HARDWOODS®

For Your Success®

2016 Annual Report

Project: Microsoft Excellence Centre, Vancouver BC
Design by: Clive Wilkinson Architects
Photography: Ema Peters
Product: Shinnoki Ivory Oak

Profile

Hardwoods Distribution Inc. ("Hardwoods" or "the Company") is listed on the Toronto Stock Exchange and trades under the symbol HWD. We are North America's largest wholesale distributor of non-structural architectural grade building products to the residential and commercial construction markets. We sell high-grade hardwood lumber, sheet goods, architectural millwork and create custom moulding and millwork packages for customers. We also own a sawmill and kiln drying operation in Michigan.

Our Customers: Our business serves over 35,000 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.

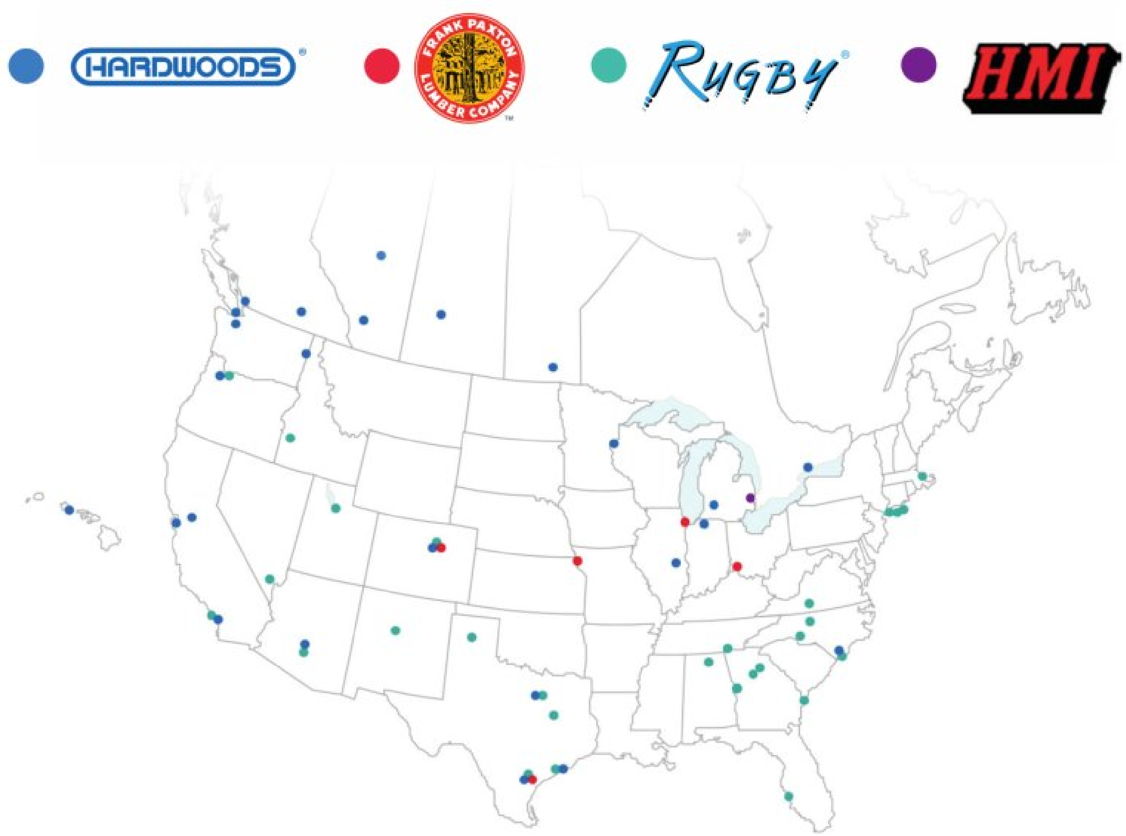
Our End-Markets: We estimate that approximately 52% of the products we sell to our manufacturing customers end up in new residential construction, 30% in the commercial/institutional construction sector, and 18% in other markets.

Our Products and Services: Our sales mix is comprised of approximately 51% sheet good products, 30% hardwood lumber products, and 19% architectural and other specialty products. We provide custom milling services to our customers from twenty three of our locations.

Our People: We employ over 1,000 dedicated employees and maintain 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 and growing commercial and related construction markets. In addition to capturing market growth, our strategy is to i) leverage our established global expertise in product sourcing to secure high-quality, differentiated products for our customers; ii) grow our sales into commercial markets, which represent a significant demand opportunity; and, iii) pursue acquisitions that complement our strategies. Since 2011, we have added 37 new locations, which together have added over $500 million (pro forma) in new annual sales from acquisitions.

Our Network: With the addition of the Rugby operations, approximately 85% of our pro-forma annual sales are expected to be generated in the United States and 15% in Canada. We operate four brands from 59 locations as follows:



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To our Shareholders

2016 was a year of growth and achievement for Hardwoods as we completed a major acquisition, established new records for top and bottom-line results, and continued to pursue our successful business strategies.

The Accretive Rugby Acquisition

Our US$107 million acquisition of Rugby in July 2016 was a transformative transaction for Hardwoods and the highlight of our year. Rugby is a large and successful US wholesale distributor of architectural-grade building products, with a focus on customers that manufacture end-products for the commercial market. With the addition of Rugby's 28 distribution facilities, Hardwoods has emerged as the number one North American distributor in our sector, with a total of 58 distribution facilities, more than 35,000 customers and pro-forma annual sales of approximately $1 billion dollars.

Rugby has significantly increased our footprint in the US, including in the Eastern US where we did not previously have a presence. It has also expanded our access to the commercial market, helping to balance our exposure to the more cyclical residential construction market. On a full-year basis, approximately 85% of our sales will now be transacted in the US, compared to 75% previously, while going forward approximately 35% of our sales will be focused on the commercial market, up from 20% previously. Our product mix has also expanded with the addition of Rugby's product offerings.

The strategic fit of our two organizations is excellent. Other than combining our Boise and Salt Lake City facilities with Rugby's facilities in the same locations, there has been minimal overlap in targeted customer base between our networks. The integration is also going smoothly and it has been a pleasure to welcome Rugby's talented employees. Rugby's full team of managers and employees joined Hardwoods following the acquisition and has increased our bench strength considerably. We continue to work on realizing synergies of the deal including those related to increased purchasing power, operational efficiencies, and tax structuring.

As we anticipated, the transaction has also proved accretive to our annual results. In the five-and-a-half months that we operated this business in 2016, Rugby contributed revenues of $175.1

million. Adjusted diluted profit per share also grew by 10.8% to $1.33 in 2016, even after increasing our share base to finance the acquisition.

Executing our Strategies to Achieve Growth

In addition to the significant growth provided by Rugby, our 2016 results were supported by organic growth, although the pace of growth reflected unevenness in the US residential construction market and some economic uncertainty in the US in the midst of an election year. Organic growth accounted for $20.4 million of our year-over-year sales growth as we continued to execute our "leverage imports" and "strengthen commercial" strategies. Foreign exchange was also a positive influence on full-year results, accounting for $22.2 million of our sales growth.

As we move forward, we are focused on ensuring that our business strategies remain well aligned with market opportunities and challenges. As discussed in section 1.3 of our Management's Discussion & Analysis, the recent launch of a US trade case against imported Chinese hardwood plywood, together with the potential for broader changes to US trade policy, could impact our import program in the US. Conversely, proposed changes to US economic policy, such as a lowering of corporate taxes and investment in infrastructure, could prove beneficial to our business. We are keeping a close eye on the evolving US macro environment and will adapt our strategies accordingly.

On the whole, we believe market conditions will continue to provide us with opportunities for profitable growth. At 1.2 million, US housing starts remain well below the 1.5-to-1.6 million level considered to be normal and sustainable for the industry. Accordingly most forecasters predict a continued gradual strengthening trend for the US residential construction market. In addition, the commercial construction market is enjoying solid growth as the US economy strengthens and key segments like retail, office and hospitality-related construction projects benefit. With our increased access to the commercial market, we are better positioned than ever to take advantage of this opportunity.

The highly fragmented US architectural building products distribution industry also provides us with numerous growth opportunities. With our larger size and scale, and our strong balance sheet, Hardwoods is well positioned to pursue smaller single or multi-site distributors that take us into new markets, expand our presence in current markets in which we operate, and provide accretive growth for our shareholders. The acquisition on March 13, 2017 of Eagle Plywood and Lumber ("Eagle") is an example of our ability to expand our presence in an existing market. Having completed five successful acquisitions in the past five and a half years, we have demonstrated our ability to achieve profitable growth in this way.

Overall, Hardwoods has emerged from 2016 as the North American industry market leader, with a strong, well-balanced distribution platform and a compelling future. We will pursue the broad range of opportunities we see before us, and we thank you, our shareholders, for participating in our continued growth. We look forward to rewarding your trust in us again in 2017.

Sincerely,

Rob Brown
President and Chief Executive Officer

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("Hardwoods" or the "Company") as of March 17, 2017. 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, 2016 and 2015. 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. Furthermore, we discuss certain EBITDA Ratios, such as EBITDA margin (being EBITDA as a percentage of sales), net debt-to-EBITDA (net debt as described in section 5.3 as compared to EBITDA), and certain Liquidity Ratios such as working capital (as defined in section 5.2 of this report) and net debt-to-total capitalization (net debt as compared to total capitalization as described in section 5.3). In addition to profit, we consider EBITDA, EBITDA Ratios, and Liquidity Ratios to be useful supplemental measures of our ability to meet debt service and capital expenditure requirements, and we interpret trends in EBITDA and EBITDA Ratios (such as EBITDA margin) as an indicator of relative operating performance.

In this MD&A, references to "Adjusted EBITDA" are EBITDA as defined above, before certain items related to business acquisition activities. "Adjusted EBITDA margin" and "Adjusted net debt-to-EBITDA" (together the "Adjusted EBITDA Ratios") are as defined above, before certain items related to business acquisition activities. References to "Adjusted profit", "Adjusted basic profit per share", and "Adjusted diluted profit per share" are profit for the period, basic profit per share, and diluted profit per share, before certain items related to business acquisition activities. "Adjusted cash flow per share" is cash provided by operating activities before changes in non-cash working capital and certain items related to business acquisition activities, divided by diluted weighted average common shares outstanding. The aforementioned adjusted measures are collectively referenced as "the Adjusted Measures". We consider the Adjusted Measures to be useful supplemental measures of our profitability, our ability to meet debt service and capital expenditure requirements, our ability to generate cash flow from operations, and as an indicator of relative operating performance, before considering the impact of business acquisition activities.

EBITDA, EBITDA Ratios, Liquidity Ratios and the Adjusted Measures (collectively "the Non-GAAP Measures") are not measures recognized by International Financial Reporting Standards (“IFRS”) and do not have a standardized meaning prescribed by IFRS. Investors are cautioned that the Non-GAAP Measures should not replace profit, earnings per share or cash flows (as determined in accordance with IFRS) as an indicator of our performance. Our method of calculating the Non-GAAP Measures may differ from the methods used by other issuers. Therefore, our Non-GAAP Measures may not be comparable to similar measures presented by other issuers. For a reconciliation between Non-GAAP Measures and measures as determined in accordance with IFRS, please refer to the discussion of Results of Operations described in section 3.0, Cash Flows from Operating, Investing and Financing Activities in section 5.1, Working Capital in section 5.2, and Revolving Credit Facilities and Debt Management Strategy in section 5.3 of this report.

Furthermore, in discussing the acquisition of Rugby we refer to pro-forma annual sales of approximately $1 billion. This represents management's estimate of what the Company's sales for 2016 would have been had the acquisition of Rugby Architectural Building Products ("Rugby") occurred on January 1, 2016 instead of July 15, 2016.

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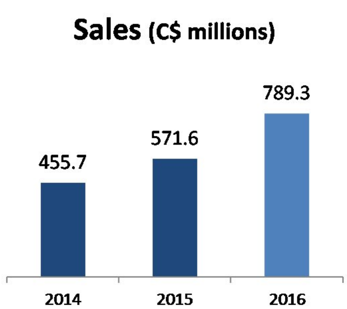
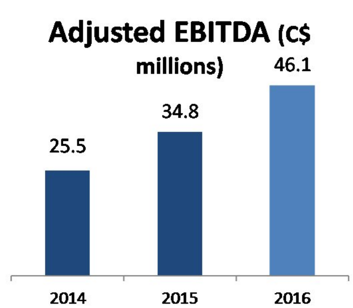
1.0 Executive Summary

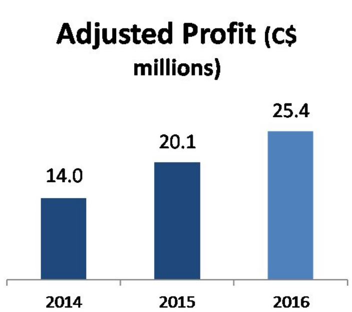
1.1 Overview

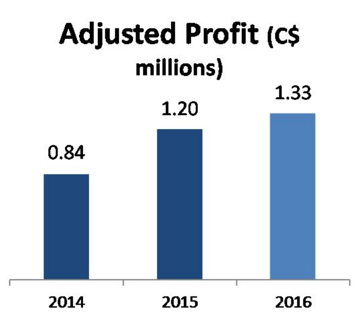
We set new sales, Adjusted EBITDA, profit and Adjusted profit records in 2016, driven by our accretive acquisition of Rugby Architectural Building Products ("Rugby"), continued execution of our business strategies, and the foreign exchange benefits of a stronger US dollar. For the year ended December 31, 2016, sales increased 38.1% to $789.3 million and profit increased 18.4% to $23.9 million compared to 2015. After adjusting for expenses associated with the Rugby acquisition, Adjusted EBITDA grew 32.6% to $46.1 million and Adjusted profit climbed 26.0% to $25.4 million.

During the third quarter of 2016, we issued 4.0 million common shares of Hardwoods in connection with the bought deal financing and 0.6 million common shares were purchased by sellers of Rugby. Even with the increase in our share base, our diluted profit per share grew 4.2% to $1.25 per share. After adjusting for expenses associated with the Rugby acquisition, Adjusted diluted profit per share grew 10.8% to $1.33 in 2016, from $1.20 in 2015. The $0.13 per share improvement reflects accretion related to the Rugby acquisition and our 2016 operating performance.









Acquisition-Based and Organic Growth

Our 2016 results include approximately five-and-a-half-months of financial contribution from Rugby, which expanded our US distribution network with 28 new distribution facilities and contributed $175.1 million to sales. Organic growth accounted for $20.4 million of our sales growth, with the balance driven by favorable foreign exchange influences resulting from a stronger US dollar. A stronger US dollar benefits us by: i) increasing the value of sales and profits earned in our US operations when translated into Canadian dollars for financial reporting purposes; ii) increasing the selling price 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 in the US.

Improved Profitability

Gross profit margin grew to 18.2%, from 17.4% in 2015. Our improved gross profit margin performance reflects our ability to capitalize on product pricing opportunities and the positive impact of Rugby's product lines, which carry a higher gross profit margin.

As anticipated, operating expenses were higher year-over-year. This reflects the addition of the Rugby operations, as well as one-time transaction-related costs of $2.4 million. Operating expenses as a percentage of revenue were also higher at 13.3% in 2016 compared to 11.8% in 2015. This increase reflects the one-time transaction expenses, as well as Rugby's sales model, which involves supplying more orders to more customers, but with smaller average order sizes.

Bad debt expense represented just 0.1% of sales, below our long-term historical average of approximately 0.4% of sales.

Balance Sheet

In response to trade uncertainties (see section 1.3) we also increased our inventory balances to ensure product supply availability for our customers. Even with this increase in inventory, our balance sheet remains strong. As at December 31, 2016, our net debt-to-Adjusted EBITDA ratio was 2.1 times, our debt-to-capital ratio was just 30.1%, and we had $57.8 million of unused borrowing capacity.

1.2 Business Strategy

Our strategy in 2016 focused on three key areas: i) leveraging our import program, ii) strengthening access to commercial markets, and iii) pursuing accretive acquisitions.

Leveraging Imports

Hardwoods has created 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. During 2016, we continued to leverage this program, increasing our product offering and expanding our supply lines in Africa, Southeast Asia, Russia and parts of Europe. Sales of import products represented approximately 25% of our 2016 sales. Going forward, we will continue to leverage our product sourcing capabilities to secure a steady supply of high-quality, well-priced product solutions for our customers, drawing on the most advantageous combination of imported and domestic supply.

Strengthening Commercial

Our "strengthen commercial" strategy focuses on expanding our base of customers in the commercial and institutional sectors as we work to diversify our end markets served. In 2016, our acquisition of Rugby significantly increased our focus on the commercial market with commercial sales expected to represent approximately 35% of our total sales going forward, compared to 20% previously. We also continued to grow our supply of first-tier quality products for commercial customers and capitalized on our import capabilities to offer both domestic and off-shore product solutions to the commercial sector. In addition, we further expanded our sales capabilities with training and other initiatives focused on the commercial market. In 2017, we will continue to focus on growing both our commercial customer base and the line-up of attractive and differentiated products we supply to this market.

Pursuing Accretive Acquisitions

We have completed five successful acquisitions in the past five and a half years which have increased our sales by approximately $500 million annually on a pro-forma basis, added 37 locations to our network, and provided us with a national footprint and reach into almost every region in North America. Our 2016 acquisition of Rugby was the largest of these transactions and provided us with access to new markets, strengthened our access in existing markets, and provided immediate accretion for shareholders.

Going forward, we now have the size, scale, and strong balance sheet position to continue pursuing growth by acquisition, and the highly fragmented nature of the US architectural building products industry provides numerous opportunities. We plan to continue pursuing opportunities that take us into new markets, expand our presence in existing markets, and that can be added on an accretive basis for shareholders. The acquisition on March 13, 2017 of Eagle Plywood and Lumber ("Eagle") is an example of our ability to expand our presence in an existing market.

1.3 Outlook

The recent change in US government administration is expected to usher in new approaches to trade and economic growth in the US. While it is still too early to identify what specific policies will be implemented or how they will impact the US economy, proposals for a large infrastructure spending program, a reduction in the corporate tax rate, and a more protectionist approach to trade, including the potential for a border adjustment tax (BAT), have been discussed.

With a strong majority of our operations now domiciled in the US, Hardwoods is positioned to benefit from policies that stimulate the US economy or prove generally positive for US-based businesses. However we could also be negatively impacted, at least in the near term, by trade decisions that affect our import program. As we discussed in our press release of November 21, 2016, a trade case has been initiated in the US with respect to imported hardwood plywood from China. Although we sell more domestically sourced hardwood plywood than imported, approximately 11% of our total sales could be affected by this case. In the event that trade duties are levied against hardwood plywood, this would impact the market for hardwood plywood in the US with the potential for significant changes in selling prices, margins, and/or product supply availability. Should the US government move to impose a BAT, we could see similar effects on a wider range of our import products, and not just those from China. We are watching both the current trade case and broader US trade policy decisions closely, and have worked to secure a range of alternative supply solutions. Furthermore, we have increased our inventory balances and positioned ourselves to respond in the event significant changes occur.

Notwithstanding the uncertainty around US trade and economic policy, our outlook for 2017 is positive. We expect that our gross profit margin as a percentage of sales will remain above the levels Hardwoods has traditionally achieved, reflecting Rugby's higher-margin product mix. Operating expenses are also expected to be moderately higher due to Rugby's sales model. While EBITDA on a dollar basis is expected to benefit from increased sales, EBITDA as a percentage of revenue is expected to be moderately lower due to the increased operating expenses.

In terms of market outlook, the unevenness and relatively slow growth experienced in the US residential construction market in 2016 is expected to continue into 2017. As a result, we expect organic growth to remain modest in the near term. Market fundamentals remain sound however, with US job growth and income levels gaining momentum. Harvard's Joint Center for Housing Studies June 2016 report on "state of the nation's housing" concluded that housing construction should average at least 1.6 million units a year over the next decade in order to replace older units and meet demand. With average housing starts at 1.2 million in 2016, there is considerable room for growth in this market, although we expect it will take time to reach the 1.6 million level.

In the non-residential construction market, the American Institute of Architects predicts growth of 6.7% in 2017, with the strongest gains anticipated for the commercial sectors that we focus on.

Strategically, we will continue to implement our strategies, including leveraging our product sourcing capabilities, capitalizing on significant opportunities in the commercial market and pursuing strategic acquisitions, such as our acquisition on March 13, 2017 of Eagle.

Our Board will continue to review our financial performance and assess dividend levels on a regular basis. However, our primary focus will be to retain the cash necessary to finance the significant market growth opportunity in the US and to keep our balance sheet strong, reduce debt and support future strategic acquisitions.

Supplier: Panasphere   Colour: Vintage Oak

2.0 Background

2.1 Company Overview

Hardwoods Distribution Inc. is a publicly traded company listed on the Toronto Stock Exchange and trades under the symbol HWD.

2.2 Rugby acquisition

On July 15, 2016, we acquired Rugby for a base purchase price of $138.8 million (US $107.0 million), plus up to another $16.9 million (US $13.0 million) of purchase consideration and bonuses based on future performance. Rugby is a leading US wholesale distributor of architectural grade building products to customers that supply end-products to the commercial market. It also serves industrial, retail, residential and institutional construction end-markets. Rugby has a strong national US footprint, operating 28 strategically located distribution facilities that serve over 22,000 customers across 48 US states.

The transaction was financed using approximately $55.7 million (US$43.0 million) of net proceeds from a bought deal share offering, $74.1 million (US$57.0 million) of draw-down of our amended US credit facility, and the issuance of 563,542 common shares of Hardwoods for proceeds of $9.0 million (US$7.0 million).

2.3 Business and Industry Overview

Serving customers for over 50 years, Hardwoods is North America's largest distributor of non-structural architectural grade building products to the cabinet, moulding, millwork, furniture and specialty wood products industries. As at March 17, 2017 we operated 58 distribution facilities located in 25 US states and 5 Canadian provinces. Certain of these facilities include light manufacturing capabilities which enable us to create custom moulding and millwork packages for our customers. An additional facility, HMI, is a fully integrated producer and exporter of high-quality, value-added hardwood lumber.

Approximately 51% of our 2016 sales were made up of hardwood plywood and non-structural sheet goods such as medium-density fiberboard, particleboard and thermally fused laminate. Approximately 30% of our sales were of high-grade hardwood lumber. Our sheet goods and lumber are complementary product lines; customers typically use both of these key products in the manufacture of their own end-use products. The balance of our product sales, about 19%, was made up of architectural and other products.

Our primary role in the industry is to provide the critical link between mills that manufacture large volumes of hardwood lumber, sheet goods and specialty products, and industrial customers that require smaller quantities of many different architectural products for their own manufacturing processes. We provide a means for hundreds of 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 when 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 end up in each sector of the economy. We estimate that 52% 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 ends up in other sectors of the economy not associated with new residential construction, such as home renovations, finishing millwork for office buildings, recreational vehicles, 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, as well as by overseas hardwood plywood manufacturers. Both domestic and imported hardwood lumber and plywood are distributed principally by third parties such as us.

3.0 Results of Operations

3.1 Years Ended December 31, 2016 and December 31, 2015

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

	For the year ended December 31 2016	For the year ended December 31 2015	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 789,321	$ 571,598	$ 217,723	38.1 %
Sales in the US (US$)	*498,198*	*355,724*	142,474	40.1 %
Sales in Canada	*129,935*	*116,805*	13,130	11.2 %
Gross profit	143,778	99,633	44,145	44.3 %
Gross profit %	*18.2%*	*17.4%*		
Operating expenses	(104,871)	(67,422)	37,449	55.5 %
Profit from operating activities	38,907	32,211	6,696	20.8 %
Add: Depreciation and amortization	4,806	2,593	2,213	85.3 %
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 43,713	$ 34,804	$ 8,909	25.6 %
Add (deduct):				
Depreciation and amortization	(4,806)	(2,593)	(2,213)	
Net finance income (expense)	(1,465)	143	(1,608)	
Income tax expense	(13,580)	(12,208)	(1,372)	
Profit for the period	$ 23,862	$ 20,146	$ 3,716	18.4 %
Basic profit per share	$ 1.27	$ 1.21		
Diluted profit per share	$ 1.25	$ 1.20		
Average Canadian dollar exchange rate for one US dollar	$ 1.32	$ 1.28		

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)

	For the year ended December 31 2016	For the year ended December 31 2015	$ Increase (Decrease)	% Increase (Decrease)
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	$ 43,713	$ 34,804	$ 8,909	25.6 %
Transaction expenses	2,436	—	2,436	
Adjusted EBITDA	$ 46,149	$ 34,804	11,345	32.6 %
Adjusted EBITDA as a % of revenue	*5.8%*	*6.1%*		
Profit for the period, as reported	$ 23,862	$ 20,146	3,716	18.4 %
Transaction expenses, net of tax	1,516	—	1,516	
Adjusted Profit	$ 25,378	$ 20,146	5,232	26.0 %
Basic profit per share, as reported	$ 1.27	$ 1.21	$ 0.06	5.0 %
Net impact of above items per share	0.08	—	0.08	
Adjusted basic profit per share	$ 1.35	$ 1.21	$ 0.14	11.6 %
Diluted profit per share, as reported	$ 1.25	$ 1.20	$ 0.05	4.2 %
Net impact of above items per share	0.08	—	0.08	
Adjusted diluted profit per share	$ 1.33	$ 1.20	$ 0.13	10.8 %

Sales

For the year ended December 31, 2016, total sales increased 38.1% to $789.3 million, from $571.6 million in 2015. Of the $217.7 million year-over-year increase, $175.1 million, representing a 30.6% increase in sales, was due to the addition of Rugby's operations and $20.4 million, representing a 3.6% increase in sales, was due to organic growth. Sales results also benefited from a $22.2 million positive impact of a stronger US dollar when translating our US sales to Canadian dollars for reporting purposes.

Sales from our US operations increased by US$142.5 million, or 40.1%, to US$498.2 million, from US$355.7 million in 2015. Rugby, which was acquired on July 15, 2017, contributed sales of US$132.6 million. Organic growth accounted for US$9.9 million of the US sales uplift as we increased sales volumes in response to higher demand.

Sales in Canada increased by $13.1 million, or 11.2%, year-over-year. The increase in Canadian sales reflects our success in winning new business, as well as the positive impacts of a stronger US dollar as described in Section 1.1.

Gross Profit

Gross profit for the year ended December 31, 2016 increased 44.3% to $143.8 million, from $99.6 million in 2015. This $44.1 million improvement reflects higher gross profit margin from both the Rugby and Hardwoods businesses, together with higher sales for the year. As a percentage of sales, gross profit margin increased to 18.2% in 2016, from 17.4% in 2015.

Operating Expenses

For the year ended December 31, 2016, operating expenses increased to $104.9 million, from $67.4 million in 2015. The $37.4 million increase includes Rugby operating expenses of $29.3 million, $2.4 million of transaction expenses related to the Rugby acquisition, a $3.0 million increase in expenses due to the impact of a stronger US dollar on translation of US operating expenses, and $2.7 million of added costs to support our organic growth. As a percentage of sales, operating expenses increased to 13.3% from 11.8% year-over-year, primarily reflecting Rugby's higher ratio of operating expenses as a percentage of sales.

Depreciation and Amortization

For the year ended December 31, 2016, amortization expense increased to $4.8 million, from $2.6 million in 2015. The $2.2 million increase primarily relates to amortization of Rugby property, plant and equipment of $0.9 million, a $0.9 million increase to amortization of intangible assets related to customer relationships acquired in connection with the Rugby acquisition, and a $0.4 million increase from the Hardwoods business.

Adjusted EBITDA

For the year ended December 31, 2016 Adjusted EBITDA grew 32.6% to $46.1 million, an increase of $11.3 million from $34.8 million in 2015. The growth in Adjusted EBITDA primarily reflects the $44.1 million increase in gross profit, partially offset by the $32.8 million increase in operating expenses (before expenses related to the Rugby acquisition and before an increase in depreciation and amortization).

Net Finance Income (Cost)

(in thousands of Canadian dollars)						
		For the year ended December 31 2016		For the year ended December 31 2015		$ Change
Finance expense:						
Interest on bank indebtedness	$	(1,675)	$	(1,217)	$	(458)
Accretion of finance lease obligation		(137)		(116)		(21)
Foreign exchange loss		(11)		—		(11)
Total finance expense		(1,823)		(1,333)		(490)
Finance income:						
Interest on trade receivables, customer notes, and employee loans		358		421		(63)
Foreign exchange gain		—		1,055		(1,055)
Total finance income		358		1,476		(1,118)
Net finance income (expense)	$	(1,465)	$	143	$	(1,608)

We recorded a net finance expense of $1.5 million in 2016 as compared to net finance income of $0.1 million in 2015. The $1.6 million year-over-year increase reflects the impact of changes in the value of the US dollar on US dollar denominated intercompany debt between the two years. On June 21, 2016 we settled the intercompany debt in full. The increase in net finance expense also reflects higher interest expense related to increased borrowings to finance part of the purchase price of Rugby.

Income Tax Expense

Income tax expense increased to $13.6 million for the year ended December 31, 2016, from $12.2 million in 2015. This increase primarily reflects higher taxable income.

Profit for the Period

Profit for the year ended December 31, 2016 increased 18.4% to $23.9 million, from $20.1 million in 2015. The $3.7 million improvement reflects the $8.9 million year-over-year increase in EBITDA, partially offset by the $1.4 million increase in income tax expense, the $1.6 million increase in net finance cost, and a $2.2 million increase in depreciation and amortization.

Adjusted profit, which excludes the $1.5 million in expenses related to the Rugby acquisition, net of tax, increased to $25.4 million in 2016. This was $5.2 million or 26.0% higher than 2015.

3.2 Three-Month Periods Ended December 31, 2016 and December 31, 2015

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

	Three months ended December 31 2016	Three months ended December 31 2015	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 239,449	$ 141,017	$ 98,432	69.8 %
Sales in the US (US$)	*155,661*	*84,384*	71,277	84.5 %
Sales in Canada	*31,676*	*28,058*	3,618	12.9 %
Gross profit	43,523	24,988	18,535	74.2 %
Gross profit %	*18.2%*	17.7%		
Operating expenses	(34,785)	(18,039)	16,746	92.8 %
Profit from operating activities	8,738	6,949	1,789	25.7 %
Add: Depreciation and amortization	2,125	702	1,423	202.7 %
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 10,863	$ 7,651	$ 3,212	42.0 %
Add (deduct):				
Depreciation and amortization	(2,125)	(702)	(1,423)	
Net finance income (expense)	(668)	83	(751)	
Income tax expense	(1,493)	(2,571)	1,078	
Profit for the period	$ 6,577	$ 4,461	$ 2,116	47.4 %
Basic profit per share	$ 0.31	$ 0.27		
Diluted profit per share	$ 0.29	$ 0.27		
Average Canadian dollar exchange rate for one US dollar	$ 1.33	$ 1.34		

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)

	Three months ended December 31 2016	Three months ended December 31 2015	$ Increase (Decrease)	% Increase (Decrease)
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	$ 10,863	$ 7,651	$ 3,212	42.0 %
Transaction expenses	50	—	50	
Adjusted EBITDA	$ 10,913	$ 7,651	$ 3,262	42.6 %
Adjusted EBITDA as a % of revenue	*4.6%*	*5.4%*		
Profit for the period, as reported	$ 6,577	$ 4,461	$ 2,116	47.4 %
Transaction expenses, net of tax	31	—	31	
Adjusted Profit	$ 6,608	$ 4,461	$ 2,147	48.1 %
Basic profit per share, as reported	$ 0.31	$ 0.27	$ 0.04	14.8 %
Net impact of above items per share	—	—	—	
Adjusted basic profit per share	$ 0.31	$ 0.27	$ 0.04	14.8 %
Diluted profit per share, as reported	$ 0.29	$ 0.27	$ 0.02	7.4 %
Net impact of above items per share	—	—	—	
Adjusted diluted profit per share	$ 0.29	$ 0.27	$ 0.02	7.4 %

Sales

For the three months ended December 31, 2016, total sales increased 69.8% to $239.4 million, from $141.0 million during the same period in 2015. Of the $98.4 million year-over-year increase, $93.5 million, representing a 66.3% increase in sales, was due to the addition of Rugby's operations and $5.8 million, representing a 4.1% increase in sales, was due to organic growth. The sales gain was partially offset by a $0.9 million negative foreign exchange impact resulting from a stronger Canadian dollar when translating our US sales to Canadian dollars for reporting purposes.

Sales from our US operations increased by US$71.3 million, or 84.5%, to US$155.7 million, from US$84.4 million in the same period in 2015. Rugby, which was acquired on July 15, 2016, contributed US$70.1 million of this increase, with the remaining increase relating to organic growth. Sales in Canada increased by $3.6 million, or 12.9%, year-over-year. The increase in Canadian sales reflects our success in winning new business.

Gross Profit

Gross profit for the three months ended December 31, 2016 increased 74.2% to $43.5 million, from $25.0 million in the fourth quarter of 2015. This $18.5 million improvement reflects higher gross profit margin from both the Rugby and Hardwoods operations. As a percentage of sales, gross profit margin increased to 18.2% in the fourth quarter of 2016, from 17.7% in the fourth quarter 2015.

Operating Expenses

Operating expenses increased to $34.8 million in the fourth quarter of 2016, from $18.0 million during the same period in 2015. The $16.7 million increase includes Rugby operating expenses of $16.3 million, $0.1 million of transaction expenses related to the Rugby acquisition, and $0.5 million of added costs to support organic growth. These increases were partially offset by a $0.1 million decrease in expenses due to the impact of a stronger Canadian dollar on translation of US operating expenses. As a percentage of sales, operating expenses increased to 14.5% from 12.8% year-over-year, primarily reflecting Rugby's higher ratio of operating expenses as a percentage of sales.

Depreciation and Amortization

For the three months ended December 31, 2016, amortization expense increased to $2.1 million, from $0.7 million in 2015. The $1.4 million increase primarily relates to amortization of Rugby property, plant and equipment of $0.5 million, and a $0.9 million increase to amortization of intangible assets related to customer relationships acquired in connection with the Rugby acquisition.

Adjusted EBITDA

For the three months ended December 31, 2016 Adjusted EBITDA grew 42.6% to $10.9 million, from $7.7 million in the same period in 2015. The $3.3 million growth in Adjusted EBITDA primarily reflects the $18.5 million increase in gross profit, partially offset by the $15.2 million increase in operating expenses (before expenses related to the Rugby acquisition and before an increase in depreciation and amortization).

Net Finance Income (expense)

(in thousands of Canadian dollars)						
		Three months ended December 31 2016		Three months ended December 31 2015		$ Change
Finance expense:						
Interest on bank indebtedness	$	(607)	$	(234)	$	(373)
Accretion of finance lease obligation		(38)		(30)		(8)
Foreign exchange losses		(86)		—		(86)
Total finance expense		(731)		(264)		(467)
Finance income:						
Interest on trade receivables, customer notes, and employee loans		63		123		(60)
Foreign exchange gain		—		224		(224)
Total finance income		63		347		(284)
Net finance income (expense)	$	(668)	$	83	$	(751)

For the three months ended December 31, 2016, we recorded a net finance expense of $0.7 million as compared to net finance income of $0.1 million during the same period in 2015. The $0.8 million increase in net finance expense is primarily comprised of a foreign exchange loss and an increase in interest expense as a result of higher bank indebtedness.

Income Tax Expense

Income tax expense decreased to $1.5 million in the fourth quarter of 2016, from $2.6 million in the same period in 2015. The $1.1 million decrease primarily reflects adjustments to our tax estimates in the fourth quarter of 2016 to reflect the impact of certain corporate restructuring activities during the second half of 2016.

Profit for the Period

Profit for the three months ended December 31, 2016 increased 47.4% to $6.6 million, from $4.5 million during the same period in 2015. The $2.1 million improvement reflects the $3.2 million increase in EBITDA and the $1.1 million decrease in income tax expense, partially offset by the $0.8 million increase in net finance cost, and a $1.4 million increase in depreciation and amortization.

4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Total sales	$ 239,449	$ 235,428	$ 157,031	$ 157,413	$ 141,017	$ 152,114	$ 143,351	$ 135,116
Profit	6,577	7,296	5,367	4,622	4,461	5,963	5,009	4,713
Basic profit per share	0.31	0.35	0.32	0.28	0.27	0.36	0.30	0.28
Diluted profit per share	0.29	0.35	0.32	0.27	0.27	0.35	0.30	0.28
EBITDA	10,863	13,186	10,231	9,433	7,651	10,227	9,280	7,646
Adjusted profit	6,608	8,084	6,200	4,622	4,461	5,963	5,009	4,713
Adjusted basic profit per share	0.31	0.39	0.37	0.28	0.27	0.36	0.30	0.28
Adjusted diluted profit per share	0.29	0.39	0.37	0.27	0.27	0.35	0.30	0.28
Adjusted EBITDA	10,913	14,280	11,523	9,433	7,651	10,227	9,280	7,646
Adjusted cash flow per share	0.31	0.55	0.48	0.29	0.40	0.53	0.39	0.27

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 the impact of our acquisition of Rugby on Q3 and Q4 2016, and by changes in the foreign exchange rate of the Canadian and US dollars.

4.2 Annual Financial Information

(in thousands of dollars except per unit amounts)	For the year ended December 31 2016	For the year ended December 31 2015	For the year ended December 31 2014
Total sales	$ 789,321	$ 571,598	455,694
Profit	23,862	20,146	14,015
Basic profit per share	1.27	1.21	0.85
Fully diluted profit per share	1.25	1.20	0.84
Total assets	371,076	190,004	160,813
Total non-current financial liabilities	1,877	696	4,120
EBITDA	43,713	34,804	25,478

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)

	Years ended December 31			Three months ended December 31		
	2016	**2015**	**$ change**	**2016**	**2015**	**$ change**
Cash provided by operating activities before changes in non-cash working capital	$ 28,844	$ 26,788	$ 2,056	$ 6,692	$ 6,706	$ (14)
Changes in non-cash working capital	(14,172)	(6,044)	(8,128)	(2,172)	10,689	(12,861)
Net cash provided by operating activities	14,672	20,744	(6,072)	4,520	17,395	(12,875)
Net cash provided by (used in) investing activities	(138,814)	(1,352)	(137,462)	292	(389)	681
Net cash provided by (used in) financing activities	124,908	(19,405)	144,313	(4,721)	(17,006)	12,285
Increase (decrease) in cash	766	(13)	779	91	—	91
Cash, beginning of period	—	13	(13)	675	—	675
Cash, end of the period	$ 766	$ —	$ 766	$ 766	$ —	$ 766

Calculation of Adjusted Cash Flow per Share (in thousands, except per share amounts)

	Years ended December 31			Three months ended December 31		
	2016	**2015**	**$ change**	**2016**	**2015**	**$ change**
Cash provided by operating activities before changes in non-cash working capital	$ 28,844	$ 26,788	$ 2,056	$ 6,692	$ 6,706	$ (14)
Transaction expenses	2,436	—	2,436	50	—	50
Adjusted Cash provided by operating activities before changes in non-cash working capital	$ 31,280	$ 26,788	$ 4,492	$ 6,742	$ 6,706	$ 36
Weighted average common shares - diluted	19,018	16,781	2,237	21,498	16,810	4,688
Adjusted cash flow per share	$ 1.64	$ 1.60	$ 0.04	$ 0.31	$ 0.40	$ (0.09)

Net cash used in operating activities

For the year ended December 31, 2016, net cash provided by operating activities was $14.7 million, compared to $20.7 million in 2015. Cash provided by operating activities before changes in non-cash working capital increased by $2.1 million primarily reflecting the $8.9 million increase in EBITDA, partially offset by a $6.2 million increase in income taxes paid and an increase in interest paid of $0.3 million. Investment in non-cash working capital increased by $8.1 million in 2016 compared to 2015. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2016, net cash provided by operating activities decreased to $4.5 million, from $17.4 million in the same period in 2015, a reduction of $12.9 million. There was no change in fourth quarter cash provided by operating activities before changes in non-cash working capital. Investment in non-cash working capital increased by

$12.9 million in the fourth quarter of 2016, compared to the fourth quarter of 2015. An analysis of changes in working capital is provided in section 5.2 of this report.

For the year ended December 31, 2016, adjusted cash flow per share increased by $0.04 to $1.64, as compared to 2015. For the three months ended December 31, 2016 adjusted cash flow per share was $0.31 compared to $0.40 in the same period in the prior year. The decrease of $0.09 primarily relates to an increase in taxes paid of $2.7 million in the quarter, relating to timing of these payments. Adjusted cash flow per share is one of the measures we review to assess the operating performance of the business and the cash flow available to finance investments in non-cash working capital, and financing and investing activities.

Net cash used in investing activities

Net cash used in investing activities increased by $137.5 million to $138.8 million in 2016, from $1.4 million in 2015. The increase primarily relates to the $136.9 million paid on acquisition of Rugby on July 15, 2016.

Capital expenditures in our distribution business have historically been low as we generally lease our buildings and typically contract out delivery equipment. Capital expenditures in this part of our business are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment.

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.

For the three months ended December 31, 2016 cash used in investing activities decreased by $0.7 million. This decrease primarily relates to fewer purchases of property, plant and equipment in the quarter as compared to the same quarter in 2015.

Net cash provided by financing activities

For the year ended December 31, 2016 net cash provided by financing activities increased by $144.3 million as compared to 2015. The increase primarily relates to an increase in our credit facilities and the issuance of common shares to finance the purchase of Rugby.

For three months ended December 31, 2016 net cash used in financing activities decreased $12.3 million as compared to the same period in 2015. There were no significant changes in the composition of cash provided by and used in financing activities, with changes in our credit facilities and dividends paid to shareholders being the main financing activities during the period.

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 $220.8 million as at December 31, 2016, compared to $149.4 million at December 31, 2015. The increase is attributable to the acquisition of Rugby, increased investment in accounts receivable and inventory to support sales growth, and the impact of a strengthening US dollar when translating the working capital of our US operations.

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, as a result, sales and working capital requirements may be lower in these quarters. In the fourth quarter of 2016 however we made additional investments in inventory in response to trade uncertainties (see section 1.3) and this increased our investment in working capital. A summary of changes in our non-cash operating working capital during the twelve and three month periods ended December 31, 2016 and 2015 is provided below.

(in thousands of Canadian dollars)								
Source (use) of funds		Years ended ended December 31 2016		Years ended ended December 31 2015		Three months ended December 31 2016		Three months ended December 31 2015
Accounts receivable	$	(956)	$	(2,930)	$	10,350	$	9,242
Inventory		(15,723)		(4,499)		(8,224)		3,775
Prepaid expenses		187		39		1,350		284
Accounts payable, accrued liabilities and provisions		2,320		1,346		(5,648)		(2,612)
Increase in non-cash operating working capital	$	(14,172)	$	(6,044)	$	(2,172)	$	10,689

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, 2016		As at December 31, 2015
Cash	$	766	$	—
Bank indebtedness		97,886		28,894
Net Debt		97,120		28,894
Shareholders' equity		225,999		142,948
Total Capitalization	$	323,119	$	171,842
Net debt to total capitalization		30.1%		16.8%
Previous 12 months Adjusted EBITDA	$	46,149	$	34,804
Net debt to previous 12 months Adjusted EBITDA		2.1		0.8

We consider our capital to be bank indebtedness (net of cash) and shareholders' equity. As shown above, our net debt balance increased by $68.2 million to $97.1 million at December 31, 2016, from $28.9 million at December 31, 2015. Overall net debt compared to total capitalization stood at 30.1% as at December 31, 2016, compared to 16.8% at December 31, 2015. At December 31, 2016 our ratio of net debt-to-Adjusted EBITDA for the previous 12 months was 2.1 times, compared to 0.8 times at December 31, 2015. The net debt-to-Adjusted EBITDA for the previous 12 months includes approximately 5.5 months of Rugby's results and we expect the net debt-to-Adjusted EBITDA ratio to decrease from its current levels once a full 12 month of Rugby's results are included. Net debt-to-Adjusted 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. These facilities may be drawn down to meet short-term financing requirements such as fluctuations in non-cash working capital, and in the case of the Canadian credit facility, to also make capital contributions to our US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is limited to the extent of the value of certain accounts receivable and inventories held by our subsidiaries. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities as at December 31, 2016 is provided in the following table.

Selected unaudited consolidated financial information (in thousands of dollars)	Canadian Credit Facility	US Credit Facility
Maximum borrowings under the credit facility	$ 20.0 million	$ 167.4 million (US$125.0 million)
Credit facility expiry date	August 5, 2021	July 14, 2021
Available to borrow	$ 19.4 million	$ 135.8 million (US$101.3 million)
Credit facility borrowings	$ 12.5 million	$ 84.9 million (US$63.4 million)
Unused credit facility	$ 6.9 million	$ 50.9 million (US$37.9 million)
Financial covenants:	Covenant does not apply when the unused credit facility available exceeds $2.0 million, which it did at December 31, 2016	Covenant does not apply when the unused credit facility available exceeds 10% of the maximum borrowings under the credit facility or US$12.5 million, which it did at December 31, 2016

The terms of the agreements with our lenders provide that dividends cannot be made to our shareholders in the event that our subsidiaries are not compliant with their financial covenants. Our operating subsidiaries were compliant with all required credit ratios as at December 31, 2016. Accordingly, there were no restrictions on dividends arising from non-compliance with financial covenants.

In connection with the closing of the Rugby acquisition on July 15, 2016, we entered into a new US credit facility with our lender ("the USLP Credit Facility"). The USLP Credit Facility replaces the existing US credit facility and consists of a revolving credit line of US$125.0 million. The amounts made available under the USLP Credit Facility are limited based on a borrowing base determined by reference to the value of certain eligible accounts receivable and inventories held by certain of our subsidiaries.

The financial covenants under the USLP Credit Facility include, among others, a springing fixed charge coverage ratio of 1.0x, triggered if excess availability under the USLP Credit Facility falls below 10% of the USLP Credit Facility at any time.

In addition to the financial covenants, the ability of our subsidiaries to pay distributions and dividends, complete acquisitions, make additional investments, take on additional indebtedness, allow assets to become subject to liens, complete affiliate transactions and make capital expenditures are limited and subject to the satisfaction of certain conditions. The USLP Credit Facility has a five-year term and can be prepaid at any time with no prepayment penalty.

On August 5, 2016 we renewed our Canadian credit facility with our existing lender ("the LP Credit Facility"). The LP Credit Facility replaces the existing Canadian credit facility and consists of a revolving credit line of $20.0 million. The amounts made available under the LP Credit Facility are limited based on a borrowing base determined by reference to the value of certain eligible accounts receivable and inventories held by our Canadian subsidiary. The covenants under the LP Credit Facility relate to our Canadian subsidiary and include, among others: (i) a springing fixed charge covenant ratio of 1.0x, triggered if excess availability under the LP Credit Facility falls below $2.0 million, and (ii) restrictions on our ability to pay distributions and dividends, complete acquisitions, make additional investments, take on additional indebtedness, allow our assets to become subject to liens, complete affiliate transactions and make capital expenditures. We were in compliance with these covenants as at December 31, 2016. The new Canadian credit facility has a five-year term and can be prepaid at any time with no prepayment penalty.

On February 24, 2017 we amended the LP Credit Facility such that the credit line was increased from $20.0 million to $25.0 million.

Our debt management strategy is to roll and renew (as opposed to repay and retire) our credit facilities as they expire. 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, 2016. These obligations relate to leases on various premises and automobiles and become due in the fiscal years indicated.

(in thousands of dollars)						
2017	**2018**	**2019**	**2020**	**2021**	**thereafter**	**Total**
$19,218	$13,685	$11,238	$8,503	$5,763	$8,118	$66,525

5.5 Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

5.6 Financial Instruments

Financial assets include cash and current and non-current receivables, which are measured at amortized cost. Financial liabilities include bank indebtedness, accounts payable and accrued liabilities, income taxes payable, dividend payable, notes payable and finance lease obligations which are measured at amortized cost. The carrying values of our cash, current accounts receivable, income taxes payable, accounts payable and accrued liabilities, and dividend payable approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of non-current receivables, notes payable 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 17, 2017, the date of this MD&A, we had 21,350,572 common shares issued and outstanding. In addition, at March 17, 2017, we had outstanding 58,601 performance shares and 73,661 restricted shares 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, common 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 employees have the option, when the restricted and performance share vest, to receive up to half the fair value in cash and the remainder in common shares. We intend to issue common shares from treasury to settle the portion of the obligation not paid to employees in cash.

5.8 Dividends

In the fourth quarter of 2016, we declared a quarterly dividend of $0.0625 per share, which was paid on January 31, 2017 to shareholders of record as at January 20, 2017. On March 17, 2017 we declared a quarterly dividend of $0.0625 per share, payable on April 28, 2017 to shareholders of record as at April 17, 2017. The Board regularly assesses our dividend strategy, giving due consideration to anticipated cash needs for additional working capital to support growing the business, appropriate debt levels, acquisition opportunities which may be available, expected market conditions, demand for our products, and other factors.

6.0 Related Party Transactions

There were no material related party transactions in the three and twelve months ended December 31, 2016 or in the comparative periods in the prior year.

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.

Valuation of inventory: We are required to make estimates and assumptions regarding the net realizable value of our inventory. The estimates and assumptions may have a material impact on the values at which we recognize inventory.

Rugby acquisition: We are required to make estimates and assumptions related to the Rugby acquisition, including the net asset value acquired, the amounts payable under the earn-out, the fair values of identifiable assets acquired and liabilities assumed, and the value of goodwill and intangible assets assumed.

7.2 Adoption of New Accounting Policies

There were no new standards effective January 1, 2016 that have an impact on our consolidated financial statements.

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these consolidated financial statements. We consider the following pronouncements to be the most significant of several pronouncements that may affect the consolidated financial statements in future periods.

IFRS 9, Financial Instruments ("IFRS 9")

IFRS 9 will replace the multiple classification and measurement models in IAS 39 Financial Instruments: Recognition and Measurement, with a single model that has only two classification categories: amortized cost and fair value. The new standard also requires a single impairment method to be used, provides additional guidance on the classification and measurement of financial liabilities, and provides a new general hedge accounting standard.

The mandatory effective date has been set for January 1, 2018, however early adoption of the new standard is permitted. We do not intend to early adopt IFRS 9. The adoption of IFRS 9 is currently not expected to have a material impact on our consolidated financial statements given the nature of our operations and the types of financial instruments that we currently hold; however, we will continue to assess the extent of impact as the mandatory adoption date approaches.

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

IFRS 15 is effective for fiscal years commencing on or after January 1, 2018 and will replace IAS 18, Revenue and a number of revenue related standards and interpretations. IFRS 15 contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have also been introduced, which may affect the amount and/or timing of revenue recognized.

We intend to adopt IFRS 15 in our consolidated financial statements for the annual period beginning on January 1, 2018. We are assessing the impact of this new standard, but do not expect the amendments to have a material impact on our consolidated financial statements

IFRS 16, Leases ("IAS 16")

On January 13, 2016, the IASB published a new standard, IFRS 16, Leases, eliminating the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Under the new standard, a lease becomes an on-balance sheet liability that attracts interest, together with a new right-of-use asset. In addition, lessees will recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. Upon adoption of IFRS 16, the Company's operating leases, which are principally comprised of its warehouse facilities and automobiles, will be recorded in the statement of financial position with a corresponding lease obligation. We are assessing the impact of this new standard and the impact of adopting this standard has not yet been determined.

IAS 12, Income Taxes (Amendments)

On January 19, 2016, the IASB issued Recognition of Deferred Tax Assets for Unrealized Losses as an amendment to IAS 12. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments apply retrospectively for annual periods beginning on or after January 1, 2017 with early adoption permitted. We intend to adopt the amendments to IAS 12 in our consolidated financial statements for the annual period beginning on January 1, 2017. We do not expect the amendments to have a material impact on the consolidated financial statements.

IFRS 2, Share-Based Payment (Amendments)

On June 20, 2016, the IASB issued amendments to IFRS 2 clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for: the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; share-based payment transactions with a net settlement feature for withholding tax obligations; and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early, application is permitted if information is available without the use of hindsight. We intend to adopt the amendments to IFRS 2 in our consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

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 documents at www.sedar.com.

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, 2016. 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, 2016.

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, 2016. The evaluation was carried out within the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control - Integrated Framework (2013) (the "2013 COSO framework") and under the supervision of, and with the participation of, our CEO and the CFO. Based on this evaluation, our CEO and CFO concluded that our ICFR were effective as of December 31, 2016.

There have not been any changes in our ICFR during the quarter ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our ICFR.

The CEO and CFO have limited the scope of their design of disclosure controls and procedures and internal control over financial reporting to exclude controls, policies and procedures of the Rugby business unit, which we acquired on July 15, 2016. Summary financial information about the acquired Rugby business can be found in section 3.0.

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: Going forward, we will continue to leverage our product sourcing capabilities to secure a steady supply of high-quality, well-priced product solutions for our customers, drawing on the most advantageous combination of imported and domestic supply; in 2017, we will continue to focus on growing both our commercial customer base and the line-up of attractive and differentiated products we supply to this market; we plan to continue pursuing opportunities that take us into new markets, expand our presence in existing markets, and that can be added on an accretive basis for shareholders; Hardwoods is positioned to benefit from policies that stimulate the US economy or prove generally positive for US-based businesses; Hardwoods could also be negatively impacted, at least in the near term, by trade decisions that affect our import program; approximately 11% of our total sales could be affected by the trade case; in the event that trade duties are levied against hardwood plywood, this would impact the market for hardwood plywood in the US with the potential for significant changes in selling prices, margins, and/or product supply availability; should the US government move to impose a BAT, we could see similar effects on a wider range of our import products, and not just those from China; our outlook for 2017 is positive; we expect that our gross profit margin as a percentage of sales will remain above the levels Hardwoods has traditionally achieved, reflecting Rugby's higher-margin product mix; operating expenses are also expected to be moderately higher due to Rugby's sales model; EBITDA on a dollar basis is expected to benefit from increased sales; EBITDA as a percentage of revenue is expected to be moderately lower due to the increased operating expenses; in terms of market outlook, the unevenness and relatively slow growth experienced in the US residential construction market in 2016 is expected to continue into 2017; we expect organic growth to remain modest in the near term; market fundamentals remain sound however, with US job growth and income levels gaining momentum; Harvard's Joint Center for Housing Studies June 2016 report on "state of the nation's housing" concluded that housing construction should average at least 1.6 million units a year over the next decade in order to replace older units and meet demand, and with average housing starts at 1.2 million in 2016, there is considerable room for growth in this market, although we expect it will take time to reach the 1.6 million level; historically, the first and fourth quarters have been seasonally slower periods for our business; 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; we do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity; 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 believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy, we intend to issue common shares from treasury to settle the portion of the LTIP obligation not paid to employees in cash.

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; we do not become subject to product liability claims that could adversely affect our revenues, profitability and reputation; 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; we may be subject to product liability claims that could adversely affect our revenues, profitability and reputation; 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 our Information Circular and in 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.

Robert J. Brown
President and Chief Executive Officer

Independent Auditors' 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, 2016 and 2015, 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, 2016 and 2015, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP (signed)

Chartered Professional Accountants

March 17, 2017
Vancouver, Canada

Consolidated Financial Statements
(Expressed in Canadian dollars)

HARDWOODS DISTRIBUTION INC.

Years ended December 31, 2016 and 2015

HARDWOODS DISTRIBUTION INC.
Consolidated Statements of Financial Position
(Expressed in thousands of Canadian dollars)

	Note	December 31, 2016	December 31, 2015
Assets			
Current assets:			
Cash		$ 766	$ —
Accounts and other receivables	7	94,534	56,156
Inventories	8	164,547	103,476
Prepaid expenses		2,689	2,193
Total current assets		262,536	161,825
Non-current assets:			
Non-current receivables	7	1,378	969
Property, plant and equipment	9	20,710	16,200
Intangible assets	10	20,114	36
Deferred income taxes	14	11,631	10,974
Goodwill	4	54,707	—
Total non-current assets		108,540	28,179
Total assets		$ 371,076	$ 190,004
Liabilities			
Current liabilities:			
Bank indebtedness	11	$ 97,886	$ 28,894
Accounts payable and accrued liabilities		40,978	12,438
Income taxes payable		1,949	2,987
Finance lease obligation	12(a)	1,055	1,119
Dividend payable	5	1,332	922
Total current liabilities		143,200	46,360
Non-current liabilities:			
Finance lease obligation	12(a)	905	696
Other liabilities	13(b)	972	—
Total non-current liabilities		1,877	696
Total liabilities		145,077	47,056
Shareholders' equity			
Share capital	13(a)	112,362	46,859
Contributed surplus		104,333	105,547
Deficit		(14,258)	(33,361)
Accumulated other comprehensive income		23,562	23,903
Shareholders' equity		225,999	142,948
Total liabilities and shareholders' equity		$ 371,076	$ 190,004

Subsequent event (note 5 and note 11)
Commitments (note 12)

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) WILLIAM R. SAUDER** Director

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2016 and 2015

	Note		2016		2015
Sales	16	$	789,321	$	571,598
Cost of goods sold	8		(645,543)		(471,965)
Gross profit			143,778		99,633
Operating expenses:					
Selling and distribution	17		(77,070)		(52,965)
Administration	17		(27,801)		(14,457)
			(104,871)		(67,422)
Profit from operations			38,907		32,211
Finance expense	15		(1,823)		(1,333)
Finance income	15		358		1,476
Net finance income (expense)			(1,465)		143
Profit before income taxes			37,442		32,354
Income tax expense:					
Current	14		(13,600)		(9,732)
Deferred	14		20		(2,476)
			(13,580)		(12,208)
Net profit			23,862		20,146
Other comprehensive income:					
Exchange differences translating foreign operations			(341)		16,399
Total comprehensive income		$	23,521	$	36,545
Basic net profit per share	13(c)	$	1.27	$	1.21
Diluted net profit per share	13(c)	$	1.25	$	1.20

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, 2016 and 2015

	Note	Share capital	Contributed surplus	Accumulated other comprehensive income - translation reserve	Deficit	Total
Balance at January 1, 2015		$ 45,830	$ 105,154	$ 7,504	$ (49,999)	$ 108,489
Share based compensation expense	13 (b)	—	1,299	—	—	1,299
Share based compensation tax adjustment		—	123	—	—	123
Shares issued pursuant to LTIP	13 (b)	1,029	(1,029)	—	—	—
Profit for the year		—	—	—	20,146	20,146
Dividends declared		—	—	—	(3,508)	(3,508)
Translation of foreign operations		—	—	16,399	—	16,399
Balance at December 31, 2015		46,859	105,547	23,903	(33,361)	142,948
Share based compensation expense	13 (b)	—	1,130	—	—	1,130
Shares issued in connection with the bought deal financing, net of share issue costs	13 (a)	54,434	—	—	—	54,434
Shares issued concurrent with the Rugby acquisition	13 (a)	9,091	—	—	—	9,091
Shares issued pursuant to LTIP	13 (b)	1,162	(1,162)	—	—	—
Share reclassified to liabilities	13 (b)	—	(1,182)	—	—	(1,182)
Deferred tax recovery on share issue costs		816	—	—	—	816
Profit for the year		—	—	—	23,862	23,862
Dividends declared		—	—	—	(4,759)	(4,759)
Translation of foreign operations		—	—	(341)	—	(341)
Balance at December 31, 2016		$ 112,362	$ 104,333	$ 23,562	$ (14,258)	$ 225,999

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, 2016 and 2015

	Note	2016	2015
Cash flow from operating activities:			
Profit for the year		$ 23,862	$ 20,146
Adjustments for:			
Depreciation and amortization	9,10	4,806	2,593
Gain on sale of property, plant and equipment	9	(171)	(29)
Share-based compensation expense	13(b)	1,130	1,299
Income tax expense	14	13,580	12,208
Net finance expense (income)	15	1,465	(143)
Interest received		358	421
Interest paid		(1,651)	(1,333)
Income taxes paid		(14,535)	(8,374)
		28,844	26,788
Changes in non-cash working capital:			
Accounts receivable		(956)	(2,930)
Inventories		(15,723)	(4,499)
Prepaid expenses		187	39
Accounts payable and accrued liabilities		2,320	1,346
		(14,172)	(6,044)
Net cash provided by operating activities		14,672	20,744
Cash flow from financing activities:			
Increase (decrease) in bank indebtedness	11	67,343	(15,030)
Principle payments on finance lease obligation		(1,204)	(1,045)
Note repayment		(407)	—
Issue of common shares, net of share issue costs	13(a)	63,525	—
Dividends paid to shareholders	5	(4,349)	(3,330)
Net cash provided by (used in) financing activities		124,908	(19,405)
Cash flow from investing activities:			
Additions to property, plant and equipment		(2,785)	(1,850)
Proceeds on disposal of property, plant and equipment		421	140
Business acquisition	4	(136,875)	—
Payments received on non-current receivables		425	358
Net cash used in investing activities		(138,814)	(1,352)
Increase (decrease) in cash		766	(13)
Cash, beginning of year		—	13
Cash, end of year		$ 766	$ —
Supplementary information:			
Property, plant and equipment acquired under finance leases, net of disposals		$ 1,404	$ 860
Deferred income tax on share issue costs in share capital		816	—
Future cash settlement of LTIP's in accrued liabilities and non-current liabilities	13(b)	1,182	—
Property, plant and equipment purchases in accrued liabilities and non-current liabilities		596	—
Transfer of accounts receivable to non-current customer notes receivable		199	192

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 and trades on the Toronto Stock Exchange under the symbol "HWD." The Company operates a network of 58 distribution centers in Canada and the US engaged in the wholesale distribution of hardwood lumber, sheet goods, specialty products and non-structural architectural grade building products to customers that supply end-products to the residential and commercial construction markets. The Company also has a sawmill and kiln drying operation in Clinton, Michigan. The Company's principal office is located at #306, 9440 202nd Street, Langley, British Columbia V1M 4A6.

On July 15, 2016 (the "Acquisition date"), the Company acquired through one of its wholly owned subsidiaries substantially all the assets used in the business of Rugby Acquisition, LLC and its subsidiaries ("Rugby") and assumed certain of Rugby's liabilities (the "Acquisition") for a base purchase price of $138.8 million (US$107.0 million) (the "Purchase Price") plus up to another $16.9 million (US$13.0 million) in earn-outs based on future performance (note 4). Rugby operates a network of 28 distribution centers in the US and is engaged in the wholesale distribution of non-structural architectural grade building products to customers that supply end-products to the commercial construction market. Rugby also serves industrial, retail, residential and institutional construction end-markets.

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 17, 2017.

(b) Basis of measurement:

These 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. The Company's subsidiaries operating in the United States have a US dollar functional currency. All financial information presented in the financial statements, with the exception of per share amounts, has been rounded to the nearest thousand dollar.

(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 value of assets acquired and liabilities assumed and proforma sales and profitability associated with the Acquisition of Rugby;
- Notes 6 and 7 - the collectability of accounts receivable and the determination of the allowance for credit loss; and
- Note 8 - the valuation of inventories.

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 12 - the classification of lease obligations; and
- Note 14 - 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 of ownership 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 prior to their expiry. 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 and business acquisitions:

These consolidated financial statements include the accounts of the Company and its subsidiaries. All significant inter-company 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 GP Inc. II, Hardwoods Specialty Products USLP, Hardwoods Specialty Products USGP, Hardwoods Specialty Products (Washington) Corp., Hardwoods USLP II, LP, Hardwoods US LLC, Hardwoods Finance LLC, Hardwoods Finance Company Inc., Paxton Hardwoods LLC, HMI Hardwoods LLC and Rugby Holdings LLC.

The Company accounts for business combinations using the acquisition method when control is transferred to the Company. The consideration transferred in the acquisition is measured at fair value, as are the identifiable net assets acquired. The Company measures goodwill in business acquisitions as the fair value of the consideration transferred less the fair value of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, other contingent consideration is re-measured at fair value at each reporting date and subsequent changes in the fair value of the contingent consideration are recognized in profit or loss.

Transaction costs, other than those associated with the issuance of debt or equity securities, are expensed as incurred.

(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.

3. Significant accounting policies (continued):

(b) Foreign currencies (continued):

Translation of foreign operations for consolidation

For purposes of consolidation, the assets and liabilities of foreign operations with functional currencies other than the Canadian dollar are translated to Canadian dollars using the rate of exchange in effect at the financial statement date. Revenue and expenses of the foreign operations are translated to Canadian dollars at exchange rates at the date of the transactions. 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 business that management uses to make decisions about operating matters. The subsidiaries of the Company engage in one main business activity being the sourcing and distribution of hardwood lumber and related sheet goods and specialty products, hence operating segment information is not provided. Geographical segment information is provided by country of operations in note 16.

(d) Revenue recognition:

Revenue from the sale of hardwood lumber, sheet goods, specialty products and non-structural architectural grade building 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, collection 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 expense and income:

Finance expense is primarily comprised of interest on the Company's operating lines of credit, notes payable and the unwinding of the discount on the Company's finance lease obligations. Interest on these liabilities 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.

(f) Inventories:

Finished goods are measured at the lower of cost and net realizable value. Raw materials are measured at the lower of cost and replacement cost. Work-in-process and goods-in-transit are measured at cost. For purchased wood products, cost is determined using the weighted average cost method and includes invoice cost, duties, freight, and other directly attributable costs of acquiring the inventory. For manufactured wood products, cost is defined as all costs that relate to bringing the inventory to its present condition and location under normal operating conditions and includes manufacturing costs, such as raw materials and labor and production overhead.

3. Significant accounting policies (continued):

(f) Inventories (continued):

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 values as follows:

Assets	Estimated useful life
Buildings, machinery and equipment	3 to 30 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 significant 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 considered necessary.

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) Intangible assets:

Intangible assets with finite lives consist of acquired customer relationships. These customer relationships are amortized on a straight-line basis over their estimated useful life of 10 years and are measured at cost less accumulated amortization.

Amortization methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

After initial measurement in a business combination (note 3(a)), goodwill is recorded at cost less accumulated impairment losses.

(i) 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. Goodwill is tested annually regardless of whether there is any indication of impairment.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use or 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 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").

3. Significant accounting policies (continued):

(i) Impairment (continued):

Non-financial assets (continued)

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. An impairment loss for goodwill is not reversed.

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 account balance level.

All individually significant receivables are assessed for specific impairment. 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.

(j) Financial instruments:

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

Financial assets and financial liabilities are measured initially at fair value plus transaction costs, 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

The Company considers deposits in banks as cash.

3. Significant accounting policies (continued):

(j) Financial instruments (continued):

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 provisions for impairment, if any. 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 exists that a specific counterparty will default. Impairment of trade receivables is presented within selling and distribution expenses.

Loans receivable consist of notes from customers and loans to employees for relocation costs, discounted using the effective interest method. 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. Discounting is omitted when the effect of discounting is immaterial. The revolving bank line of credit is not discounted; rather, actual interest accrued is based on the daily balances and is recorded each month.

(k) 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.

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.

(l) 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.

3. Significant accounting policies (continued):

(l) Leases (continued):

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

(m) Provisions:

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.

(n) 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.

(o) Share based compensation:

The Company has a share based long-term incentive plan as described in note 13(b). At the discretion of the Board of Directors, the Restricted Shares and Performance Shares to which a grantee is entitled may be settled by the Company in Shares or in an amount of cash equal to the fair market value of such Shares, or a combination of the foregoing.

The Company is accounting for half of 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. For the remaining 50% of Restricted and Performance Shares that can be settled in either cash or common shares at the employees option, the Company accounts for the award as cash-settled share based compensation. Compensation expense is recorded over the vesting period based on the estimated fair value at the date of grant. The fair value of this 50% portion of the Restricted and Performance Shares is subsequently re-measured at each reporting date with any change in fair value reflected in share based compensation expense in the statement of comprehensive income. The liability associated with cash-settled awards is recorded in accounts payable and accrued liabilities, for amounts expected to be settled within one year, and in non-current liabilities for amounts to be settled in excess of one year.

(p) New accounting policy:

Amendments to IAS 1, *Presentation of Financial Statements*

Effective January 1, 2016, the Company adopted the amendments to IAS 1, *Presentation of Financial Statements* that improved the presentation and disclosure in financial reports. The adoption of these amendments did not impact the Company's consolidated financial statements.

(q) Future accounting pronouncements:

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2016, and have not been applied in preparing these consolidated financial statements. The following pronouncements are considered by the Company to be the most significant of several pronouncements that may affect the consolidated financial statements in future periods.

3. Significant accounting policies (continued):

(q) Future accounting pronouncements (continued):

IFRS 9, *Financial Instruments ("IFRS 9")*

IFRS 9 will replace the multiple classification and measurement models in IAS 39 *Financial Instruments: Recognition and Measurement*, with a single model that has only two classification categories: amortized cost and fair value. The new standard also requires a single impairment method to be used, provides additional guidance on the classification and measurement of financial liabilities, and provides a new general hedge accounting standard.

The mandatory effective date has been set for January 1, 2018, however early adoption of the new standard is permitted. The Company does not intend to early adopt IFRS 9. The adoption of IFRS 9 is currently not expected to have a material impact on the consolidated financial statements given the nature of the Company's operations and the types of financial instruments that it currently holds; however, the Company will continue to assess the extent of impact as the mandatory adoption date approaches.

IFRS 15, *Revenue from Contracts with Customers ("IFRS 15")*

IFRS 15 is effective for fiscal years commencing on or after January 1, 2018 and will replace IAS 18, *Revenue* and a number of revenue related standards and interpretations. IFRS 15 contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have also been introduced, which may affect the amount and/or timing of revenue recognized.

IFRS 15 permits two methods of adoption: (i) the retrospective method, under which comparative periods would be restated, and the cumulative impact of applying the standard would be recognized as at January 1, 2017, the earliest period presented; and (ii) the cumulative effect method, under which comparative periods would not be restated and the cumulative impact of applying the standard would be recognized at the date of initial adoption January 1, 2018. The Company expects to use the cumulative effect method, however it continues to monitor industry developments. Any significant industry developments could change the Company's expected method of adoption.

The majority of the Company's revenue is generated from the sale of hardwood lumber, sheet goods, specialty products and non-structural architectural grade building products to customers. The Company does not expect the adoption of this standard will have a material impact on the measurement of revenue generated from the sale of its products to customers.

IFRS 16, *Leases ("IFRS 16")*

On January 13, 2016, the IASB published a new standard, IFRS 16, eliminating the current dual accounting model for lessees, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. The main provision of IFRS 16 is the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases that were previously classified as operating leases. Under IFRS 16, a lessee is required to do the following: (i) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; and (ii) recognize a front-loaded pattern of expense for most leases, even when cash rentals are constant, as the right-of-use asset is depreciated and the lease liability is accreted using the effective interest method. The new standard also requires qualitative disclosures along with specific quantitative disclosures. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. Upon adoption of IFRS 16, the Company's operating leases, which are principally comprised of its warehouse facilities and automobiles, will be recorded in the statement of financial position with a corresponding lease obligation. The Company continues to assess the impact of adopting this standard on its consolidated financial statements.

3. Significant accounting policies (continued):

(q) Future accounting pronouncements (continued):

IAS 12, Income Taxes (Amendments)

On January 19, 2016, the IASB issued Recognition of Deferred Tax Assets for Unrealized Losses as an amendment to IAS 12. The amendments clarify that the existence of a deductible temporary difference depends solely on a comparison of the carrying amount of an asset and its tax base at the end of the reporting period, and is not affected by possible future changes in the carrying amount or expected manner of recovery of the asset. The amendments apply retrospectively for annual periods beginning on or after January 1, 2017 with early adoption permitted.

The Company intends to adopt the amendments to IAS 12 in its consolidated financial statements for the annual period beginning on January 1, 2017. The Company does not expect the amendments to have a material impact on the consolidated financial statements.

IFRS 2, Share-Based Payment (Amendments)

On June 20, 2016, the IASB issued amendments to IFRS 2 clarifying how to account for certain types of share-based payment transactions. The amendments provide requirements on the accounting for: the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; share-based payment transactions with a net settlement feature for withholding tax obligations; and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

The amendments apply for annual periods beginning on or after January 1, 2018. As a practical simplification, the amendments can be applied prospectively. Retrospective, or early, application is permitted if information is available without the use of hindsight. The Company intends to adopt the amendments to IFRS 2 in its consolidated financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

4. Rugby acquisition:

On July 15, 2016, a subsidiary of the Company completed the Acquisition of Rugby (note 1). The base purchase price was comprised of (i) $129.8 million (US$100.0 million) in cash consideration and the assumption of notes payable, and (ii) $9.0 million (US$7.0 million) in cash that was immediately used by the sellers to acquire 563,542 common shares of the Company from treasury. The base purchase price paid in cash was adjusted downwards by $0.9 million (US$0.7 million) for the value of notes payable assumed by the Company.

The base purchase price was determined on the basis that the sellers would deliver working capital, as defined in the asset purchase agreement as net asset value ("NAV"), on closing of the acquisition of between US$47.5 million and US$48.5 million and, to the extent that the NAV is outside this range at closing of the Acquisition, the purchase price will be adjusted on a dollar for dollar basis. As security for the NAV adjustment, the Company retained $1.0 million (US$0.8 million) of the base purchase price as a holdback. The holdback, which is accrued in accounts payable and accrued liabilities, is expected to be paid to the sellers in tranches over the next 12 months. As of the date of these financial statements, the NAV delivered by the sellers has not been finalized.

As disclosed in note 1, in addition to the base purchase price, the parties agreed to an earn-out which is intended to pay future consideration, to be determined at the two-year anniversary of closing of the Acquisition based on achievement of certain gross profit thresholds during such two-year period (the "Earn-Out Period"), of up to US$4.8 million (the "Earn-Out Consideration") to one of the principals of the sellers (the "former owner"). In addition, the earn-out is also intended to pay certain management of Rugby, who will be employed by the Company after closing of the Acquisition ("Rugby Management"), remuneration of up to US$8.2 million (the "Earn-Out Bonuses") for the achievement of the same gross profit thresholds during the Earn-Out Period. The earn-out is payable in either cash or common shares at the Company's option. The Earn-Out Consideration is accounted for as purchase price consideration, while the Earn-Out Bonuses are accounted for as compensation expense over the next two years. The Company estimates that neither the Earn-Out Consideration nor the Earn-Out Bonuses will result in further

(Tabular amounts expressed in thousands of Canadian dollars)

4. Rugby acquisition (continued):

payments by the Company and no value was attributed to the Earn-Out Consideration in the purchase price allocation and, as at the date of these financial statements, no accrual has been made in respect of either the Earn-Out Consideration or the Earn-Out Bonuses.

The Acquisition has been accounted for as a business combination using the acquisition method, with the Company being the acquirer and Rugby being the acquiree, and where the assets acquired and liabilities assumed are recorded at their fair values at the Acquisition date.

In connection with the Acquisition, the Company incurred, $2.4 million in transaction costs which are included in administration expense in the consolidated statement of comprehensive income. In addition to transaction costs, the Company incurred to December 31, 2016, additional fees of $3.3 million related to the financing of the Acquisition, which are described in notes 11 and 13(a).

Fair value of assets acquired and liabilities assumed

The estimated fair value of Rugby's identified assets and liabilities assumed in accordance with the acquisition method are as follows:

		US$		CDN$
Cash consideration	$	106,291	$	137,913
Notes payable assumed		709		920
Consideration	$	107,000	$	138,833
Assets acquired and liabilities assumed:				
Accounts and other receivables	$	28,931	$	37,538
Inventories		35,546		46,121
Prepaid expenses		549		712
Non-current receivables		577		749
Property plant and equipment		3,166		4,108
Intangible assets - customer relationships		15,700		20,371
Accounts payable and accrued liabilities		(18,213)		(23,631)
Estimated identifiable net assets acquired		66,256		85,968
Goodwill		40,744		52,865
Estimated net assets acquired	$	107,000	$	138,833

The above is the fair values of the assets acquired and liabilities assumed of Rugby as of the Acquisition date. The estimate will remain preliminary until the Company is able to finalize the NAV acquired. During the fourth quarter of 2016, the Company completed its valuation of intangible assets acquired, resulting in a reduction in the value of goodwill, and an increase in intangible assets of $20.4 million (US$15.7 million) from the purchase price allocation presented at September 30, 2016.

The goodwill of $52.9 million (US$40.7 million) is attributable primarily to the skills and talent of Rugby's workforce, and synergies expected to be achieved in respect of purchasing power with vendors, increases in market share, and operational efficiencies related to the combined operations. The goodwill is deductible for tax purposes.

The intangible asset of $20.4 million (US$15.7 million) represents the value of customer relationships acquired and is being amortized over 10 years, which is the period the Company expects to benefit from these relationships. Amortization related to intangible assets from the Acquisition date to December 31, 2016 was $0.9 million and this expense was recorded in the fourth quarter. The intangible asset is deductible for tax purposes.

The Company financed the Acquisition through a combination of an equity offering (the "Bought Deal Financing") (note 13(a)) and a renegotiated Hardwoods USLP Credit Facility (note 11).

(Tabular amounts expressed in thousands of Canadian dollars)

4. Rugby acquisition (continued):

Had the Acquisition occurred on January 1, 2016 management estimates that the Company's consolidated sales would have been approximately $989.3 million and profit before tax would have been approximately $42.6 million for the year ended December 31, 2016. Included in these consolidated financial statements for the year ended December 31, 2016 are sales of $175.1 million (US$132.6 million) and profit before tax of $4.0 million (US$3.1 million) relating to Rugby.

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 growth 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, 2016	December 31, 2015
Cash	$ (766)	$ —
Bank indebtedness	97,886	28,894
Shareholder's equity	225,999	142,948
Total capitalization	$ 323,119	$ 171,842

The terms of the Company's US and Canadian credit facilities are described in note 11. The terms of the agreements with the Company's lenders provide that distributions cannot be paid 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, 2016 and December 31, 2015, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Dividends are one way the Company manages its capital. Dividends are declared having given consideration to a variety of factors including the outlook for the business and financial leverage. There were no changes to the Company's approach to capital management during the year ended December 31, 2016.

On November 8, 2016, the Company declared a cash dividend of $0.0625 per common share to shareholders of record as of January 20, 2017. The dividend was paid to shareholders on January 31, 2017. On March 17, 2017, the Company declared a cash dividend of $0.0625 per common share to shareholders of record as of April 17, 2017, to be paid on April 28, 2017.

6. Financial instruments:

Financial instrument assets include cash and current and non-current receivables, which are designated as loans and receivables and measured at amortized cost. Non-derivative financial instrument liabilities include bank indebtedness, accounts payable and accrued liabilities, income taxes payable, dividend payable, notes 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 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.

6. Financial instruments (continued):

Fair value hierarchy (continued):

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

Fair values of financial instruments

The carrying values of cash, accounts and other receivables, income tax payable, dividend payable and accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of non-current receivables, notes payable 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.

Financial risk management:

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

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

(*i*) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk arises principally from the Company's current and non-current 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 $96.7 million at December 31, 2016 (December 31, 2015 - $57.1 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 2.5% (December 31, 2015 - 3.9%) of trade accounts receivable and customer notes receivable at December 31, 2016. No one customer represents more than 1.4% 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.

6. Financial instruments (continued):

(*i*) Credit risk (continued):

Customer notes:

Customer notes are issued to certain customers to provide fixed repayment schedules for amounts owing that have been agreed will be repaid over longer periods of time. The terms of each note are negotiated with the customer. For notes issued the Company requires a fixed payment amount, personal guarantees, general security agreements, and security over specific property or assets. Customer notes bear market interest rates ranging from 5%-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.

Cash:

Cash balances are maintained with high credit quality financial institutions. The Company does not believe there is any material credit risk associated with cash.

(*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, 2016, in Canada, a subsidiary of the Company had a revolving credit facility of up to $20.0 million, and, in the US, a subsidiary of the Company had a revolving credit facility of up to $167.8 million (US$125.0 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 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. See note 11 for further information regarding the Company's credit facilities and borrowing capacity.

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 12 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 the December 31, 2016 bank indebtedness balance of $97.9 million, a 1% increase or decrease in the interest rates charged would result in a decrease or increase to profit after tax by approximately $0.6 million.

Currency risk

As the Company conducts business in both Canada and the United States it is exposed to currency risk. Most of the products sold by the Company in Canada are purchased in U.S. dollars from suppliers in the United States. Although the Company reports its financial results in Canadian dollars, approximately 85% 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 products 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 products are resold in Canada it is generally sold at a

6. Financial instruments (continued):

Financial risk management (continued):

(*iii*) Market risk (continued):

Currency risk (continued)

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, 2016, the primary exposure to foreign denominated financial instruments was in the Company's Canadian subsidiaries and relates to US dollar cash balances, accounts receivable from U.S. customers (2016 - US$0.2 million, 2015 - US$0.1 million) and accounts payable to U.S. suppliers (2016 - US$0.4 million, 2015 - 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, 2016 or December 31, 2015.

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, 2016 and December 31, 2015 and does not take into account the effect of a change in currency rates will have on the translation of the balance sheet and operations of the Company's U.S. subsidiaries nor is it intended to estimate the potential impact changes in currency rates would have on the Company's sales and purchases.

Commodity price risk:

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

(Tabular amounts expressed in thousands of Canadian dollars)

7. Accounts and other receivables:

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

	December 31, 2016	December 31, 2015
Trade accounts receivable - Canada	$ 14,246	$ 11,937
Trade accounts receivable - United States	81,776	47,586
Sundry receivable	2,417	726
Current portion of non-current receivables	1,133	751
	99,572	61,000
Less:		
Allowance for credit loss	5,038	4,844
	$ 94,534	$ 56,156
Non-current receivables:		
Employee housing loans	$ 424	$ 546
Customer notes	758	631
Security deposits	1,329	543
	2,511	1,720
Less:		
Current portion, included in accounts receivable	1,133	751
	$ 1,378	$ 969

The aging of trade receivables is:

	December 31, 2016	December 31, 2015
Current	$ 70,936	$ 44,377
1 - 30 days past due	17,467	9,142
31 - 60 days past due	4,957	3,122
60+ days past due	2,662	2,882
	$ 96,022	$ 59,523

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, 2016 was $5.0 million (December 31, 2015 - $4.8 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.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Accounts and other receivables (continued):

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

		2016		2015
Balance as at January 1	$	4,844	$	3,478
Additions during the year		1,764		1,922
Use during the year		(1,426)		(1,217)
Changes due to currency rate fluctuations		(144)		661
Balance as at December 31	$	5,038	$	4,844

Bad debt expense, net of recoveries, for the year ended December 31, 2016 was $0.8 million which equates to 0.1% of sales (year ended December 31, 2015 - $1.5 million, being 0.3% of sales).

8. Inventories:

		December 31, 2016		December 31, 2015
Raw materials	$	1,779	$	1,265
Work in process		5,021		5,054
Goods in-transit		10,927		7,611
Finished goods:				
Lumber		43,279		38,649
Sheet goods		76,224		42,102
Architectural and other		27,317		8,795
	$	164,547	$	103,476

After the acquisition of Rugby, architectural and other now includes specialty products, solid surface countertops, post-form countertops, high-pressure laminate, interior and exterior doors and millwork, cabinets and casework, mouldings, and industrial wood coatings. The Company regularly reviews and assesses the condition and value of its inventories and records write-downs to net realizable value as necessary.

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

		2016		2015
Inventory write-downs, included in cost of goods sold	$	1,972	$	1,530
Cost of inventory sold		620,115		455,544
Other cost of goods sold		25,428		16,421
Total cost of goods sold	$	645,543	$	471,965

(Tabular amounts expressed in thousands of Canadian dollars)

9. Property, plant and equipment:

	Land	Leased vehicles (note 12(a))	Buildings, machinery and equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2015	$ 580	$ 3,149	$ 18,156	$ 824	$ 22,709
Additions	—	1,200	1,695	155	3,050
Disposals	—	(1,088)	(277)	(119)	(1,484)
Adjustments:					
Foreign currency transaction	112	432	3,151	49	3,744
Balance at December 31, 2015	692	3,693	22,725	909	28,019
Additions	151	1,656	3,124	113	5,044
Acquisition of Rugby (note 4)	—	—	3,861	247	4,108
Disposals	—	(1,452)	(482)	—	(1,934)
Adjustments:					
Foreign currency transaction	(19)	(82)	(432)	3	(530)
Balance at December 31, 2016	$ 824	$ 3,815	$ 28,796	$ 1,272	$ 34,707
Accumulated depreciation					
Balance at January 1, 2015	$ —	$ 1,235	$ 6,950	$ 760	$ 8,945
Depreciation	—	962	1,584	47	2,593
Disposals	—	(747)	(173)	(113)	(1,033)
Adjustments:					
Foreign currency transaction	—	176	1,097	41	1,314
Balance at December 31, 2015	—	1,626	9,458	735	11,819
Depreciation	—	1,077	2,620	125	3,822
Disposals	—	(1,059)	(357)	—	(1,416)
Adjustments:					
Foreign currency transaction	—	(30)	(194)	(4)	(228)
Balance at December 31, 2016	$ —	$ 1,614	$ 11,527	$ 856	$ 13,997
Net book value:					
December 31, 2015	$ 692	$ 2,067	$ 13,267	$ 174	$ 16,200
December 31, 2016	$ 824	$ 2,201	$ 17,269	$ 416	$ 20,710

(Tabular amounts expressed in thousands of Canadian dollars)

9. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the year ended December 31, 2016 was $3.8 million (2015 - $2.6 million) and is included in the statement of comprehensive income as follows:

		2016		2015
Cost of sales	$	1,477	$	1,080
Selling and distribution		2,195		1,447
Administration		150		66
	$	3,822	$	2,593

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2016 was a net gain of $171,000 (2015 - net gain of $28,566) and is included in selling and distribution in the statement of comprehensive income.

10. Intangible assets:

		Customer relationships
Cost		
Balance at December 31, 2015	$	57
Acquisition of Rugby (note 4)		20,371
Eliminate fully amortized intangibles		(57)
Adjustments:		
Foreign currency transaction		709
Balance at December 31, 2016	$	21,080
Accumulated amortization		
Balance at December 31, 2015	$	21
Amortization		984
Eliminate fully amortized intangibles		(57)
Adjustments:		
Foreign currency transaction		18
Balance at December 31, 2016	$	966
Net book value:		
December 31, 2015	$	36
December 31, 2016	$	20,114

Amortization of intangible assets for the year ended December 31, 2016 was $0.9 million (2015 - nil) and is included in selling and distribution expenses in the statement of comprehensive income.

(Tabular amounts expressed in thousands of Canadian dollars)

11. Bank indebtedness:

	December 31, 2016	December 31, 2015
Cheques issued in excess of funds on deposit	$ 480	$ 3,049
Credit facility, Hardwoods LP	12,546	5,314
Credit facility, Hardwoods USLP (December 31, 2016 - US$63,398 December 31, 2015 - US$14,835)	84,860	20,531
	$ 97,886	$ 28,894

Bank indebtedness consists of cheques issued in excess of funds on deposit and advances under operating lines of credit (the “Credit Facilities”) available to subsidiaries of the Company, Hardwoods Specialty Products LP (“Hardwoods LP”) and Hardwoods Specialty Product USLP (“Hardwoods USLP”).

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, Rugby Holdings LLC, Paxton Hardwoods LLC and HMI Hardwoods LLC, and the Hardwoods USLP partnership units held indirectly by the Company.

The Credit Facilities are payable in full at maturity. The Credit Facilities are revolving credit facilities which the Company 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.

Hardwoods LP Credit Facility ("LP Credit Facility")

In August 2016, a subsidiary of the Company renewed the LP Credit Facility for a period of five years. As part of the renewal, the LP Credit Facility was increased to $20.0 million from $15.0 million. The amount made available under the LP Credit Facility is limited to the extent of 90% of the net book value of eligible accounts receivable and the lesser of 60% of the book value or 85% of appraised value of eligible 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 LP Credit Facility. Hardwoods LP is required to maintain a fixed charge coverage ratio of not less than 1.0 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, 2016, the LP Credit Facility has unused availability of $6.9 million, before cheques issued in excess of funds on deposit of $0.5 million (December 31, 2015 - $9.7 million, cheques issued in excess of funds on deposit - $0.9 million).

In February 2017 the LP Credit Facility was amended to increase the amount made available under the facility from $20.0 million to $25.0 million.

11. Bank indebtedness (continued):

Hardwoods USLP Credit Facility ("USLP Credit Facility")

In connection with the closing of the Acquisition, a subsidiary of the Company entered into a new USLP Credit Facility with its lender, and has made the funds available to Hardwoods USLP. The USLP Credit Facility has a five year term and can be prepaid at any time with no prepayment penalty. The USLP Credit Facility is guaranteed by certain of the Company's subsidiaries and replaces the previous credit facility. The USLP Credit Facility consists of a revolving credit facility of up to US$125.0 million with the amount made available limited to the extent of 85% of the value of eligible accounts receivable, and 60% of the value of eligible inventory plus the lesser of (i) 55% of the book value of eligible in-transit inventory or (ii) $2.0 million.

The financial covenants under the USLP Credit Facility include, among others, a springing fixed charge coverage ratio of 1.0 to 1, triggered if excess availability under the USLP Credit Facility falls below 10% of the USLP Credit Facility at any time.

In addition to the financial covenants, the ability of the Company's US subsidiaries to pay distributions and dividends, complete acquisitions, make additional investments, take on additional indebtedness, allow its assets to become subject to liens, complete affiliate transactions and make capital expenditures are limited and subject to the satisfaction of certain conditions.

In connection with the USLP Credit Facility, the Company incurred for the year ended December 31, 2016, $0.3 million, respectively, in fees, which are netted against bank indebtedness in the consolidated statement of financial position. These fees will be amortized over the term of the USLP Credit Facility.

At December 31, 2016, the USLP Credit Facility has unused availability of $50.9 million (US$37.9 million), before cheques issued in excess of funds on deposit of nil. At December 31, 2015, the USLP Credit Facility had unused availability of $51.1 million (US$36.9 million), before cheques issued in excess of funds on deposit of $2.1 million (US$1.5 million).

The Company has a letter of credit outstanding at December 31, 2016 totaling $0.8 million (US$0.6 million) (2015 - nil) against the USLP Credit Facility to support self-insured benefit claims.

The average annual interest rates paid in respect of bank indebtedness for the year ended December 31, 2016 were 3.2% and 2.8% (2015 - 3.4% and 2.7%) for the LP and USLP credit facilities, respectively.

12. 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.

(Tabular amounts expressed in thousands of Canadian dollars)

12. Leases (continued):

(a) Finance leases as lessee (continued):

Finance lease liabilities are payable as follows:

Minimum lease payments due		Within one year		One to three years		Total
December 31, 2016:						
Future minimum lease payments	$	1,137	$	938	$	2,075
Interest		82		33		115
Present value of minimum payments	$	1,055	$	905	$	1,960
December 31, 2015:						
Future minimum lease payments	$	1,190	$	719	$	1,909
Interest		71		23		94
Present value of minimum payments	$	1,119	$	696	$	1,815

The present value of the lease payments is calculated using the interest rate implicit in the lease, which range from 4.1% - 7.1%.

(b) Operating leases as lessee:

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

		With one year		One to five years		After five years		Total
Minimum lease payments due:								
December 31, 2016	$	18,081	$	41,422	$	4,947	$	64,450

Minimum lease payments recognized as an expense during the year ended December 31, 2016 amounted to $13.5 million (2015 - $7.3 million).

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. Renewal options are reviewed regularly by management. The operating lease agreements do not contain any restrictions regarding distributions, further leasing or additional debt.

13. Share capital:

(a) Share capital

At December 31, 2016, the authorized share capital of the Company comprised an unlimited number of common shares without par value ("Shares").

(Tabular amounts expressed in thousands of Canadian dollars)

13. Share capital (continued):

(a) Share capital (continued)

A continuity of share capital is as follows:

	Shares		Total
Balance at December 31, 2014	16,651,414	$	45,830
Issued pursuant to long term incentive plan	110,657		1,029
Balance at December 31, 2015	16,762,071		46,859
Bought deal financing - conversion of subscription receipts, net of share issue costs of $3.1 million	3,966,350		54,434
Issued concurrent with the Rugby acquisition (note 4)	563,542		9,091
Issued pursuant to long term incentive plan	58,607		1,162
Deferred income tax on share issue costs	—		816
Share adjustment	2		—
Balance at December 31, 2016	21,350,572	$	112,362

In July 2016, the Company issued 563,542 common shares for cash consideration to the sellers of Rugby in accordance with the terms of the Acquisition (note 4) and issued 3,966,350 common shares as part of the financing arrangement related to the Acquisition, as described below.

Bought Deal Financing

In connection with the Rugby Acquisition, the Company entered into an agreement with a syndicate of investment dealers pursuant to which the underwriters agreed to purchase for resale to the public on a bought deal basis 3,449,000 subscription receipts of the Company, at a price of $14.50 per receipt with an over-allotment option for an additional 517,350 subscription receipts for gross overall proceeds of $57.5 million ($54.4 million net of fees associated with the offering).

On June 30, 2016, the Bought Deal Financing closed and $50.0 million, representing 3,449,000 subscription receipts, was received by the Company and was held in escrow pending the closing of the Acquisition. Each subscription receipt was converted to one common share of the Company on the Acquisition date for no additional consideration in accordance with the terms of the subscription agreement. The over-allotment option, representing 517,350 subscription receipts, was fully exercised by the underwriters in July 2016 and these subscription receipts were also converted on the basis of one subscription receipt to one common share of the Company on the Acquisition date.

In connection with the Bought Deal Financing, the Company incurred $3.1 million in share issue costs. These amounts were recorded in equity on closing of the Acquisition as share issue costs, along with the associated deferred income tax impact of $0.8 million.

(b) Long Term Incentive Plan (“LTIP”):

The Company has an approved long term incentive plan which authorizes the issuance of a maximum of 1,650,000 Shares to qualified trustees, directors, officers, employees and consultants to align the interests of such persons with the interests of shareholders.

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

(Tabular amounts expressed in thousands of Canadian dollars)

13. Share capital (continued):

(b) Long Term Incentive Plan ("LTIP") (continued):

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. In December 2016, the Board of Directors provided grantees with the option to settle up to 50% of the Restricted Shares and Performance Shares in cash. The Company has made an estimate of the amount it expects to settle in cash related to future vestings of Restricted Shares and Performance Shares. As at December 31, 2016 the fair value of the Restricted Shares and Performance Shares estimated to be settled in the future in cash is $1.2 million (December 31, 2015 - nil) and this value has been removed from contributed surplus and classified within accounts payable and accrued liabilities and non-current liabilities.

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 dividends are paid on the Shares by an amount equal to a fraction having as its numerator the amount of the dividends 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.

A continuity of the LTIP Shares outstanding is as follows:

	Performance Shares	Restricted Shares
Balance at December 31, 2014	20,952	98,913
LTIP shares issued during the year	43,005	70,588
LTIP shares settled by exchange for free-trading Shares	(14,748)	(82,674)
Balance at December 31, 2015	49,209	86,827
LTIP shares issued during the year	20,502	53,166
LTIP shares forfeited during the year	(2,763)	(8,292)
LTIP shares settled	(8,347)	(58,040)
Balance at December 31, 2016	58,601	73,661

On December 31, 2016, 8,347 (December 31, 2015 - 14,748) Performance Shares and 58,040 (December 31, 2015 - 82,674) Restricted Shares became fully vested and were settled by the issuance of 58,607 (December 31, 2015 - 110,657) Shares and $0.3 million in cash (December 31, 2015 - nil). On issuance of the Shares, the accumulated share-based compensation expense of $1.2 million (December 31, 2015 - $1.0 million) associated with the settled Performance Shares and Restricted Shares was transferred from contributed surplus to share capital.

(Tabular amounts expressed in thousands of Canadian dollars)

13. Share capital (continued):

(b) Long Term Incentive Plan ("LTIP") (continued):

Non-cash LTIP compensation expense of $1.1 million was recognized in the consolidated statement of comprehensive income for the year ended December 31, 2016 (2015 - $1.3 million). 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 net profit per share is based on the net profit for the year ended December 31, 2016 of $23.9 million (December 31, 2015 - $20.1 million). The weighted average number of common shares outstanding in each of the reporting years was as follows:

	December 31, 2016	December 31, 2015
Issued ordinary shares at beginning of year	16,762,071	16,651,414
Effect of shares issued during the year		
Pursuant to long-term incentive plan	13,322	815
Pursuant to Bought Deal Financing	1,817,910	—
Pursuant to Rugby acquisition	258,290	—
Weighted average common shares - basic	18,851,593	16,652,229
Effect of dilutive securities:		
Long-term incentive plan	166,377	128,649
Weighted average common shares - diluted	19,017,970	16,780,878

14. Income taxes:

	2016	2015
Current tax expense	$ (13,600)	$ (9,732)
Deferred tax expense	20	(2,476)
	$ (13,580)	$ (12,208)

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 ended December 31, 2016 is 26.4% (2015 - 26.3%) and in the United States is 39.4% (2015 - 39.4%). The majority of the Company's tax expense is generated from its US subsidiaries, and as such the Company reconciles its consolidated income tax expense to the statutory tax rate applicable to the United States.

(Tabular amounts expressed in thousands of Canadian dollars)

14. Income taxes (continued):

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

	2016	2015
Profit before income tax	$ 37,442	$ 32,354
Statutory rate	39.4%	39.4%
Computed tax expense at statutory rate	(14,752)	(12,747)
Effect of lower tax rates in Canada, other rate changes and restructuring	1,798	697
Non-deductible expenses	(73)	(484)
Change in unrecognized deferred tax assets	(363)	(43)
Other	(190)	369
Income tax expense	$ (13,580)	$ (12,208)

Certain comparative period figures in the table above have been changed to adhere to the current period presentation.

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, 2016	December 31, 2015
Deferred tax assets:		
Accounts receivable	$ 2,838	$ 1,902
Accounts payable and provisions	1,629	556
Inventory	1,985	1,539
Finance lease obligations	681	654
Goodwill and intangibles	5,711	7,797
Tax loss carry forwards and future interest deductions	810	1,209
Share and debt issuance costs	1,122	—
Other	—	224
	14,776	13,881
Deferred tax liabilities:		
Prepaid expenses	(325)	(248)
Property, plant and equipment	(2,725)	(2,659)
Other	(95)	—
	(3,145)	(2,907)
Deferred tax asset	$ 11,631	$ 10,974

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, 2016, the Company and its subsidiaries have operating loss carry forwards for income tax purposes of approximately $3.1 million in Canada that may be utilized to offset future taxable income (December 31, 2015 - $4.3 million). These losses, if not utilized, expire between 2026 and 2031. The Company's US subsidiaries have no operating loss carry forwards.

(Tabular amounts expressed in thousands of Canadian dollars)

14. Income taxes (continued):

At December 31, 2016, the Company and its Canadian subsidiaries have capital losses of approximately $23.1 million (December 31, 2015 - $24.1 million), and suspended capital losses of approximately $44.7 million (December 31, 2015 - $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 (December 31, 2015 - $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.

15. Finance income and expense:

	Note		2016		2015
Finance expense:					
Interest on bank indebtedness	11	$	(1,675)	$	(1,217)
Accretion of finance lease obligation	12(a)		(137)		(116)
Foreign exchange losses			(11)		—
Total finance expense			(1,823)		(1,333)
Finance income:					
Interest on trade receivables, customer notes, and employee loans	7		358		421
Foreign exchange gain			—		1,055
Total finance income			358		1,476
Net finance (expense) income		$	(1,465)	$	143

16. Segment reporting:

Information about geographic areas is as follows:

		2016		2015
Revenue from external customers:				
Canada	$	129,935	$	116,805
United States		659,386		454,793
	$	789,321	$	571,598

		December 31, 2016		December 31, 2015
Non-current assets[1]:				
Canada	$	1,552	$	1,347
United States		93,979		14,889
	$	95,531	$	16,236

[1] Excludes financial instruments and deferred income taxes.

(Tabular amounts expressed in thousands of Canadian dollars)

17. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are summarized below.

		2016		2015
Wages, salaries and benefits	$	72,528	$	45,116
Pensions - defined contribution plans		1,078		831
LTIP share based compensation		1,130		1,300
	$	74,736	$	47,247

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

		2016		2015
Cost of sales	$	14,967	$	8,996
Selling and distribution		43,936		29,636
Administration		15,833		8,615
	$	74,736	$	47,247

(b) Pensions:

Hardwoods USLP, Rugby Holdings LLC, Paxton Hardwoods LLC and HMI Hardwoods LLC maintain defined contribution 401(k) retirement savings plans (the “USLP Plan”, the "Rugby Plan", the “Paxton Plan” and the “HMI Hardwoods 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, 2016, Hardwoods USLP contributed and expensed $0.5 million (US$0.4 million) (2015 - $0.4 million (US $0.3 million)) in relation to the USLP Plan.

The assets of the Rugby Plan are held and related investment transactions are executed by the Plan’s Trustee, Fidelity Management Trust Company and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2016, Rugby Holdings LLC contributed and expensed $0.1 million (US $0.1 million) in relation to the Rugby 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, 2016, Hardwoods USLP contributed and expensed $0.1 million (US $0.1 million) (2015 - $0.1 million (US $0.1 million)) in relation to the Paxton Plan.

The assets of the HMI Hardwoods Plan are held and related investment transactions are executed by the Plan’s Trustee, Voya Financial (Voya Institutional Trust Company) and, accordingly, are not reflected in these consolidated financial statements. There is no requirement for an employer contribution to this plan and accordingly HMI Hardwoods LLC did not make any contributions to this 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 Trust Inc., and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2016, Hardwoods LP contributed and expensed $0.3 million (2015 - $0.3 million) in relation to the LP plan.

(Tabular amounts expressed in thousands of Canadian dollars)

18. 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 and Chief Executive Officer, Chief Financial Officer, Senior Vice President and Vice Presidents. Key management personnel remuneration includes the following expenses:

		2016		2015
Short-term employee benefits:				
Salaries and benefits including bonuses	$	4,260	$	2,915
Automobile benefit		38		39
LTIP Share compensation		896		932
Total remuneration	$	5,194	$	3,886

(b) Transactions with post-employment benefit plans:

The defined contribution plans referred to in note 17(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 17(b). The Company has not entered into other transactions with the pension plans, nor has it any outstanding balances at December 31, 2016 or December 31, 2015.

19. Provisions:

Legal

The Company and its subsidiaries are subject to legal proceedings from time to time that arise in the ordinary course of its business. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for or insured, would be material in relation to the Company's consolidated financial statements as at December 31, 2016.

Decommissioning

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

Corporate Information

Directors

Robert J. Brown
Director

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Chair, Interfor Corporation

William Sauder
President, Emax Investments Ltd.

Peter M. Bull
President, Blenheim Realty Ltd.

Jim C. Macaulay
Chief Financial Officer, Marvin Companies

Officers

Robert J. Brown
President & Chief Executive Officer

Lance R. Blanco
Senior Vice President, Corporate Development

Faiz H. Karmally
Vice President and Chief Financial Officer

Jason West
Vice President, Canada

Dan A. Besen
Vice President, United States

Dan Figgins
Vice President, Imports

John Griffin
Vice President, Paxton

Dave Hughes
President, Rugby

Head Office

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

Auditors

KPMG LLP
Vancouver, British Columbia

Investor Relations

Faiz H. Karmally
Chief Financial Officer
Telephone:604-881-1982
fkarmally@hardwoods-inc.com

Listings

The Toronto Stock Exchange
Trades under **HWD**

Transfer Agent

Computershare Trust

Supplier: Arauco
Product Line: Prism
Colour: Noce Como