financial Statements.

In accordance with the transitional provisions of IFRS 13, the Company has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurement of the Company's assets and liabilities.

The following new or amended IFRSs became effective on January 1, 2013. However, they did not have a material impact on the consolidated financial statements of the Company:
IFRS 10, *Consolidated Financial Statements*
IFRS 11, *Joint Arrangements*
IFRS 12, *Disclosure of Interests in Other Entities*
Amendments to IAS 28, *Investments in Associates and Joint Ventures*
Amendments to IAS 1, *Presentation of Financial Statements (presentation of items in other comprehensive income).*

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2013, and have not been applied in preparing the Audited Financial Statements. The following pronouncements are considered by the Company to be the most significant of several pronouncements that may affect the financial statements in future periods.

IFRS 9, *Financial Instruments*

IFRS 9, *Financial Instruments* (2009, 2010 and 2013) ("IFRS 9 (2009)", "IFRS 9 (2010)" and "IFRS 9 (2013)") will replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 (2009) will replace the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortized cost and fair value. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Also, IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities and IFRS 9 (2013) provides a new general hedge accounting standard.

The mandatory effective date is not yet determined, however early adoption of the new standard is permitted. The Company does not intend to adopt IFRS 9 (2009), IFRS 9 (2010) or IFRS 9 (2013) in its consolidated financial statements for the annual period beginning on January 1, 2014. The Company does not expect IFRS 9 (2009), IFRS 9 (2010) and/or IFRS 9 (2013) to have a material impact on the consolidated financial statements. The classification and measurement of the Company's financial instruments is not expected to change under IFRS 9 because of the nature of the Company's operations and the types of financial instruments that it holds.

IAS 32, *Offsetting Financial Assets and Liabilities*

The amendments to IAS 32, which are effective for years commencing on or after January 1, 2014, clarify the guidance as to when an entity has a legally enforceable right to set off financial assets and financial liabilities, and clarify when a settlement mechanism provides for net settlement. The Company intends to adopt the amendments to IAS 32 in its consolidated

financial statements for the year commencing January 1, 2014. The Company does not expect the amendments to have a material impact on the consolidated 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 identify significant risks that we were aware of in our Annual Information Form which is available to readers along with other disclosure information at www.sedar.com.

US Trade Case:

On September 27, 2012 an unfair trade petition was filed in the United States seeking the imposition of countervailing duties (“CVD”) and antidumping duties (“AD”) against Chinese hardwood plywood. Hardwoods estimates approximately 14% of its total sales are of product imported from China that was subject to the outcomes of this trade dispute. The trade petition was brought by a coalition of U.S. plywood manufacturers (“Petitioners”), alleging that Chinese imports are sold in the United States at prices below cost and are subsidized by the Government of China. On February 27, 2013 the US Department of Commerce (“Commerce”) completed the preliminary stage of its CVD investigation and imposed a preliminary CVD rate of 22.63% against most Chinese mill producers. On April 29, 2013 Commerce announced it had completed the preliminary stage of its AD duty investigation, and imposed a preliminary AD duty rate of 22.14% against most Chinese mill producers. On September 27, 2013 Commerce issued its final determinations with respect to the trade case and imposed a final CVD rate of 13.58% and final AD rate of 59.46%, for a total combined final CVD/AD duty rate of 73.04% which was scheduled to come fully into effect in late November 2013.

On November 5, 2013 a second US government agency, the International Trade Commission (“ITC”), issued a ruling which resulted in the complete dismissal of the trade case. On January 17, 2014 Petitioners filed a summons with the U.S. Court of International Trade to appeal the ITC ruling. We will follow the appeal process closely. It is expected a ruling from the U.S. court system will take 18 to 24 months, and that no duty liabilities related to importing Chinese hardwood plywood will arise during this period of time.

Economic Sanctions against Russia:

In March 2014 trade sanctions were threatened by the United States and Canada against Russia, in response to Russia's actions in the Crimean peninsula of Ukraine. Hardwoods is closely monitoring developments in Ukraine that may lead to trade sanctions against Russia, as approximately 2% of Hardwoods sales are of product that is sourced from Russia.

9.0 Disclosure Controls and Procedures and Internal Control over Financial Reporting

Our management, under the supervision of our 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.

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, 2013. The evaluation was carried out under the supervision of, and with the participation of, the CEO and CFO. Based on this evaluation, our CEO and CFO concluded that our DC&P were effective as of December 31, 2013.

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, 2013. The evaluation was carried out within the 1992 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, 2013.

There have not been any changes in our ICFR during the quarter ended December 31, 2013 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: we view 18% as a sustainable gross margin target for our business, while recognizing that results may fluctuate up or down based upon short-term market conditions; our view that while the overall impact on 2013 results was not significant, a sustained reduction in the value of the Canadian value dollar would be a positive trend for our business going forward; that we believe our financial position gives us the flexibility we need to continue implementing our strategy and capitalizing on growth in the US market; that with approximately 75% of our business in the US, and approximately 60% of our products estimated as going into the residential construction market, we are well positioned to capitalize on the market recovery underway; our perspective that the outlook for the US repair and remodeling market is also positive with growth of over 10% forecast into 2014 by Harvard's Joint Center for Housing Studies, while indicators for commercial construction are for steady mid-single digit growth in 2014; that our outlook for the US market is strengthened by the recent dismissal of the US trade case against imported hardwood plywood panels produced in China; that with trade duties eliminated and the expectation of ongoing strength in pricing for our key products, we anticipate 2014 will be a strong year for our US operations; our outlook for the Canadian market remains neutral, with 2014 housing starts expected to remain unchanged from 2013 levels, and that growth in the Canadian renovation and commercial construction markets is expected to be in line with inflation; that our goal in 2014 continues to be to capture the US market growth potential, both in terms of volume and pricing; our perspective that with a consistent gross margin percentage and the ability to pass price increases through to our customers, our business model enables increases in volume and pricing to have a significantly positive impact on our earnings and cash flow; that our priorities will be to implement our "leverage imports and strengthen commercial" strategies, while continuing to pursue well-priced, acquisition opportunities that support our objectives; that our in terms of cash utilization our primary focus in 2014 will remain on

retaining the cash necessary to finance the significant market growth opportunity in the US and to keep our balance sheet strong to support strategic acquisitions; that we estimate about 60% of our products are used in new residential construction, in the form of cabinets, mouldings, custom finishing, and home furniture and 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; that 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; that our ongoing maintenance capital expenditures for our operations are anticipated to be approximately $1.0 million annually; 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 2016, 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; that we believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy; what we will follow the appeal process closely in the US trade case against Chinese hardwood plywood imports; that it is expected a ruling from the U.S. court system will take 18 to 24 months, and that no duty liabilities related to importing Chinese hardwood plywood will arise during this period of time; and that Hardwoods is closely monitoring developments in Ukraine that may lead to trade sanctions against Russia, as approximately 2% of Hardwoods sales are of product that is sourced from Russia.

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 International Financial Reporting Standards and, where appropriate, reflect management's best estimates and judgments. 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, 2013 and 2012, the consolidated statements of comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with 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 the 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, 2013 and 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Accountants

March 10, 2014
Vancouver, Canada

HARDWOODS DISTRIBUTION INC.

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

	Note	December 31, 2013	December 31, 2012
Assets			
Current assets:			
Cash		$ 78	$ 94
Accounts receivable	7	42,382	34,760
Inventories	8	62,288	51,116
Prepaid expenses		1,205	1,023
Total current assets		105,953	86,993
Non-current assets:			
Long-term receivables	7	1,363	1,208
Property, plant and equipment	9	7,492	6,492
Deferred income taxes	13	13,443	14,625
Intangible asset		13	17
Total non-current assets		22,311	22,342
Total assets		$ 128,264	$ 109,335
Liabilities			
Current liabilities:			
Bank indebtedness	10	$ 27,881	$ 24,683
Accounts payable and accrued liabilities	7,426	6,673	
Income taxes payable		-	211
Finance lease obligation	11	872	697
Dividend payable	5	574	492
Total current liabilities		36,753	32,756
Non-current liabilities:			
Finance lease obligation	11	828	567
Total non-current liabilities		828	567
Total liabilities		37,581	33,323
Shareholders' equity			
Share capital	12(a)	45,298	44,762
Contributed surplus		104,911	104,903
Deficit		(61,031)	(71,803)
Accumulated other comprehensive income (loss)	1,505	(1,850)	
Shareholders' equity		90,683	76,012
Total shareholders' equity and liabilities		$ 128,264	$ 109,335

Subsequent events (note 5)

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, 2013 and 2012

	Note	2013	2012
Sales		$ 371,215	$ 306,087
Cost of sales	8	(303,599)	(252,277)
Gross profit		67,616	53,810
Operating expenses:			
Selling and distribution		(38,757)	(33,980)
Administration		(8,933)	(8,749)
		(47,690)	(42,729)
Profit from operating activities		19,926	11,081
Finance expense	14	(1,112)	(1,163)
Finance income	14	934	410
Net finance costs		(178)	(753)
Profit before income taxes		19,748	10,328
Income tax expense:			
Current	13	(5,002)	(1,423)
Deferred	13	(1,679)	(2,726)
		(6,681)	(4,149)
Profit for the year		13,067	6,179
Other comprehensive income (loss):			
Exchange differences translating foreign operations		3,355	(787)
Total comprehensive income for the year		$ 16,422	$ 5,392
Basic profit per share	12(c)	$ 0.80	$ 0.38
Diluted profit per share	12(c)	$ 0.79	$ 0.38

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, 2013 and 2012

	Note	Share capital	Contributed surplus	Accumulated other comprehensive income (loss) - translation reserve	Deficit	Total
Balance at January 1, 2012		$ 44,061	$ 105,097	$ (1,063)	$ (76,196)	$ 71,899
Share based compensation expense	12(b)	-	477	-	-	477
Share based compensation tax adjustment		-	30	-	-	30
Shares issued pursuant to LTIP	12(b)	701	(701)	-	-	-
Profit for the year		-	-	-	6,179	6,179
Dividends declared		-	-	-	(1,786)	(1,786)
Translation of foreign operations		-	-	(787)	-	(787)
Balance at December 31, 2012		44,762	104,903	(1,850)	(71,803)	76,012
Share based compensation expense	12(b)	-	436	-	-	436
Share-based compensation tax adjustment		-	108	-	-	108
Shares issued pursuant to LTIP	12(b)	536	(536)	-	-	-
Profit for the year		-	-	-	13,067	13,067
Dividends declared		-	-	-	(2,295)	(2,295)
Translation of foreign operations		-	-	3,355	-	3,355
Balance at December 31, 2013		$ 45,298	$ 104,911	$ 1,505	$ (61,031)	$ 90,683

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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2013 and 2012

	Note	2013	2012
Cash flows from operating activities:			
Profit for the year		$ 13,067	$ 6,179
Adjustments for:			
Depreciation and amortization		1,442	1,266
Gain on sale of property, plant and equipment	9	(79)	(37)
Non-cash employee share based compensation	12(b)	436	477
Income tax expense		6,681	4,149
Net finance costs		178	753
Interest received		362	397
Interest paid		(1,117)	(848)
Income taxes paid		(5,203)	(1,185)
		15,767	11,151
Changes in non-cash working capital:			
Accounts receivable		(6,198)	(2,905)
Inventories		(5,366)	(12,768)
Prepaid expenses		(134)	(137)
Accounts payable, accrued liabilities and provisions		444	1,188
		(11,254)	(14,622)
Net cash provided by (used in) operating activities		4,513	(3,471)
Cash flow from financing activities:			
Increase in bank indebtedness		1,776	5,230
Principle payments on finance lease obligation		(781)	(740)
Dividends paid to shareholders	5	(2,213)	(1,615)
Net cash provided by (used in) financing activities		(1,218)	2,875
Cash flow from investing activities:			
Additions to property, plant and equipment		(944)	(848)
Proceeds on disposal of property, plant and equipment		212	112
Business acquisition	4	(2,984)	-
Payments received on long-term receivables		405	1,034
Net cash provided by (used in) investing activities		(3,311)	298
Decrease in cash		(16)	(298)
Cash, beginning of year		94	392
Cash, end of year		$ 78	$ 94
Supplementary information:			
Property, plant and equipment acquired under finance leases, net of disposals		$ 1,159	$ 620
Accounts receivable transferred to long-term notes receivable		869	-

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

1. Nature of operations:

Hardwoods Distribution Inc. (the "Company") is incorporated under the Canada Business Corporations Act trading on the Toronto Stock Exchange under the symbol "HWD." Subsidiaries of the Company operate a network of 32 distribution centers in Canada and the US engaged in the wholesale distribution of hardwood lumber and related sheet goods and specialty products.

The Company's principal office is located at #306, 9440 202nd Street, Langley, British Columbia V1M 4A6.

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. The consolidated financial statements were authorized for issue by the Board of Directors on March 10, 2014.

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis.

(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 year. 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 year in which the estimates are revised and in any future years affected.

Information about significant areas of estimation uncertainty 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 Olam Wood Products business combination;
- Note 6 and 7 – the collectability of accounts receivable and the determination of the allowance for credit loss;
- Note 12(b) – the measurement of long term incentive plan compensation; and
- Note 18 – the determination and measurement of provisions and contingencies.

2. Basis of preparation (continued):

(d) Use of estimates and judgment (continued)

Critical judgments in applying policies that have the most significant effect on the amounts recognized in the consolidated financial statements are included in the following notes:

- Note 11 – the classification of lease obligations; and
- Note 13 – the valuation of deferred income taxes and utilization of tax loss carry forwards.

In assessing the Company's vehicle leases judgment is required in determining whether substantially all of the risks and rewards are transferred to the Company. This involves assessing the term of each lease, the risk associated with the residual value of leased vehicles and assessing the present value of the minimum lease payments in relation to the fair value of the vehicle at the inception of the lease. For deferred income taxes judgment is required in determining whether it is probable that the Company's net deferred tax assets will be realized. In making such a determination, the Company considers the carry forward periods of losses and the Company's projected future taxable income.

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 years presented in these consolidated financial statements.

(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 LP, Hardwoods Specialty Products GP, Hardwoods Specialty Products USLP, Hardwoods Specialty Products USGP, Paxton Hardwoods LLC, and Hardwoods Specialty Products (Washington) Corp.

(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 year, adjusted for effective interest and payments during the year, and the amortized cost in the foreign currency translated at the exchange rate at the end of the year. Such exchange gains or losses arising from translation are recognized in profit and loss for the reporting year in net finance costs.

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

3. Significant accounting policies (continued):

(b) Foreign currencies (continued):

Translation of foreign operations for consolidation (continued)

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 year 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 considered 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 15.

(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 and the unwinding of the discount on the Company's finance lease obligations. Interest on bank indebtedness and accretion of the lease obligation is expensed using the effective interest method.

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.

3. Significant accounting policies (continued):

(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
Machinery and equipment	3 to 30 years
Mobile equipment	5 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.

(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

3. Significant accounting policies (continued):

(h) Impairment (continued):

Non-financial assets (continued)

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 years 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.

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

3. Significant accounting policies (continued):

(i) Financial instruments (continued):

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.

Financial assets

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 is 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".

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 except to the extent that it relates to items recognized directly in equity or in other comprehensive income. 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.

3. Significant accounting policies (continued):

(j) Income taxes (continued):

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 policies applicable to property, plant and equipment. 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.

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.

3. Significant accounting policies (continued):

(m) Basic and diluted profit per share:

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

(n) Share based compensation:

The Company has a share based long-term incentive plan as described in note 12(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.

(o) New accounting policies:

(i) Change in accounting policy:

The Company has adopted the following new standard, including any consequential amendments to other standards, with a date of initial application of January 1, 2013:

IFRS 13, *Fair Value Measurement*

IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair values measurements when such measurements are required or permitted by other IFRSs. It unifies the definition of fair values as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7, *Financial Instruments: Disclosures* ("IFRS 7"). As a result, the Company has included additional disclosure over fair value measurements in Note 6.

In accordance with the transitional provisions of IFRS 13, the Company has applied the new fair value measurement guidance prospectively and has not provided any comparative information for new disclosures. Notwithstanding the above, the change had no significant impact on the measurement of the Company's assets and liabilities.

(ii) The following new or amended IFRSs became effective on January 1, 2013. However, they did not have a material impact on the consolidated financial statements of the Company:

IFRS 10, *Consolidated Financial Statements*

IFRS 11, *Joint Arrangements*

IFRS 12, *Disclosure of Interests in Other Entities*

Amendments to IAS 28, *Investments in Associates and Joint Ventures*

3. Significant accounting policies (continued):

(o) New accounting policies (continued):

(ii) New or amended IFRSs (continued):

Amendments to IAS 1, *Presentation of Financial Statements (presentation of items in other comprehensive income)*

(iii) New standards and interpretations not yet adopted:

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2013, and have not been applied in preparing these financial statements. The following pronouncements are considered by the Company to be the most significant of several pronouncements that may affect the financial statements in future periods.

IFRS 9, *Financial Instruments*

IFRS 9, *Financial Instruments* (2009, 2010 and 2013) ("IFRS 9 (2009)", "IFRS 9 (2010)" and "IFRS 9 (2013)") will replace IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 (2009) will replace the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortized cost and fair value. The approach in IFRS 9 (2009) is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Also, IFRS 9 (2010) added guidance to IFRS 9 (2009) on the classification and measurement of financial liabilities and IFRS 9 (2013) provides a new general hedge accounting standard.

The mandatory effective date is not yet determined, however early adoption of the new standard is permitted. The Company does not intend to adopt IFRS 9 (2009), IFRS 9 (2010) or IFRS 9 (2013) in its consolidated financial statements for the annual period beginning on January 1, 2014. The Company does not expect IFRS 9 (2009), IFRS 9 (2010) and/or IFRS 9 (2013) to have a material impact on the consolidated financial statements. The classification and measurement of the Company's financial instruments is not expected to change under IFRS 9 because of the nature of the Company's operations and the types of financial instruments that it holds.

IAS 32, *Offsetting Financial Assets and Liabilities*

The amendments to IAS 32, which are effective for years commencing on or after January 1, 2014, clarify the guidance as to when an entity has a legally enforceable right to set off financial assets and financial liabilities, and clarify when a settlement mechanism provides for net settlement. The Company intends to adopt the amendments to IAS 32 in its consolidated financial statements for the year commencing January 1, 2014. The Company does not expect the amendments to have a material impact on the consolidated financial statements.

4. Business acquisition:

On May 31, 2013 a subsidiary of the Company purchased certain assets of Olam Wood Products ("OWP") with the intention to continue operations of the business. OWP is an importer of high quality tropical lumber and decking material from Africa and South America for resale to industrial customers and wholesale distributors located in North America. OWP conducts business in Leland, North Carolina. The Company's subsidiary purchased the inventory and property, plant and equipment of OWP for cash consideration of $3.0 million (US$2.9 million) and hired OWP's employees to continue operating the business.

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

Inventory	$	2,911
Property, plant and equipment		73
Cash paid	$	2,984

As part of the acquisition, the building has been leased from the previous landlord at market rates. Liabilities were not assumed.

Had the acquisition occurred on January 1, 2013 management estimated that the Company's consolidated sales would have been approximately $373.3 million and profit would have been approximately $13.2 million for the year ended December 31, 2013. Sales included in these condensed consolidated interim financial statements for the period from June 1, 2013 to December 31, 2013 for OWP were $2.9 million. There was no material impact on profit in the period arising from the OWP acquisition.

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. The Company's capitalization is as follows:

		December 31, 2013		December 31, 2012
Cash	$	(78)	$	(94)
Bank indebtedness		27,881		24,683
Shareholders' equity		90,683		76,012
Total capitalization	$	118,486	$	100,601

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, 2013 and December 31, 2012 and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

5. Capital management (continued):

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, 2013.

On November 14, 2013 Hardwoods Distribution Inc. declared a cash dividend of $0.035 per common share to shareholders of record as of January 20, 2014. The dividend was paid to shareholders on January 31, 2014. On March 10, 2014, the Company declared a cash dividend of $0.045 per common share to shareholders of record as of April 18, 2014 to be paid on April 30, 2014.

6. Financial instruments:

Financial instrument assets include cash and current and long-term receivables, which are designated as loans and receivables and measured at amortized cost. Non-derivative financial instrument liabilities include bank indebtedness, accounts payable, income taxes payable, and finance lease obligation. 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.

Fair value hierarchy

IFRS 13 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. The three levels of the fair value hierarchy established by IFRS 7 are as follows:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly, for substantially the full contractual term.

Level 3 - Inputs for the asset or liability are not based on observable market data.

The Company has no financial assets or financial liabilities measured in the statement of financial position at fair value or included in Level 3 of the fair value hierarchy.

Fair values of financial instruments

The carrying values of cash, accounts receivable, income tax payable, and accounts payable 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, being level 2 of the fair value hierarchy.

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,

6. Financial instruments (continued):

Financial risk management (continued):

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 $43.7 million at December 31, 2013 (2012 - $36.1 million), represents the Company's maximum exposure to credit risk.

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. The Company attempts 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 5.3% (2012 – 6.0%) of trade accounts receivable and customer notes receivable at December 31, 2013. No one customer represents more than 2.0% 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

6. Financial instruments (continued):

Financial risk management (continued):

Customer notes (continued):

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%-10%.

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.

(*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, 2013, 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 $53.2 million (US$50.0 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, 2013 the Canadian and U.S. credit facilities had $10.3 million and $19.5 million (US$18.3million), respectively, of additional borrowing capacity before checks issued in excess of funds on deposit of $0.4 million (2012 - $0.1 million).

The Company's accounts payable and accrued liabilities are subject to normal trade terms and have contracted maturities that will result in payment in the following quarter. The undiscounted contractual maturities of finance lease obligations are presented in note 11 to these consolidated 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, 2013 bank indebtedness balance of $27.8 million, a 1% increase or decrease in the interest rates charged would result in decrease or increase to annual net earnings by approximately $0.2 million.

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 three-quarters 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, 2013 the Company's Canadian subsidiaries primary exposure to foreign denominated financial instruments was in relation to US dollar cash balances, accounts receivable from U.S. customers (2013 - US$0.4 million, 2012 – US$0.2 million) and accounts payable to U.S. suppliers (2013 - $0.4 million, 2012 – US$0.3 million).

Based on the Company's Canadian subsidiaries exposure to foreign denominated financial instruments, the Company estimates a $0.05 weakening or strengthening in the Canadian dollar as compared to the U.S. dollar would not have a material effect on net income for the years ended December 31, 2013 or December 31, 2012.

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, 2013 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.

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, 2013	December 31, 2012
Trade accounts receivable - Canada	$ 11,642	$ 11,128
Trade accounts receivable - United States	31,138	26,284
Sundry receivable	1,807	159
Income taxes receivable	90	7
Current portion of long-term receivables	693	260
	45,370	37,838
Less:		
Allowance for credit loss	2,988	3,078
	$ 42,382	$ 34,760
Long-term receivables:		
Employee housing loans	$ 378	$ 382
Customer notes	1,268	675
Security deposits	410	411
	2,056	1,468
Less:		
Current portion, included in accounts receivable	693	260
	$ 1,363	$ 1,208

The aging of trade receivables was:

	December 31, 2013	December 31, 2012
Current	$ 30,822	$ 23,232
Past due 31 - 60 days	7,143	8,484
Past due 61 - 90 days	2,524	2,709
Past due 90+ days	2,291	2,987
	$ 42,780	$ 37,412

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, 2013 was $3.0 million (December 31, 2012 - $3.1 million). The amount of the allowance is considered sufficient based on the past experience of the business, current and expected collection trends, the security the Company has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

7. Accounts receivable (continued):

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

	2013	2012
Balance as at January 1	$ 3,078	$ 2,830
Additions during the year	2,344	822
Use during the year	(2,686)	(529)
Changes due to currency rate fluctuations	252	(45)
Balance as at December 31	$ 2,988	$ 3,078

Bad debt expense, net of recoveries, for the year ended December 31, 2013 was $1.9 million which equates to 0.5% of sales (year ended December 31, 2012 – $1.0 million, being 0.3% of sales).

8. Inventories:

	December 31, 2013	December 31, 2012
Lumber	$ 18,189	$ 15,394
Sheet goods	29,802	25,607
Specialty	7,223	5,249
Goods in-transit	7,074	4,866
	$ 62,288	$ 51,116

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

	Year ended December 31, 2013	Year ended December 31, 2012
Inventory write-downs	$ 1,103	$ 712
Cost of inventory sold	$ 293,394	$ 243,389
Other cost of sales	10,205	8,888
Total cost of sales	$ 303,599	$ 252,277

9. Property, plant and equipment:

	Leased vehicles	Machinery and equipment	Mobile equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2012	$ 2,536	$ 5,678	$ 3,504	$ 756	$ 12,474
Additions	948	450	361	37	1,796
Disposals	(992)	(69)	(24)	(34)	(1,119)
Adjustments:					
Foreign currency translation	(33)	(105)	(55)	(5)	(198)
Balance at December 31, 2012	2,459	5,954	3,786	754	12,953
Additions	1,408	813	196	8	2,425
Disposals	(1,172)	(156)	(47)	(13)	(1,388)
Adjustments:					
Foreign currency translation	112	353	186	25	676
Balance at December 31, 2013	$ 2,807	$ 6,964	$ 4,121	$ 774	$ 14,666
Accumulated depreciation					
Balance at January 1, 2012	$ 1,022	$ 1,849	$ 2,493	$ 627	$ 5,991
Depreciation during year	654	357	200	51	1,262
Disposals	(600)	(69)	(9)	(34)	(712)
Adjustments:					
Foreign currency translation	(13)	(24)	(39)	(4)	(80)
Balance at December 31, 2012	1,063	2,113	2,645	640	6,461
Depreciation during year	713	461	209	55	1,438
Disposals	(838)	(111)	(44)	(13)	(1,006)
Adjustments:					
Foreign currency translation	43	99	128	11	281
Balance at December 31, 2013	$ 981	$ 2,562	$ 2,938	$ 693	$ 7,174
Net book value:					
December 31, 2012	$ 1,396	$ 3,841	$ 1,141	$ 114	$ 6,492
December 31, 2013	1,826	4,402	1,183	81	7,492

Depreciation of property, plant and equipment for the year ended December 31, 2013 was $1.4 million (2012 - $1.3 million) and is included in the statement of comprehensive income as follows:

	2013	2012
Selling and distribution	$ 1,033	$ 935
Cost of sales	364	287
Administration	41	40
	$ 1,438	$ 1,262

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2013 was a net gain of $79,225 (2012 - $37,181) and is included in selling and distribution in the statement of comprehensive income.

10. Bank indebtedness:

	December 31, 2013	December 31, 2012
Checks issued in excess of funds on deposit	$ 440	$ 127
Credit facility, Hardwoods LP	4,000	5,693
Credit facility, Hardwoods USLP (December 31, 2013 - US$22,039; December 31, 2012 - US$18,959)	23,441	18,863
	$ 27,881	$ 24,683

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 directly and indirectly by 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 directly and indirectly by the Company.

The Hardwoods LP Credit Facility, which expires August 7, 2016, provides financing up to $15.0 million. At December 31, 2012 the Hardwoods USLP Credit Facility had a four year term with a maturity date of May 26, 2015 and the maximum borrowing available under the credit facility was US$30 million. On February 15, 2013 the Hardwoods USLP credit facility was amended to increase the maximum borrowing available under the credit facility to US$45 million, and extend the maturity date of the credit facility to May 26, 2016. On May 31, 2013 the Hardwoods USLP Credit Facility was further amended to increase the maximum borrowing available under the Credit Facility to US$50.0 million concurrently with completion of the OWP acquisition. 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 earnings before interest, tax, depreciation and amortization ("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, 2013, the Hardwoods LP credit facility had $10.3 million of available borrowing capacity (December 31, 2012 - $7.6 million).

10. Bank indebtedness (continued):

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, 2013, the Hardwoods USLP credit facility had unused availability of $19.5 million (US$18.3 million) before checks issued in excess of funds on deposit of $0.4 million (December 31, 2012 - $11.0 million (US$11.1 million), checks issued in excess of funds on deposit of $0.1 million).

The average annual interest rates paid in respect of bank indebtedness for the year ended December 31, 2013 were 3.4% and 2.3% (2012 – 3.4% and 2.5%) for the Hardwoods LP and Hardwoods USLP credit facilities, respectively. In addition, standby fees of 0.25% and 0.25% (2012 – 0.25% and 0.25%) related to the unused portion of the credit facilities was charged by the banks for Hardwoods LP and Hardwoods USLP respectively.

11. Leases:

(a) Finance leases as lessee:

Subsidiaries of the Company lease vehicles with terms ranging from 18 to 36 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:

		Within	One to
Minimum lease payments due	one year	three years	Total
December 31, 2013:			
Future minimum lease payments	$ 949	$ 862	$ 1,811
Interest	77	34	111
Present value of minimum payments	$ 872	$ 828	$ 1,700
December 31, 2012:			
Future minimum lease payments	$ 750	$ 592	$ 1,342
Interest	53	25	78
Present value of minimum payments	$ 697	$ 567	$ 1,264

The present value of the lease payments is calculated using the interest rate implicit in the lease, which range from 2.1% – 6.9%.

11. Leases (continued):

(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	one year	Within five years	One to five years	After Total
Minimum lease payments due:				
December 31, 2013	$ 5,713	$ 10,084	$ 1,648	$ 17,444
Minimum sublease revenue receivable:				
December 31, 2013	47	-	-	47

Minimum lease payments recognized as an expense during the year ended December 31, 2013 amount to $5.8 million (2012 - $5.5 million). Sublease payments received during the year ended December 31, 2013 were $0.3 million (2012 - $0.2 million) and are recognized as a reduction to selling and distribution costs on the statement of comprehensive income.

The Company's warehouse leases are combined leases of the land and building; however both the land and building elements are considered operating leases as the risk and reward of ownership remains with the landlord. The Company's operating lease agreements do not contain any contingent rent clauses. Some operating warehouse lease agreements contain renewal options but none contain any restrictions regarding distributions, further leasing or additional debt. Renewal options are reviewed regularly by management.

12. Share Capital:

(a) Share Capital

At December 31, 2013, the authorized share capital of the Company comprised an unlimited number of common shares without par value ("Shares").

A continuity of share capital is as follows:

	Shares	Total
Balance at December 31, 2011	16,095,343	$ 44,061
Issued pursuant to long term incentive plan	299,147	701
Balance at December 31, 2012	16,394,490	44,762
Issued pursuant to long term incentive plan	144,888	536
Balance at December 31, 2013	16,539,378	$ 45,298

12. Share Capital (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.

At the Annual General Meeting held on May 22, 2013, shareholders approved to increase the number of common shares issuable under the LTIP by 800,000 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.

12. Share Capital (continued):

(b) Long Term Incentive Plan (continued):

A continuity of the LTIP Shares outstanding is as follows:

	Performance Shares	Restricted Shares
Balance at December 31, 2011	104,856	219,442
LTIP shares issued during the year	17,049	60,537
LTIP shares settled by exchange for free-trading Common shares	(80,225)	(130,834)
Balance at December 31, 2012	41,680	149,145
LTIP shares issued during the year	13,569	48,182
LTIP shares settled by exchange for free-trading Common shares	(24,631)	(88,608)
Balance at December 31, 2013	30,618	108,719

On December 31, 2013, 24,631 Performance Shares and 88,608 Restricted Shares became fully vested and were settled by the issuance of 144,888 shares with a value of $0.4 million.

As of March 31, 2012, 40,113 Performance Shares became fully vested and were settled by the issuance of 80,774 Shares with a value of $0.2 million. On December 31, 2012, 40,112 Performance Shares and 130,834 Restricted Shares became fully vested and were settled by the issuance of 218,403 Shares with a value of $0.5 million.

Non-cash LTIP compensation expense amount of $435,607 was recorded for the year ended December 31, 2013 (2012 – $476,941). The key estimate in determining the compensation in any period is whether the performance criteria have been met and the amount of the payout multiplier on the Performance Shares. The payout multiplier is reviewed and approved by the Company's compensation committee on an annual basis.

(c) Weighted average shares

The calculation of basic and fully diluted profit per share is based on the profit for the year of $13.1 million (2012 – $6.2 million). The weighted average number of common shares outstanding in each of the reporting years was as follows:

	2013	2012
Issued ordinary shares/units at January 1	16,394,490	16,095,342
Effect of shares issued during the year:		
Pursuant to long-term incentive plan	397	61,433
Weighted average common shares (basic)	16,394,887	716,156,775
Effect of dilutive securities:		
Long term incentive plan	232,411	259,583
Weighted average common shares (diluted)	16,627,298	16,416,358

13. Income taxes:

	2013	2012
Current tax expense	$ (5,002)	$ (1,423)
Deferred tax recovery (expense)	(1,679)	(2,726)
	$ (6,681)	$ (4,149)

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, 2013 is 26.0% (2012 – 25.7%) and in the United States is 39.4% (2012 – 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.

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:

	2013	2012
Profit before income tax	$ 19,748	$ 10,328
Statutory rate	39.4%	39.4%
Computed tax expense at statutory rate	$ (7,781)	$ (4,069)
Effect of lower tax rates in Canada and other rate changes	731	127
Non-deductible expenses	(190)	(217)
State tax	(8)	(35)
Other	567	45
Income tax expense	$ (6,681)	$ (4,149)

13. Income taxes (continued):

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, 2013	December 31, 2012
Deferred tax assets:		
Accounts receivable	$ 1,145	$ 1,170
Accounts payable and provisions	263	135
Inventory	866	704
Finance lease obligations	579	425
Goodwill	9,350	10,211
Tax loss carry forwards and future interest deductions	2,649	3,081
Other	107	-
	14,959	15,726
Deferred tax liabilities:		
Prepaid expenses	(169)	(142)
Property, plant and equipment	(1,342)	(729)
Employee housing loans	(5)	(5)
Finance charges and other	-	(225)
	(1,516)	(1,101)
Deferred tax asset	$ 13,443	$ 14,625

Deferred tax assets and liabilities are measured at the substantively enacted rates expected to apply at the time such temporary differences are forecast to reverse.

At December 31, 2013, subsidiaries of the Company have operating loss carry forwards for income tax purposes of approximately $9.9 million in Canada and nil in the United States that may be utilized to offset future taxable income (December 31, 2012 - $11.6 million and US$nil, respectively). These losses, if not utilized, expire between 2015 and 2031.

At December 31, 2013, the Company and its Canadian subsidiaries have capital losses of approximately $24.1 million (2012 - $24.1 million), and suspended capital losses of approximately $44.7 million (2012 - $44.7 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 $8.9 million (2012 - $8.9 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.

14. Finance income and expense:

	Note	Year ended December 31, 2013	Year ended December 31, 2012
Finance expense:			
Interest on bank indebtedness	10	$ 1,016	$ 780
Accretion of finance lease obligation	11	96	83
Foreign exchange losses		-	300
Total finance expense		1,112	1,163
Finance income:			
Interest on trade receivables, customer notes, and employee loans receivable	7	375	410
Foreign exchange gains		559	-
Total finance income		934	410
Net finance costs		$ 178	$ 753

15. Segment reporting:

Information about geographic areas is as follows:

	Year ended December 31, 2013	Year ended December 31, 2012
Revenue from external customers:		
Canada	$ 94,911	$ 87,740
United States	276,304	218,347
	$ 371,215	$ 306,087

	December 31, 2013	December 31, 2012
Non-current assets [1]:		
Canada	$ 1,118	$ 1,009
United States	6,387	5,508
	$ 7,505	$ 6,517

[1] Excludes financial instruments and deferred income taxes.

16. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are summarized below.

		Year ended December 31, 2013		Year ended December 31, 2012
Wages, salaries, and benefits	$	28,954	$	24,870
Pensions - defined contribution plans		620		561
LTIP Share based compensation		436		477
	$	30,010	$	25,908

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

		Year ended December 31, 2013		Year ended December 31, 2012
Cost of sales	$	1,964	$	1,538
Selling and distribution		22,957		19,841
Administration		5,089		4,529
	$	30,010	$	25,908

(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, 2013, Hardwoods USLP contributed and expensed $274,879 (US$267,036) (year ended December 31, 2012 - $243,245 (US$243,402)) 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, 2013, Hardwoods USLP contributed and expensed $90,655 (US$88,047) (year ended December 31, 2012 $78,965 (US$79,010)) 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, 2013, Hardwoods LP contributed and expensed $254,286 (year ended December 31, 2012 - $238,892) in relation to the LP Plan.

17. Related party transactions:

The Company's related parties include key management personnel and post-employment benefit plans for the employees of the Company's subsidiaries.

(a) 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, 2013	Year ended December 31, 2012
Short-term employee benefits:		
Salaries and benefits including bonuses	$ 2,126	$ 2,036
Company car	37	37
LTIP Share compensation	240	316
Total remuneration	$ 2,403	$ 2,389

The Company offers housing loans to employees required to relocate. Key management had no loans outstanding at either December 31, 2013 or December 31, 2012.

(b) Transactions with post-employment benefit plans:

The defined contribution plans referred to in note 16(b) are related parties of the Company. The Company's transactions with the pension plans include contributions paid to the plans, which are disclosed in note 16(b). The Company has not entered into other transactions with the pension plans, neither has it any outstanding balances at December 31, 2013 or 2012.

18. Contingencies:

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. The Company has no material legal contingency provisions at either December 31, 2013 or 2012.

Decommissioning

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

19. Trade Investigation:

On September 27, 2012 an unfair trade petition was filed in the United States seeking the imposition of countervailing duties ("CVD") and antidumping duties ("AD") against Chinese hardwood plywood. The trade petition was brought by a coalition of U.S. plywood manufacturers (the "Petitioners"), alleging that Chinese imports are sold in the United States at prices below cost and are subsidized by the Government of China. The Company's wholesale distribution of hardwood lumber and related sheet goods and specialty products includes importing and selling hardwood plywood from China.

On February 27, 2013 the US Department of Commerce ("Commerce") announced it had completed the preliminary stage of its CVD investigation and determined preliminary duty rates ranging from zero to 27.16%, with product from most Chinese mills being assessed a preliminary CVD duty of 22.63%. On April 29, 2013 Commerce announced it had completed the preliminary stage of its AD investigation and imposed a preliminary AD rate of 22.14%. On September 27, 2013 Commerce issued its final determinations with respect to the trade case and imposed a final CVD rate of 13.58% and a final AD rate of 59.46%, for a total combined CVD/AD rate of 73.04% which was scheduled to come fully in effect in late November 2013.

On November 5, 2013 a second US government agency, the International Trade Commission ("ITC"), issued a ruling which resulted in the complete dismissal of the trade case. On January 17, 2014 Petitioners filed a summons with the U.S. Court of International Trade to appeal the ITC's decision to dismiss the trade case, a process which is expected to take 18 to 24 months. No duties are anticipated to apply during the appeal process.

Corporate Information

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Graham M. Wilson
President, Grawil Consultants Inc.

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Chair & CEO, Sauder Industries

William Sauder
Executive VP, Sauder Industries

Peter M. Bull
President, Blenheim Realty Ltd.

Officers

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HARDWOODS