

HDI

HARDWOODS DISTRIBUTION INC.



Annual Report

2017

HDI

HARDWOODS DISTRIBUTION INC.



3

industry-leading
distribution brands



63

locations



+1,100
employees



+ 35,000
customers



+ \$1B
in annual
revenues



#1
in North
America

Our Vision

Hardwoods Distribution Inc. (or "HDI") is a world-class distributor of architectural building products operating under multiple brands across North America. We are uncompromising in our commitment to be the preferred choice for our valued customers, the best partner for our vendors, and a great place to work for our valued employees.

Our Values

Integrity, our organization and every employee within are accountable to the highest standard of integrity in all decisions made and actions taken.

Fairness, we practice open and honest communication with our stakeholders, we treat everyone with respect and dignity.

People, the source of our competitive advantage, we attract, train and retain the best people and offer a career of opportunity to our employees.

Passion for success, we create, we innovate, constantly setting the bar higher for continuous improvement.



Profile

HDI (or "the Company") is listed on the Toronto Stock Exchange and trades under the symbol HDI. We are North America's largest wholesale distributor of architectural building products to the residential and commercial construction sectors.

Our Products and Services: We sell decorative surfaces and composite panels, hardwood plywood, high-grade hardwood lumber, and other architectural building products to industrial manufacturing customers across North America. We also provide custom moulding and millwork services at 26 of our locations, and own a sawmill and kiln drying operation in Michigan.

Our Customers: Our business serves over 35,000 customers, primarily small-to-mid-sized industrial 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.

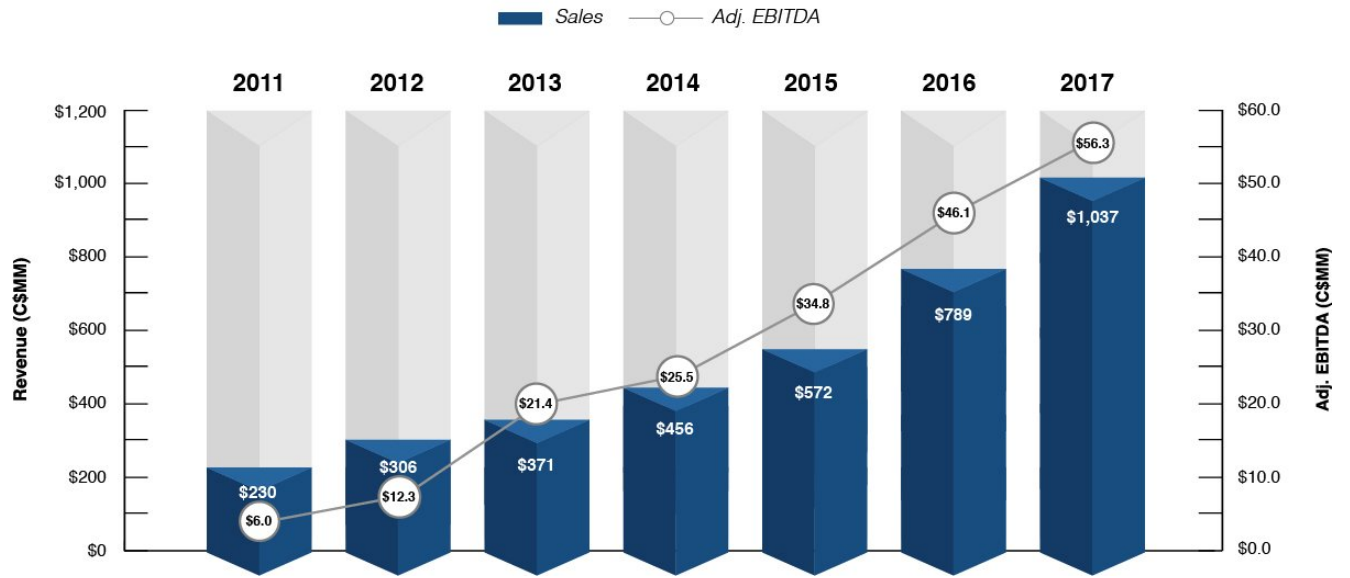
Our End-Markets: We estimate that approximately half of the products we sell to industrial manufacturers end up in residential construction applications, approximately 30% in the commercial/institutional construction sector, and the remainder in other markets.

Our People: We employ over 1,100 dedicated employees and maintain a pronounced professional and entrepreneurial sales and service culture.

Our Network: We operate from 63 locations across North America, with approximately 85% of our annual sales generated in the United States and 15% in Canada.

Our Strategy: As North America's largest distributor in our industry, with an unmatched network of locations and annual sales of over \$1 billion, we are focused on leveraging our size, capabilities, and strong financial position to create a world class distribution company. Our objectives include: i) being the **market leader** in our products; ii) developing and expanding our product offering with **high-value solutions**; iii) supporting the success of our operations and our stakeholders with **operational excellence**; and iv) continuing to **pursue acquisitions** that complement our strategies.

SALES AND ADJUSTED EBITDA – 2011 to 2017



To our Shareholders

Hardwoods Distribution Inc. ("HDI", or the "Company") has come a long way since 2010, when we first embarked on our strategy of capturing the growth that followed the extended downturn in residential and commercial construction markets, as well as in the broader economy. At that time, our revenues were approximately \$200 million and we had 26 locations serving approximately 2,100 customers. Fast forward to 2017, and we have grown to become North America's largest distributor of architectural building products with 63 locations and more than 1,100 employees serving over 35,000 customers.

I am pleased to report that our growth is contributing directly to record top and bottom line financial results. Our 2017 revenues exceeded the \$1 billion sales mark for the first time in our history and we generated Adjusted EBITDA of \$56.3 million and Adjusted profit of \$31.2 million, up 22.0% and 23.0% respectively compared to 2016. This in turn enabled investors to benefit from our achievements with the distribution of \$5.6 million in dividends, which combined with share price appreciation, contributed to a total return of 14.6% to holders of HDI shares in 2017.

Notably, we achieved our strong 2017 performance while dealing with the market challenges of a US trade case against hardwood plywood imported from China and the negative foreign exchange impact of a stronger Canadian dollar, both of which put downward pressure on our results. HDI today is not just bigger, we're stronger and more resilient than ever before, and going forward, we have the opportunity to create a world class distribution company.

The Power of Acquisitions

Our new position has arisen from the successful execution of our growth strategy, which has included the acquisitions of Frank Paxton Lumber Company in 2011, Leland in 2013, Hardwoods of Michigan ("HMI") in 2014, and our largest acquisition, Rugby Architectural Building Products ("Rugby"), in mid-2016. The Rugby transaction brought us 28 distribution facilities across 40 US states positioning us as the number one distributor in our industry. I'm pleased to report that Rugby is now fully onboard following a very smooth integration.

Among the numerous benefits brought to us by Rugby was a strong pipeline of acquisition opportunities and we acted on two of these in 2017. In March, we expanded our market share

in Texas with the purchase of Eagle Plywood and Lumber (“Eagle”), a single site, wholesale distributor based in Dallas. The Eagle operation was consolidated into our existing Rugby distribution facility in Dallas, expanding our presence in this significant market, adding customers and enhancing our team with additional bench strength. In July, we went on to purchase Downes & Reader Hardwood Company Inc. (“D&R”), a distributor of hardwood lumber in the US Northeast. D&R brought us four new locations, a comprehensive lumber products offering, and 2,400 new customers. The D&R locations are now operating under the Rugby brand.

These newly acquired businesses, including Rugby, contributed \$224.1 million to our 2017 sales. All three acquisitions have also proved accretive to our results, and consistent with our previous three acquisitions, their positive impact has extended beyond the financial.

HDI has now achieved a size and scale that brings significant benefit to our customers and supply partners. We have three of the industry’s best known and most respected distribution brands: Hardwoods, Rugby and Paxton. We’ve gained new depth in our senior management team and we’re attracting the industry’s best people across our organization. We’ve also become the leading choice of world-class suppliers looking for a sophisticated North America-wide distribution engine.

Having arrived at this exciting point in our history, the question in 2017 was this: how do we now leverage our new strengths for even greater success?

Our Vision for the Business

A common tactic for growth-oriented companies is to bring acquired businesses together under a single name and identity. They seek scale. But HDI’s multi-year track record of success has come only partially from size. As a selling organization, we have benefited as much from our entrepreneurial, customer-centered approach to the business. Customers identify strongly with our existing distribution brands, each of which has distinct qualities. And we know we are more agile and successful when we keep decision making close to the customer. Accordingly, we are moving forward with a business structure that retains our existing distribution brands, but supports them with the collective strength and capabilities of HDI.

During 2017 we articulated our vision as follows: *HDI is a world class distributor of architectural buildings products operating multiple brands across North America. We are*

uncompromising in our commitment to be the preferred choice for our valued customers, the best partner for our vendors, and a great place to work for our valued employees.

To realize this vision, we are putting our three distribution brands at the top of our organizational chart, with HDI underpinning them. We want our brands to continue to interface directly with customers and to retain significant autonomy. This is what has made them so successful in the past. The opportunity the brands have now is the ability to draw on HDI's size and strength to access unified marketing support, sophisticated information technology solutions, professional human resources management, and highly developed global importing and vendor management capabilities as they work to create a world class distribution company.

Our operational strategy is shifting to support this vision. We are focused on:

- Being the **market leader** in our products.
- Developing and expanding our product offering with **high-value solutions**.
- Supporting the success of our operations and stakeholders with **operational excellence**.
- Continuing to **pursue acquisitions** that complement our strategies.

We have already begun to operationalize this strategy. We recently completed extensive research into customer product needs and preferences in order to guide our product strategy. An upgrade of our enterprise resource planning (ERP) system in some locations is also underway to provide world-class technology-enabled solutions that make it easier for customers to do business with us. In addition, we are actively exploring the robust pipeline of acquisition opportunities identified within the highly fragmented US industry, and we are supported in this pursuit by a very strong balance sheet that enables us to act.

As we move into 2018, we expect to continue achieving profitable growth, with market conditions providing moderate assistance. The US residential construction market is expected to continue its slow, uneven recovery and the US commercial market is anticipating 4% growth in the year ahead. As always, we will strive to build on underlying market growth with our own strategies and initiatives.

An important objective in 2018 will be to utilize our global sourcing expertise to adapt in the wake of the United States' imposition of duties on imported Chinese hardwood plywood. Approximately 11% of our sales prior to the trade case were impacted, with a combined duty

rate of over 206% now making hardwood plywood from China uncompetitive in the United States. During 2017, we demonstrated that we could meet customer needs despite the significant supply disruption present throughout the year and suffered no significant loss of customers or market share. We are confident that we can continue to meet our customers' needs in 2018, while also working closely with our domestic and overseas vendors to establish new supply channels. Over the past seven years, we have built expertise and a skilled team of specialists on our path to becoming a leading one-step importer of high-quality, differentiated products. This skillset is highly transferable and will be instrumental in helping us broaden our supply relationships.

Our 2018 profitability will benefit from the change in the US corporate taxation rate from 35% to 21%. As we note in the outlook provided in our Management's Discussion and Analysis, had these rates been in place in 2017 our Adjusted earnings per share would have been \$1.58, nearly 9% higher than the \$1.46 per share we recorded for the year. This represents a decrease in income tax expense of \$2.6 million.

Overall, I am excited by our prospects and deeply proud of the growth and evolution of the Company thus far. We are not just getting bigger, we are focused on quality, integrity and professionalism as we create long-term value for all of our stakeholders. By striving to be a great place to work for our employees, the best partner to our vendors, and the leading problem solver for our customers, we are laying the foundation to deliver continued strong performance for you, our investors. We thank you for your confidence in HDI and look forward to telling you about our continued progress in 2018.

Sincerely,

A handwritten signature in black ink, appearing to read "Rob Brown", with a small comma at the end.

Rob Brown
President and Chief Executive Officer

Management's Discussion and Analysis

March 15, 2018

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of March 15, 2018. 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, 2017 and 2016. 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, mark-to-market adjustments, and revaluation of deferred tax assets. "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, mark-to-market adjustments, and revaluation of deferred tax assets. 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, mark-to-market adjustments, and revaluation of deferred tax assets. 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, mark-to-market adjustments, and revaluation of deferred tax assets.

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.

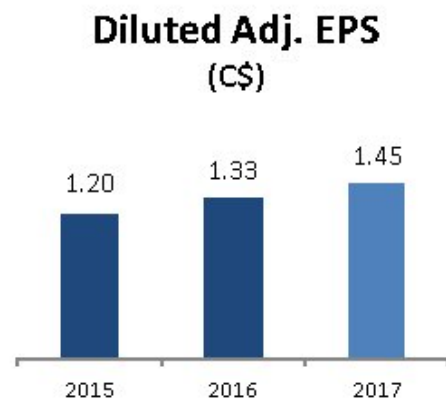
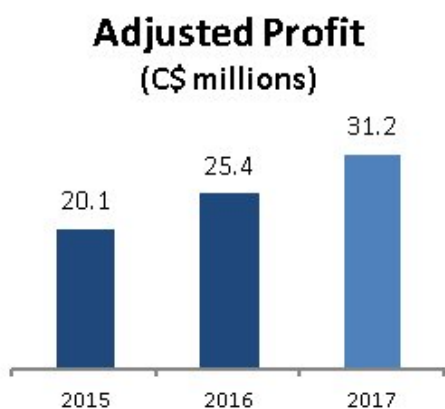
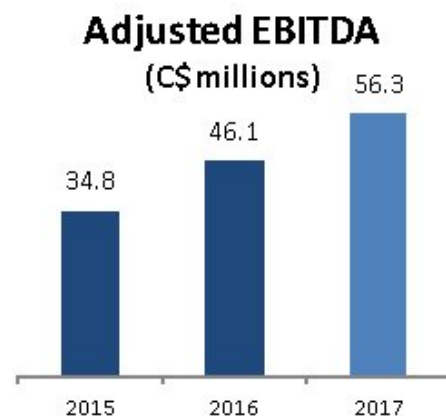
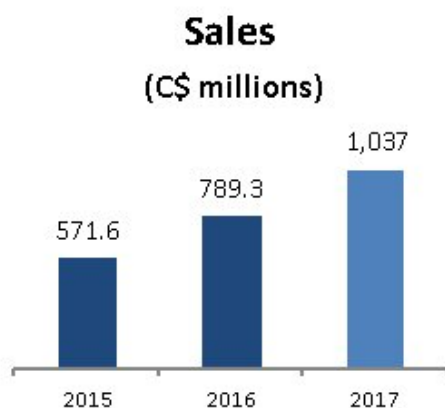
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1.0 Executive Summary

1.1 Overview

We set new sales, profit, Adjusted EBITDA, and Adjusted profit records in 2017. Our financial performance was driven by a full year of results from our accretive acquisition of Rugby Architectural Building Products (“Rugby”), which we completed in July, 2016. Our 2017 acquisitions of Eagle Plywood and Lumber (“Eagle”) and Downes & Reader Hardwood Company (“D&R”) (collectively referred to as the “Acquired Businesses”) and continued execution of our business strategies also contributed to our performance. For the year ended December 31, 2017, our sales increased 31.4% to \$1,037.0 million and profit increased 25.5% to \$30.0 million, compared to 2016. After adjusting for expenses associated with acquisitions, mark-to-market adjustments on cash settled Long Term Incentive Plan Units (“LTIPs”), and revaluation of deferred tax assets, Adjusted EBITDA grew 22.0% to \$56.3 million and Adjusted profit climbed 23.0% to \$31.2 million.



Our 2017 results were achieved despite some margin pressure created by the imposition of US duties on hardwood plywood imported from China (see Section 1.2) (the "Trade Case Impact"), and the negative foreign exchange impact of a year-over-year increase in the value of the Canadian dollar relative to the US dollar when translating our US operations to Canadian dollars for reporting purposes (the "Foreign Exchange Impact") (collectively, the "Impacts").

As a result of the Trade Case Impact and the Foreign Exchange Impact, Adjusted EBITDA was reduced by an estimated \$2.2 million and \$0.8 million, Adjusted profit was reduced by an estimated \$1.3 million and \$0.5 million, and Adjusted diluted profit per share was reduced by an estimated \$0.06 and \$0.02, respectively.

For the three months ended December 31, 2017, Adjusted EBITDA was reduced by an estimated \$1.2 million and \$0.5 million related to the Impacts. Adjusted profit was reduced by an estimated \$0.7 and \$0.3 million related to the Impacts.

Acquisition-Based and Organic Growth

Our 2017 results include the positive impact of acquisition-based growth, including a full year of results from Rugby (compared to five-and-a-half months in 2016), nine-and-a-half-months from Eagle, and five-and-a-half-months financial contribution from D&R. Combined, the Acquired Businesses contributed \$224.1 million to 2017 sales and expanded our US distribution network with 32 new distribution facilities.

Organic growth accounted for \$37.1 million of the 2017 sales increase, with our US and Canadian operations achieving 4.6% and 4.7% organic sales growth respectively. These gains were achieved despite the negative effects of foreign exchange influences resulting from a stronger Canadian dollar. A stronger Canadian dollar: i) decreases the value of sales and profits earned in our US operations when translated into Canadian dollars for financial reporting purposes; and ii) decreases the selling price of US dollar-denominated products sold to our Canadian customers.

Profitability

Our gross profit margin grew to 18.5% in 2017, from 18.2% in 2016. This improvement primarily reflects the positive impact of Rugby's higher margin product lines, and was achieved despite the Trade Case Impact, which reduced gross profit margin by an estimated 20 basis points in 2017.

As anticipated, operating expenses were higher year-over-year, reflecting the addition of the Acquired Businesses. Operating expenses as a percentage of revenue were also slightly higher at 13.8% in 2017, compared to 13.3% in 2016. This was primarily driven by Rugby's sales model, which involves supplying more orders to more customers, but with smaller average order sizes.

As anticipated, Adjusted EBITDA margin was slightly lower year-over-year at 5.4%, compared to 5.8% in 2016. This primarily reflects the Impacts and the higher operating expenses as described above. We estimate that the Trade Case Impact reduced Adjusted EBITDA margin by 20 basis points in 2017.

Balance Sheet and Cash Flows

We continued to strengthen our balance sheet in 2017. As at December 31, 2017, our net debt-to-Adjusted EBITDA ratio strengthened to 1.6 times, from 2.1 times as at December 31, 2016. Our debt-to-capital ratio decreased to 27.6%, from 30.1%, and we had \$66.7 million of unused borrowing capacity at the end of 2017, as compared to \$57.8 million a year earlier.

1.2 US Trade Case

As previously announced, on November 18, 2016, a trade case was filed in the US seeking the imposition of countervailing duties ("CVD") and antidumping duties ("AD") against imported hardwood plywood produced in China.

On April 19, 2017 the Department of Commerce ("Commerce") announced a preliminary CVD of 9.89%, and on June 20, 2017 Commerce announced a preliminary AD of 57.36%. The duties applied to most Chinese producers, including those that HDI does business with. On November 13, 2017 Commerce announced final CVD and AD rates of 22.98% and 183.36% respectively.

The concluding phase of this trade case then passed to a separate US government body, the International Trade Commission ("ITC"), to rule on whether final CVD and AD duties determined by Commerce would be affirmed or rejected. On December 1, 2017, the ITC voted affirmatively that the final CVD and AD rates determined by Commerce will be implemented (the "Final Determination").

The trade case negatively affected our gross margin in the second half of 2017 as a result of (i) an increase in our cost of certain import products as we increased purchasing from brokers rather than mill direct sourcing, in order to minimize our potential exposure to retroactive CVD and AD duties; and (ii) lower-than-expected product prices for hardwood plywood during this period as significant supply of products imported prior to the imposition of final duties remained available in the market.

Going forward, we believe the final combined duty rate of 206.34% will make Chinese hardwood plywood non-competitive in the US market. Approximately 11% of our total sales prior to the trade case were affected, and we have spent the last year planning for this potential outcome. Through 2017, we were successful in securing the appropriate supply of products our customers needed and we retained our market share throughout the trade case process. At the same time, we have been working with our domestic and overseas vendor partners to develop reliable, alternative product solutions to continue to supply our customers going forward. The trade case disruption is expected to result in some downward pressure on our gross margin percentage through to mid-2018. Potentially countering this impact however is our expectation that sales will benefit from rising hardwood plywood prices in North America as we pass on price increases to the customer. By the second half of 2018, we expect the existing surplus of imported product in the North American market will have worked its way through the supply chain, and pricing

and margins on hardwood plywood should begin to more accurately reflect the new supply dynamics.

As at December 31, 2017 we had paid to customs, during periods when duties were not in effect, approximately \$3.4 million in CVD and AD duty deposits which we expect will be refunded in 2018. The \$3.4 million in CVD and AD duty deposits are included within accounts and other receivables.

1.3 Business Strategy

In 2017 we performed a comprehensive review of our business strategy with the recognition that the key objectives we have pursued since 2010 have been realized:

- We have diversified our business with our import program and commercial business to approximately 25% and 35% of our 2017 revenues respectively; and,
- the six acquisitions we have completed in the last seven years have helped us expand from 26 locations and sales of approximately \$200 million in 2010, to 63 locations and sales of over \$1 billion in 2017.

Since 2010 the successful implementation of our strategies have resulted in a sales compound annual growth rate of over 25%, and EBITDA increasing from \$4.6 million in 2010 to \$55.6 million in 2017. We have successfully captured the growth that followed the extended downturn in the residential and commercial construction markets and broader economy.

Today we are North America's largest distributor in our industry. We are focused on leveraging our size, capabilities, and strong financial position to create a world class distribution company. Our strategies to achieve this objective are:

- i) Be the **market leader** in our products: Our market share across North America is different by region. We will work to become the market leader, or expand our existing market lead, by leveraging our core product strengths, product/industry knowledge, vendor relationships and supporting infrastructure to become the dominant market leader in our regions.
- ii) Develop and expand our product offering with **high-value solutions**: We will respond to evolving customer demand and end user preferences with innovative products, both

domestic and imported, that enhance our competitive advantage and leverage our proprietary product development strengths.

iii) Support the success of our operations and stakeholders with **operational excellence**: From employing industry-leading, technology-enabled solutions, to enhancing our supply chain and partner management strengths, to optimizing our strategic human resources capabilities, we will provide best-in-class systems and support to ensure our customers, our vendors and our people succeed.

iv) Continue to **pursue acquisitions** that complement our strategies: We are uniquely positioned, with our size, scale, and strong balance sheet, 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 acquisitions of Eagle on March 13, 2017 and D&R on July 17, 2017 are examples of our ability to expand our presence in existing markets.

1.4 Outlook

On December 21, 2017, the United States enacted H.R. 1 (the "Legislation"), also known as the Tax Cuts and Jobs Act. The Legislation includes substantial changes to the US taxation for individuals, corporations, and unincorporated businesses in all industries. For HDI, the significant features and impacts of this Legislation include the change in corporate tax rate from 35% to 21%, the immediate expensing of certain qualified capital investments, and limitations on the deductibility of certain interest expense. While there is still some uncertainty about how various states will implement the interest deductibility provisions, as a whole, we view the new rules as a positive development. Had the new lower tax rate been in effect in 2017, our pro forma Adjusted EPS would have been \$1.58, or 8.9% higher than reported for the year. This represents a decrease in income tax expense of \$2.6 million.

In contrast, impacts resulting from the duties imposed on Chinese hardwood plywood entering the US (see Trade Case Impacts in section 1.2) are expected to result in some downward pressure on our gross margin percentage through to mid-2018. Potentially countering this impact however is our expectation that sales will benefit from rising hardwood plywood prices in North America as we pass on price increases to the customer. By the second half of 2018, we expect the existing

surplus of imported product in the North American market will have worked its way through the supply chain, and pricing and margins on hardwood plywood should begin to more accurately reflect the new supply dynamics. We continue to work with domestic manufacturers and our vendor partners overseas to develop reliable, alternative product solutions going forward.

In terms of market outlook, the unevenness and relatively slow growth experienced in the US residential construction market in 2017 is expected to continue in 2018. Market fundamentals remain sound however, with US job growth and income levels gaining momentum. Harvard's Joint Center for Housing Studies 2017 report on "state of the nation's housing" concluded that single-family housing construction, traditionally the largest source of residential investment, remains well below historical levels. With average housing starts at 1.3 million in 2017, there is room for growth in this market as the long term historical average is closer to 1.5 million annual starts. We expect it will take some years to reach the 1.5 million level, and as a result, expect low-to-mid single digit organic market growth for our end-markets and products.

In the non-residential construction market, the American Institute of Architects predicts growth of 4.0% in 2018, with the strongest gains anticipated for the commercial sectors that we focus on.

Strategically, we will seek to outperform organic market growth through our strategic initiatives. As discussed in section 1.3, our strategic priorities include:

- Being the **market leader** in our products.
- Developing and expanding our product offering with **high-value solutions**.
- Supporting the success of our operations and stakeholders with **operational excellence**.
- Continuing to **pursue acquisitions** that complement our strategies.

Our Board will continue to review our financial performance and assess dividend levels on a regular basis. We will maintain our focus on keeping our balance sheet strong, reducing debt and supporting future strategic acquisitions.

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 HDI.

2.2 Recent Acquisitions

Downes & Reader Hardwood Company

On July 17, 2017, HDI purchased Downes & Reader Hardwood Company Inc. ("D&R") for a total value of US\$6.0 million. D&R is a distributor of hardwood lumber with four locations in the US Northeast and estimated annual sales of US\$25.0 million. D&R brought us a comprehensive lumber products offering in the region and added over 2,400 new customers. Subsequent to the acquisition, the D&R locations are operating under the Rugby brand.

Eagle Plywood and Lumber

On March 13, 2017, HDI purchased Eagle Plywood and Lumber ("Eagle") for a total value of US\$0.4 million plus up to an additional US\$0.2 million subject to future sales performance. Eagle was a single site wholesale distributor located in Dallas, Texas with estimated annual sales of US\$5.0 million. The Eagle operations were consolidated into our existing Rugby distribution facility in Dallas, expanding our presence in this significant market, adding customers and enhancing our team with additional bench strength.

Rugby Architectural Building Products

On July 15, 2016, we acquired Rugby Architectural Building Products for a base purchase price of \$138.6 million (US \$106.8 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 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.

2.3 Business and Industry Overview

Serving customers for over 50 years, HDI is North America's largest distributor of decorative surfaces and composite panels, hardwood plywood, high-grade hardwood lumber, and other architectural building products to the cabinet, moulding, millwork, furniture and specialty wood products industries. As at March 15, 2018 we operated 62 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 20% of our 2017 sales were made up of decorative surfaces and composites, such as high pressure laminates, thermally fused laminates, medium-density fiberboard, and particleboard. Approximately 33% of our sales were of hardwood plywood, 23% of our sales were high-grade hardwood lumber, and 25% of our sales were other architectural building products such as doors, millwork, mouldings, and other ancillary architectural building products. Many of our product lines are complementary, and customers typically use a number of key products from the categories described to manufacture their own end-use products.

Our primary role in the industry is to provide the critical link between manufacturers making large volumes of products and small-to-mid-sized industrial customers that require lesser quantities of many different products for their own manufacturing processes. We provide a means for hundreds of manufacturers to get their product to thousands of customers. We add value to our suppliers by buying their product in volume and paying them promptly, by providing access to our large North American distribution network, and by supporting their products with strong sales and marketing support. We effectively act 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, 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, institutional markets and manufacturing. 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

approximately half of our products are used in 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.

Our products are sourced as follows: A majority of decorative surfaces and composites are generally supplied by large manufacturers in North America. Hardwood plywood is produced in North America by large manufacturers using domestic hardwoods and other materials, as well as by overseas hardwood plywood manufacturers. The majority of the high-grade hardwood lumber we distribute 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. A majority of other architectural building products are generally sourced from North American mills or manufacturers, of varying sizes depending on the product. Principally third parties such as us distribute the majority of the products we carry.

3.0 Results of Operations

3.1 Years Ended December 31, 2017 and December 31, 2016

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)					
	For the year		For the year		
	ended December 31	ended December 31	\$ Increase	% Increase	
	2017	2016	(Decrease)	(Decrease)	
Total sales	\$ 1,037,041	\$ 789,321	\$ 247,720	31.4 %	
<i>Sales in the US (US\$)</i>	693,826	498,198	195,628	39.3 %	
<i>Sales in Canada</i>	136,038	129,935	6,103	4.7 %	
Gross profit	191,875	143,778	48,097	33.5 %	
<i>Gross profit %</i>	18.5%	18.2%			
Operating expenses	(142,790)	(104,871)	37,919	36.2 %	
Profit from operating activities	49,085	38,907	10,178	26.2 %	
Add: Depreciation and amortization	6,504	4,806	1,698	35.3 %	
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	\$ 55,589	\$ 43,713	\$ 11,876	27.2 %	
<i>EBITDA as a % of revenue</i>	5.4%	5.5%			
Add (deduct):					
Depreciation and amortization	(6,504)	(4,806)	(1,698)		
Net finance income (expense)	(2,502)	(1,465)	(1,037)		
Income tax expense	(16,629)	(13,580)	(3,049)		
Profit for the period	\$ 29,954	\$ 23,862	\$ 6,092	25.5 %	
Basic profit per share	\$ 1.40	\$ 1.27			
Diluted profit per share	\$ 1.39	\$ 1.25			
Average Canadian dollar exchange rate for one US dollar	\$ 1.30	\$ 1.32			

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)					
	For the year		For the year		
	ended December 31	ended December 31	\$ Increase	% Increase	
	2017	2016	(Decrease)	(Decrease)	
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	\$ 55,589	\$ 43,713	\$ 11,876	27.2 %	
Transaction expenses	273	2,436	(2,163)		
Mark-to-market adjustment on cash settled LTIPs	450	—	450		
Adjusted EBITDA	\$ 56,312	\$ 46,149	\$ 10,163	22.0 %	
<i>Adjusted EBITDA as a % of revenue</i>	5.4%	5.8%			
Profit for the period, as reported	\$ 29,954	\$ 23,862	\$ 6,092	25.5 %	
Revaluation of deferred tax assets due to US tax reform	989	—	989		
Other adjustments, net of tax	275	1,516	(1,241)		
Adjusted Profit	\$ 31,218	\$ 25,378	\$ 5,840	23.0 %	
Basic profit per share, as reported	\$ 1.40	\$ 1.27	\$ 0.13	10.0 %	
Net impact of above items per share	0.06	0.08	(0.02)		
Adjusted basic profit per share	\$ 1.46	\$ 1.35	\$ 0.11	7.8 %	
Diluted profit per share, as reported	\$ 1.39	\$ 1.25	\$ 0.14	11.2 %	
Net impact of above items per share	0.06	0.08	(0.02)		
Adjusted diluted profit per share	\$ 1.45	\$ 1.33	\$ 0.12	8.9 %	

Sales

For the year ended December 31, 2017, total sales increased 31.4% to \$1,037.0 million, from \$789.3 million in 2016. Of the \$247.7 million year-over-year increase, \$224.1 million, representing a 28.4% increase in sales, was due to the addition of Acquired Businesses and \$37.1 million, representing a 4.7% increase in sales, was due to organic growth. These gains were partially offset by a \$13.5 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\$195.6 million, or 39.3%, to US\$693.8 million, from US\$498.2 million in 2016. The Acquired Businesses contributed sales of US\$172.6 million. Organic growth provided a US\$23.1 million, or 4.6%, increase in sales.

Sales in Canada increased by \$6.1 million, or 4.7%, year-over-year. The increase in Canadian sales was entirely organic and reflects our success in winning new business.

Gross Profit

Gross profit for the year ended December 31, 2017 increased 33.5% to \$191.9 million, from \$143.8 million in 2016. This \$48.1 million improvement reflects the combination of increased sales and a higher gross profit margin. As a percentage of sales, gross profit margin increased to 18.5% in 2017, from 18.2% in 2016, primarily reflecting Rugby's higher margin business model, partially offset by the negative impacts of the Trade Case on gross margin as described in Section 1.1.

Operating Expenses

For the year ended December 31, 2017, operating expenses increased to \$142.8 million, from \$104.9 million in 2016. The \$37.9 million increase includes \$37.1 million of operating expenses from the Acquired Businesses, amortization of \$1.1 million related to customer relationships acquired in connection with the Rugby acquisition, \$3.1 million of added costs to support our organic growth, and an increase of \$0.5 million related to the mark-to-market adjustment on LTIPs. These increases were offset by a \$2.2 million year-over-year reduction in acquisition-related expenses and a \$1.7 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 13.8% from 13.3% year-over-year, primarily reflecting Rugby's higher ratio of operating expenses as a percentage of sales and expenses from the Acquired Businesses.

Depreciation and Amortization

For the year ended December 31, 2017, amortization expense increased to \$6.5 million, from \$4.8 million in 2016. The \$1.7 million increase relates to amortization of Rugby property, plant and equipment of \$0.6 million, and a \$1.1 million increase to amortization of intangible assets related to customer relationships acquired in connection with the Rugby acquisition.

Adjusted EBITDA

For the year ended December 31, 2017, Adjusted EBITDA grew 22.0% to \$56.3 million, from \$46.1 million in 2016. The \$10.2 million improvement in Adjusted EBITDA primarily reflects the \$48.1 million increase in gross profit, partially offset by a \$37.9 million increase in operating expenses (before a decrease in transaction expenses, an increase in mark-to-market adjustments relating to LTIPs, and an increase in depreciation and amortization).

Adjusted EBITDA was reduced by an estimated \$2.2 million and \$0.8 million as it relates to the Trade Case Impact and the Foreign Exchange Impact respectively. As a percentage of revenue, Adjusted EBITDA margin was 5.4% in 2017, compared to 5.8% in 2016.

Net Finance Income (Cost)

We recorded a net finance expense of \$2.5 million in 2017 as compared to \$1.5 million in 2016. The \$1.0 million year-over-year increase primarily 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 \$16.6 million for the year ended December 31, 2017, from \$13.6 million in 2016. This increase primarily reflects higher taxable income. Also included in income tax expense for 2017 is an increase of \$1.0 million in deferred tax expense for the revaluation of US deferred tax assets to account for the change effective January 1, 2018 in the US corporate tax rate from 35% to 21%.

Profit for the Period

Profit for the year ended December 31, 2017 increased 25.5% to \$30.0 million, from \$23.9 million in 2016. The \$6.1 million improvement reflects the \$11.9 million year-over-year increase in EBITDA, partially offset by the \$3.0 million increase in income tax expense, the \$1.0 million increase in net finance cost, and a \$1.7 million increase in depreciation and amortization. Diluted profit per share increased to \$1.39, from \$1.25 in 2016.

Adjusted Profit for the Period

Adjusted Profit for the year ended December 31, 2017 was \$31.2 million, and reflects profit for the period adjusted for transaction expenses, mark-to-market adjustments on LTIPs, and the revaluation of deferred tax assets associated with US tax reform. This compares to Adjusted profit in 2016 of \$25.4 million, and represents an increase of 23.0%. Adjusted diluted profit per share increased to \$1.45 in 2017, from \$1.33 in 2016.

Adjusted Profit in 2017 was reduced by an estimated \$1.3 million and \$0.5 million as it relates to the Trade Case Impact and Foreign Exchange Impact respectively.

3.2 Three-Month Periods Ended December 31, 2017 and December 31, 2016

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)						
	Three months		Three months			
	ended December 31		ended December 31		\$ Increase	
	2017		2016		(Decrease)	
					% Increase	
					(Decrease)	
Total sales	\$	247,433	\$	239,449	\$ 7,984	3.3 %
<i>Sales in the US (US\$)</i>		169,615		155,661	13,954	9.0 %
<i>Sales in Canada</i>		31,784		31,676	108	0.3 %
Gross profit		44,503		43,523	980	2.3 %
<i>Gross profit %</i>		18.0%		18.2%		
Operating expenses		(35,112)		(34,785)	327	0.9 %
Profit from operating activities		9,391		8,738	653	7.5 %
Add: Depreciation and amortization		1,608		2,125	(517)	(24.3)%
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	\$	10,999	\$	10,863	\$ 136	1.2 %
<i>EBITDA as a % of revenue</i>		4.4%		4.5%		
Add (deduct):						
Depreciation and amortization		(1,608)		(2,125)	517	
Net finance income (expense)		(677)		(668)	(9)	
Income tax expense		(3,770)		(1,493)	(2,277)	
Profit for the period	\$	4,944	\$	6,577	\$ (1,633)	(24.8)%
Basic profit per share	\$	0.23	\$	0.30		
Diluted profit per share	\$	0.23	\$	0.29		
Average Canadian dollar exchange rate for one US dollar	\$	1.27	\$	1.33		

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)						
	Three months		Three months			
	ended December 31		ended December 31		\$ Increase	
	2017		2016		(Decrease)	
					% Increase	
					(Decrease)	
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	\$	10,999	\$	10,863	\$ 136	1.2 %
Transaction expenses		—		50	(50)	
Mark-to-market adjustment on cash settled LTIPs		(335)		—	(335)	
Adjusted EBITDA	\$	10,664	\$	10,913	\$ (249)	(2.3)%
<i>Adjusted EBITDA as a % of revenue</i>		4.3%		4.6%		
Profit for the period, as reported	\$	4,944	\$	6,577	\$ (1,633)	(24.8)%
Revaluation of deferred tax assets due to US tax reform		989		—	989	
Other adjustments, net of tax		(228)		31	(259)	
Adjusted Profit	\$	5,705	\$	6,608	\$ (903)	(13.7)%
Basic profit per share, as reported	\$	0.23	\$	0.30	\$ (0.07)	(22.8)%
Net impact of above items per share		0.04		—	0.04	
Adjusted basic profit per share	\$	0.27	\$	0.30	\$ (0.03)	(11.4)%
Diluted profit per share, as reported	\$	0.23	\$	0.29	\$ (0.06)	(20.1)%
Net impact of above items per share		0.04		—	0.04	
Adjusted diluted profit per share	\$	0.27	\$	0.29	\$ (0.02)	(8.4)%

Sales

For the three months ended December 31, 2017, total sales increased 3.3% to \$247.4 million, from \$239.4 million during the same period in 2016. Of the \$8.0 million year-over-year increase, \$7.7 million, representing a 3.2% increase in sales, was due to the addition of Acquired Businesses and \$10.6 million, representing a 4.4% increase in sales, was due to organic growth. Our sales gains were partially offset by a \$10.3 million negative foreign exchange impact resulting from a stronger Canadian dollar when translating our US sales to Canadian dollars for reporting purposes, as compared to the same period in 2016.

Fourth quarter sales from our US operations increased by US\$14.0 million, or 9.0%, to US \$169.6 million, from US\$155.7 million in Q4 2016. Acquired Businesses contributed sales of US\$6.1 million and our US operations achieved organic growth of US\$7.9 million, representing a 5.1% year-over-year increase in sales.

Fourth quarter sales in Canada were relatively flat at \$31.8 million, compared to \$31.7 million in the same period last year.

Gross Profit

Gross profit for the three months ended December 31, 2017 increased 2.3% to \$44.5 million, from \$43.5 million in the fourth quarter of 2016. This \$1.0 million improvement reflects the higher sales, offset by a slight decrease in gross profit margin to 18.0%, from 18.2% in the fourth quarter of 2016. The change in gross profit margin relates to the Trade Case Impacts further described in section 1.1.

Operating Expenses

Operating expenses increased to \$35.1 million in the fourth quarter of 2017, from \$34.8 million during the same period in 2016. The \$0.3 million increase includes operating expenses from Acquired Businesses of \$1.7 million and \$0.9 million of added costs to support organic growth. These increases were offset by \$0.3 million related to the mark-to-market adjustment on LTIPs, a \$1.4 million decrease in expenses due to the impact of a stronger Canadian dollar on translation of US operating expenses, a \$0.1 million year-over-year decrease in acquisition-related expenses, and a decrease in amortization of \$0.5 million related to customer relationships acquired in connection with the Rugby acquisition. As a percentage of sales, operating expenses

decreased to 14.2% from 14.5% during the same period in 2016, primarily reflecting the items noted above.

Depreciation and Amortization

For the three months ended December 31, 2017, amortization expense decreased to \$1.6 million, from \$2.1 million in 2016. The \$0.5 million decrease primarily reflects amortization of intangible assets related to customer relationships acquired in connection with the Rugby acquisition.

Adjusted EBITDA

For the three months ended December 31, 2017, we generated Adjusted EBITDA of \$10.7 million, a decrease of \$0.2 million from Adjusted EBITDA of \$10.9 million in Q4 2016. The change in Adjusted EBITDA reflects the \$1.2 million increase in operating expenses (before a decrease in transaction expenses, mark-to-market adjustments relating to LTIPs, and depreciation and amortization), partially offset by the \$1.0 million increase in gross profit.

Fourth quarter Adjusted EBITDA was reduced by an estimated \$1.2 million and \$0.5 million as it relates to the Trade Case Impact and the Foreign Exchange Impact respectively. As a percentage of revenue, Adjusted EBITDA margin was 4.3% in the fourth quarter of 2017, compared to 4.6% in the same quarter last year.

Income Tax Expense

Income tax expense increased to \$3.8 million in the fourth quarter of 2017, from \$1.5 million in the same period in 2016. The \$2.3 million increase primarily reflects adjustments to our tax estimates in the fourth quarter of 2016 that did not repeat in the fourth quarter of 2017, and an increase of \$1.0 million in deferred tax expense for the revaluation of US deferred tax assets to account for the change effective January 1, 2018 in the US corporate tax rate from 35% to 21%.

Profit for the Period

Profit for the three months ended December 31, 2017 was \$4.9 million, compared to \$6.6 in the same period in 2016. The \$1.7 million decrease reflects the \$2.3 million increase in income tax expense, partially offset by the \$0.5 million decrease in depreciation and amortization and the \$0.1 million increase in EBITDA. Fourth quarter diluted profit per share was \$0.23, compared to \$0.29 in the 2016 period.

Adjusted Profit for the Period

Adjusted Profit for the three months ended December 31, 2017 was \$5.7 million and reflects profit for the period adjusted for transaction expenses, mark-to-market adjustments on LTIPs, and the revaluation of deferred tax assets related to US tax reform.

Fourth quarter Adjusted Profit was reduced by an estimated \$0.7 million and \$0.3 million as it relates to the Trade Case Impact and Foreign Exchange Impact respectively.

4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	2017	2017	2017	2017	2016	2016	2016	2016
Total sales	\$ 247,433	\$ 257,250	\$ 275,260	\$ 257,098	\$ 239,449	\$ 235,428	\$ 157,031	\$ 157,413
Profit	4,944	7,312	9,762	7,936	6,577	7,296	5,367	4,622
Basic profit per share	0.23	0.34	0.46	0.32	0.31	0.35	0.32	0.28
Diluted profit per share	0.23	0.34	0.45	0.32	0.29	0.35	0.32	0.27
EBITDA	10,999	13,356	17,216	14,003	10,863	13,186	10,231	9,433
Adjusted profit	5,705	8,127	9,762	7,936	6,608	8,084	6,200	4,622
Adjusted basic profit per share	0.27	0.38	0.46	0.37	0.31	0.39	0.37	0.28
Adjusted diluted profit per share	0.27	0.38	0.45	0.37	0.29	0.39	0.37	0.27
Adjusted EBITDA	10,664	14,331	17,216	14,003	10,913	14,280	11,523	9,433

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		For the year	
	ended Dec 31		ended Dec 31	
	2017	2016	2015	2015
Total sales	\$ 1,037,041	\$ 789,321	\$ 571,598	
Profit	29,954	23,862	20,146	
Basic profit per share	1.40	1.27	1.21	
Fully diluted profit per share	1.39	1.25	1.20	
Total assets	372,903	371,076	190,004	
Total non-current financial liabilities	1,513	1,877	696	
EBITDA	55,589	43,713	34,804	

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		
	2017	2016	\$ change	2017	2016	\$ change
Cash provided by operating activities before changes in non-cash working capital	\$ 42,095	\$ 28,844	\$ 13,251	\$ 8,527	\$ 6,692	\$ 1,835
Changes in non-cash working capital	(24,191)	(14,172)	(10,019)	11,870	(2,172)	14,042
Net cash provided by operating activities	17,904	14,672	3,232	20,397	4,520	15,877
Net cash provided by (used in) investing activities	(9,960)	(138,814)	128,854	(829)	292	(1,121)
Net cash provided by (used in) financing activities	(8,397)	124,908	(133,305)	(19,577)	(4,721)	(14,856)
Increase (decrease) in cash	(453)	766	(1,219)	(9)	91	(100)
Cash, beginning of period	766	—	766	322	675	(353)
Cash, end of the period	\$ 313	\$ 766	\$ (453)	\$ 313	\$ 766	\$ (453)

Net cash used in operating activities

For the year ended December 31, 2017, net cash provided by operating activities increased to \$17.9 million, from \$14.7 million in 2016. Cash provided by operating activities before changes in non-cash working capital increased by \$13.3 million year-over-year, primarily reflecting the \$11.9 million increase in EBITDA. Investment in non-cash working capital increased by \$10.0 million in 2017, compared to 2016. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2017, net cash provided by operating activities increased to \$20.4 million, from \$4.5 million in the same period in 2016. Cash provided by operating activities before changes in non-cash working capital increased by \$1.8 million, primarily reflecting a \$1.5 million decrease in income taxes paid. Investment in non-cash working capital increased by \$14.0 million in the fourth quarter of 2017, compared to the fourth quarter of 2016. An analysis of changes in working capital is provided in section 5.2 of this report.

Net cash used in investing activities

Net cash used in investing activities decreased by \$128.9 million to \$10.0 million in 2017, from \$138.8 million in 2016. This decrease 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, 2017 cash used in investing activities increased by \$1.1 million. This increase primarily relates to purchases of property, plant and equipment and additions to internally generated intangible assets in the quarter.

Net cash provided by financing activities

For the year ended December 31, 2017, net cash provided by financing activities decreased by \$133.3 million as compared to 2016. This decrease primarily relates to a decrease in borrowings on our credit facilities, as well as the issuance of common shares in 2016 to finance the purchase of Rugby, which did not repeat in 2017.

For three months ended December 31, 2017, net cash used in financing activities increased by \$14.9 million as compared to the same period in 2016. There were no significant changes in the composition of cash provided by and used in financing activities, with decreases in borrowings on our credit facilities and dividends paid to shareholders being the main financing activities during the quarter.

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 \$236.0 million as at December 31, 2017, compared to \$220.8 million at December 31, 2016. The growth in our working capital is mostly attributable to increased investment in accounts receivable and inventory to service our customers.

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. Our investment in working capital this year is also impacted by

deposits made to customs relating to certain import inventory which were not made in the prior year (see Section 1.2), and the timing of payments to Rugby's suppliers as they were paid quicker in order to take advantage of early pay discounts.

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. A summary of changes in our non-cash operating working capital during the twelve and three month periods ended December 31, 2017 and 2016 is provided below.

(in thousands of Canadian dollars)				
	Years ended ended December 31	Years ended ended December 31	Three months ended December 31	Three months ended December 31
Source (use) of funds	2017	2016	2017	2016
Accounts receivable	\$ (6,813)	\$ (956)	\$ 10,833	\$ 10,350
Inventory	(8,685)	(13,772)	2,715	(6,272)
Prepaid expenses	(2,737)	(1,764)	(396)	(601)
Accounts payable, accrued liabilities and provisions	(5,956)	2,320	(1,282)	(5,648)
Increase in non-cash operating working capital	\$ (24,191)	\$ (14,172)	\$ 11,870	\$ (2,172)

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		As at
	December 31, 2017		December 31, 2016
Cash	\$	313	\$ 766
Bank indebtedness		91,146	97,886
Net Debt		90,833	97,120
Shareholders' equity		238,826	225,999
Total Capitalization	\$	329,659	\$ 323,119
Net debt to total capitalization		27.6%	30.1%
Previous 12 months Adjusted EBITDA	\$	56,313	\$ 46,149
Net debt to previous 12 months Adjusted EBITDA		1.6	2.1

We consider our capital to be bank indebtedness (net of cash) and shareholders' equity. As shown above, our net debt balance decreased by \$6.3 million to \$90.8 million at December 31, 2017, from \$97.1 million at December 31, 2016. Overall net debt compared to total capitalization

improved to 27.6% as at December 31, 2017, from 30.1% at December 31, 2016. Our ratio of net debt-to-Adjusted EBITDA for the previous 12 months was also lower at 1.6 times, compared to 2.1 times at December 31, 2016. The net debt-to-Adjusted EBITDA ratio for 2017 benefited from a full 12 months of Rugby's results, as compared to approximately 5.5 months in 2016.

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, 2017 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	\$ 25.0 million	\$ 156.8 million (US\$125.0 million)
Credit facility expiry date	August 5, 2021	July 14, 2021
Available to borrow	\$ 20.8 million	\$ 136.4 million (US\$108.7 million)
Credit facility borrowings	\$ 7.3 million	\$ 83.2 million (US\$66.3 million)
Unused credit facility	<u>\$ 13.5 million</u>	<u>\$ 53.2 million (US\$42.4 million)</u>
Financial covenants:	Covenants do not apply when the unused credit facility available exceeds \$2.0 million, which it did at December 31, 2017	Covenants do 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, 2017

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, 2017. 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 II Credit Facility"). The USLP II 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 II 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 II Credit Facility include, among others, a springing fixed charge coverage ratio of 1.0x, triggered if excess availability under the USLP II Credit Facility falls below 10% of the USLP II 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 II Credit Facility 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 replaced the previous Canadian credit facility and consists of a revolving credit line of \$25.0 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, 2017. The LP Credit Facility can be prepaid at any time with no prepayment penalty.

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, 2017. These obligations relate to leases on various premises and automobiles and become due in the fiscal years indicated.

(in thousands of dollars)						
2018	2019	2020	2021	2022	thereafter	Total
\$19,082	\$17,294	\$14,199	\$11,297	\$8,129	\$13,930	\$83,931

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 15, 2018, the date of this MD&A, we had 21,419,985 common shares issued and outstanding. In addition, at March 15, 2018, we had outstanding 121,506 performance shares and 116,650 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 shares 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 2017, we declared a quarterly dividend of \$0.0725 per share, which was paid on January 26, 2018 to shareholders of record as at January 15, 2018. On March 15, 2018 we declared a quarterly dividend of \$0.0725 per share, payable on April 27, 2018 to shareholders of record as at April 16, 2018. 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, 2017 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:

Goodwill impairment testing: We are required to make estimates and assumptions related to the annual goodwill impairment test, including the cash generating unit ("CGU") to which goodwill relates, the recoverable amount of a CGU, future cash flows and growth rates, and the post-tax discount rate.

Accounts receivable provision: Due to the nature of our business and the credit terms we provide to our customers, we anticipate that a certain portion of required customer payments will not be made, and we maintain an allowance for these doubtful accounts. The allowance is based

on our estimate of the potential of recovering our accounts receivable, and incorporates current and expected collection trends.

Valuation of 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.

7.2 Adoption of New Accounting Policies

Effective January 1, 2017, the Company adopted Recognition of Deferred Tax Assets for Unrealized Losses as an amendment to IAS 12, Income Taxes (Amendments) that clarify when a deductible temporary difference exists. The adoption of this amendment did not impact the Company's consolidated financial statements.

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2017, 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 and the adoption of IFRS 9 will not have a material impact on the consolidated financials.

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.

The adoption of this standard will impact the Company's revenue disclosures as the Company will be required to disclose the judgments, and changes in judgments made in applying IFRS 15 and a reconciliation of certain balances. The Company is in the process of drafting these required disclosures and no measurement impact is expected.

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.

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, 2017. 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, 2017.

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, 2017. 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, 2017.

There have not been any changes in our ICFR during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our ICFR.

10.0 Note Regarding Forward Looking Information

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

The forward-looking information in this MD&A includes, but is not limited to: We believe the final combined duty rate of 206.34% will make Chinese hardwood plywood non-competitive in the US market; we have been working with our domestic and overseas vendor partners to develop reliable, alternative product solutions to continue to supply our customers going forward; the trade case disruption is expected to result in some downward pressure on our gross margin percentage through to mid-2018; potentially countering this impact however is our expectation that sales will benefit from rising hardwood plywood prices in North America as we pass on price increases to the customer; by the second half of 2018, we expect the existing surplus of imported product in the North American market will have worked its way through the supply chain, and pricing and margins on hardwood plywood should begin to more accurately reflect the new supply dynamics; As at December 31, 2017 we had paid to customs, during periods when duties were not in effect, approximately \$3.4 million in CVD and AD duty deposits which we expect will be refunded in 2018; we will work to become the market leader, or expand our existing market lead, by leveraging our core product strengths, product/industry knowledge, vendor relationships and supporting infrastructure to become the dominant market leader in our regions; we will respond to evolving customer demand and end user preferences with innovative products, both domestic and imported, that enhance our competitive advantage and leverage our proprietary product development strengths; we will provide best-in-class systems and support to ensure our customers, our vendors and our people succeed; 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; while there is still some uncertainty about how various states will implement the interest deductibility provisions, as a whole, we view the new rules as a positive development; we continue to work with domestic manufacturers and our vendor partners overseas to develop reliable, alternative product solutions going forward; in terms of market outlook, the unevenness and relatively slow growth experienced in the US residential construction market in 2017 is expected to continue in 2018; with average

housing starts at 1.3 million in 2017, there is room for growth in this market as the long term historical average is closer to 1.5 million annual starts; we expect it will take some years to reach the 1.5 million level, and as a result, expect low-to-mid single digit organic market growth for our end-markets and products; strategically, we will seek to outperform organic market growth through our strategic initiatives; capital expenditures in our distribution business have historically been low and 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; 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; 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 believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy; and we intend to issue common shares from treasury to settle the portion of the 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.

Independent Auditors' Report

To the Shareholders of HDI.

We have audited the accompanying consolidated financial statements of Hardwoods Distribution Inc., which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, 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, 2017 and 2016, 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 15, 2018
Vancouver, Canada

Consolidated Financial Statements
(Expressed in Canadian dollars)

HARDWOODS DISTRIBUTION INC.

Years ended December 31, 2017 and 2016

HARDWOODS DISTRIBUTION INC.

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

	Note	December 31, 2017	December 31, 2016
Assets			
Current assets:			
Cash		\$ 313	\$ 766
Accounts and other receivables	7	97,263	94,534
Income taxes receivable		1,582	—
Inventories	8	172,106	162,576
Prepaid and other assets		5,268	4,660
Total current assets		276,532	262,536
Non-current assets:			
Non-current receivables	7	1,359	1,378
Property, plant and equipment	9	20,650	20,710
Intangible assets	10	17,215	20,114
Deferred income taxes	14	5,477	11,631
Goodwill	4	51,670	54,707
Total non-current assets		96,371	108,540
Total assets		\$ 372,903	\$ 371,076
Liabilities			
Current liabilities:			
Bank indebtedness	11	\$ 91,146	\$ 97,886
Accounts payable and accrued liabilities	13(b)	38,588	40,978
Income taxes payable		—	1,949
Finance lease obligation	12(a)	1,281	1,055
Dividend payable	5	1,549	1,332
Total current liabilities		132,564	143,200
Non-current liabilities:			
Finance lease obligation	12(a)	1,068	905
Other liabilities	13(b)	445	972
Total non-current liabilities		1,513	1,877
Total liabilities		134,077	145,077
Shareholders' equity			
Share capital	13(a)	113,788	112,362
Contributed surplus		105,426	104,333
Retained earnings (deficit)		9,919	(14,258)
Accumulated other comprehensive income		9,693	23,562
Shareholders' equity		238,826	225,999
Total liabilities and shareholders' equity		\$ 372,903	\$ 371,076

Subsequent event (note 5)

Commitments (note 12)

Contingency (note 20)

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, 2017 and 2016

	Note	2017	2016
Sales	16	\$ 1,037,041	\$ 789,321
Cost of goods sold	8	(845,166)	(645,543)
Gross profit		191,875	143,778
Operating expenses:			
Selling and distribution	17	(106,402)	(77,070)
Administration	17	(36,388)	(27,801)
		(142,790)	(104,871)
Profit from operations		49,085	38,907
Finance expense	15	(3,018)	(1,823)
Finance income	15	516	358
Net finance expense		(2,502)	(1,465)
Profit before income taxes		46,583	37,442
Income tax expense:			
Current	14	(10,781)	(13,600)
Deferred	14	(5,848)	20
		(16,629)	(13,580)
Net profit		29,954	23,862
Other comprehensive income:			
Exchange differences translating foreign operations		(13,869)	(341)
Total comprehensive income		\$ 16,085	\$ 23,521
Basic net profit per share	13(c)	\$ 1.40	\$ 1.27
Diluted net profit per share	13(c)	\$ 1.39	\$ 1.25

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, 2017 and 2016

	Note	Share capital	Contributed surplus	Accumulated other comprehensive income - translation reserve	Deficit	Total
Balance at January 1, 2016		\$ 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 pursuant to the Rugby acquisition	13 (a)	9,091	—	—	—	9,091
Shares issued pursuant to LTIP	13 (b)	1,162	(1,162)	—	—	—
Shares 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
Share based compensation expense	13 (b)	—	2,806	—	—	2,806
Shares issued pursuant to LTIP	13 (b)	1,426	(1,426)	—	—	—
Shares reclassified to liabilities		—	(287)	—	—	(287)
Profit for the year		—	—	—	29,954	29,954
Dividends declared		—	—	—	(5,777)	(5,777)
Translation of foreign operations		—	—	(13,869)	—	(13,869)
Balance at December 31, 2017		\$ 113,788	\$ 105,426	\$ 9,693	\$ 9,919	\$ 238,826

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, 2017 and 2016

	Note	2017	2016
Cash flow from operating activities:			
Profit for the year		\$ 29,954	\$ 23,862
Adjustments for:			
Depreciation and amortization	9,10	6,504	4,806
Gain on sale of property, plant and equipment	9	(204)	(171)
Share-based compensation expense	13(b)	3,287	1,130
Income tax expense	14	16,629	13,580
Net finance expense	15	2,502	1,465
Interest received		451	358
Interest paid		(2,736)	(1,651)
Income taxes paid		(14,292)	(14,535)
		42,095	28,844
Changes in non-cash working capital:			
Accounts receivable		(6,813)	(956)
Inventories		(8,685)	(13,772)
Prepaid expenses		(2,737)	(1,764)
Accounts payable and accrued liabilities		(5,956)	2,320
		(24,191)	(14,172)
Net cash provided by operating activities		17,904	14,672
Cash flow from financing activities:			
(Decrease) increase in bank indebtedness		(1,173)	67,343
Principle payments on finance lease obligation		(1,197)	(1,204)
Note repayment		(467)	(407)
Issue of common shares, net of share issue costs	13(a)	—	63,525
Dividends paid to shareholders	5	(5,560)	(4,349)
Net cash (used in) provided by financing activities		(8,397)	124,908
Cash flow from investing activities:			
Additions to property, plant and equipment		(2,257)	(2,785)
Proceeds on disposal of property, plant and equipment		458	421
Business acquisitions	4	(8,210)	(136,875)
Additions to internally generated software	10	(329)	—
Payments received on non-current receivables		378	425
Net cash used in investing activities		(9,960)	(138,814)
(Decrease) increase in cash		(453)	766
Cash, beginning of year		766	—
Cash, end of year		\$ 313	\$ 766
Supplementary information:			
Property, plant and equipment acquired under finance leases, net of disposals		\$ 1,689	\$ 1,404
Deferred income tax on share issue costs in share capital		—	816
Future cash settlement of LTIP's in accrued liabilities and non-current liabilities		287	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		632	199

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

HARDWOODS DISTRIBUTION INC.

Notes to Consolidated Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Years ended December 31, 2017 and 2016

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 "HDI." The Company operates a network of 62 distribution centers in Canada and the US engaged in the wholesale distribution of architectural 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.

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"). The consolidated financial statements were authorized for issue by the Board of Directors on March 15, 2018.

(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 3(i) - the annual goodwill impairment test;
- 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.

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 and forklift 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 and forklift 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.

HARDWOODS DISTRIBUTION INC.

Notes to Consolidated Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Years ended December 31, 2017 and 2016

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.

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.

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.

HARDWOODS DISTRIBUTION INC.

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Years ended December 31, 2017 and 2016

3. Significant accounting policies (continued):

(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 architectural grade building 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 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) Prepaid and other assets:

Prepaid and other assets includes prepaid expenses and inventory purchases for which payment has been made but title of the inventory has not transferred to the Company.

(g) 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.

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.

HARDWOODS DISTRIBUTION INC.

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3. Significant accounting policies (continued):

(h) 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.

(i) Intangible assets:

Intangible assets with finite lives consist of acquired customer relationships and costs capitalized for internally generated software. The 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. Costs capitalized for internally generated software consist of costs incurred in the development and implementation of the software and amortization will begin when the software is substantially completed and ready for use.

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

(j) Goodwill:

Goodwill represents the excess, at the dates of acquisition, of the purchase price over the fair value of the net amounts assigned to individual assets acquired and liabilities assumed relating to business acquisitions. After initial measurement in a business combination, goodwill is recorded at cost less accumulated impairment losses.

Goodwill is allocated to the cash generating unit or group of cash generating units that are expected to receive the benefits from the business combinations. Rugby Holdings LLC (the "Rugby operations") has been determined to be the cash generating unit to which the goodwill relates. The Company tests goodwill for impairment on an annual basis. The Company also performs an impairment test if events or changes in circumstances arise that suggest the carrying value of goodwill may be impaired. An impairment loss for goodwill is not reversed.

The recoverable amount of the Rugby operations was determined based on value-in-use calculations which require discounting of future cash flows generated from the continuing use of the operations. The calculations use cash flow projections based on financial budgets covering a five-year period. Cash flows beyond the five-year period are extrapolated using an estimated growth rate of 4.0%. The growth rate is consistent with past experience, market conditions and actual operating results for the Rugby operations.

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3. Significant accounting policies (continued):

(j) Goodwill (continued):

Key assumptions used are based on industry sources as well as management estimates. A post-tax discount rate of 8.77% was used in determining the recoverable amount of the Rugby operations. The discount rate was estimated with the assistance of industry data, past experience and the industry targeted capital structure.

The recoverable amount of the Rugby operations as at December 31, 2017, was determined to be higher than the related carrying amount and no impairment has been recognized.

(k) Impairment:

Non-financial assets

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

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

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

Financial assets

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

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

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

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3. Significant accounting policies (continued):

(l) 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.

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.

(m) 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.

HARDWOODS DISTRIBUTION INC.

Notes to Consolidated Financial Statements
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Years ended December 31, 2017 and 2016

3. Significant accounting policies (continued):

(m) Income taxes (continued):

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.

(n) Leases:

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

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

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

(o) 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.

(p) 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.

(q) 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

HARDWOODS DISTRIBUTION INC.

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3. Significant accounting policies (continued):

(q) Share based compensation (continued):

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.

(r) New accounting policy:

IAS 12, Income Taxes (Amendments)

Effective January 1, 2017, the Company adopted Recognition of Deferred Tax Assets for Unrealized Losses as an amendment to IAS 12, *Income Taxes (Amendments)* that clarify when a deductible temporary difference exists. The adoption of this amendment did not impact the Company's consolidated financial statements.

(s) Future accounting pronouncements:

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2017, 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.

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 adoption of IFRS 9 will not 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.

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 majority of the Company's revenue is generated from the sale of architectural grade building products. The Company has determined that the adoption of this standard will not have a material impact on the measurement of revenue generated from the sale of its products to customers and therefore, will not have a material impact on earnings. The adoption of this standard will impact the Company's revenue disclosures as the Company will be required to disclose the judgments, and changes in judgments made in applying IFRS 15 and a reconciliation of certain balances. The Company is in the process of drafting these required disclosures.

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3. Significant accounting policies (continued):

(s) Future accounting pronouncements (continued):

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.

4. Business acquisitions:

(a) Rugby acquisition

On July 15, 2016 (the "Rugby 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 "Rugby Acquisition") for a base purchase price of \$138.6 million (US\$106.8 million) (the "Purchase Price") plus up to another \$16.9 million (US\$13.0 million) in earn-outs based on future performance. Rugby operates a network of 28 distribution centers in the US and is engaged in the wholesale distribution of 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.

The base purchase price was comprised of (i) \$129.6 million (US\$99.8 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 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 was outside this range at closing of the Rugby Acquisition, the purchase price would have been 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. In March 2017, the Company finalized the NAV and the estimated NAV exceeded the final NAV by \$0.2 million. The Company reduced the holdback amount for the \$0.2 million NAV adjustment and the remaining amount of the holdback was settled in the third quarter of 2017.

The Rugby Acquisition was 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 Rugby Acquisition date.

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4. Business acquisitions (continued):

(a) Rugby acquisition (continued):

Fair value of assets acquired and liabilities assumed

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

	US\$		CDN\$	
Cash consideration	\$	106,140	\$	137,717
Notes payable assumed		709		920
Consideration	\$	106,849	\$	138,637
Assets acquired and liabilities assumed:				
Accounts and other receivables	\$	28,931	\$	37,538
Inventories		35,546		46,121
Prepaid expenses		499		647
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		(18,314)		(23,762)
Identifiable net assets acquired		66,105		85,772
Goodwill		40,744		52,865
Net assets acquired	\$	106,849	\$	138,637

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 assets of \$20.4 million (US\$15.7 million) primarily represent the value of customer relationships acquired and are being amortized over 10 years, which is the period the Company expects to benefit from these relationships. The intangible asset is deductible for tax purposes.

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

Had the Rugby 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, 2017 are sales of \$402.8 million (US\$310.2 million) and profit before tax of \$11.3 million (US\$8.7 million) relating to Rugby.

(b) Eagle Plywood and Lumber acquisition

On March 13, 2017, the Company acquired through one of its wholly owned subsidiaries substantially all of the assets and assumed certain liabilities of Eagle Plywood and Lumber ("Eagle") for a base purchase price of US\$0.4 million plus up to an additional US\$0.2 million subject to future sales performance. During the fourth quarter, \$0.1 million was paid related to the amount subject to future sales performance.

Eagle is a single site wholesale distributor located in Dallas, Texas distributing architectural grade building products to customers that supply end-products to the residential and commercial construction markets. The acquisition has been accounted for as a business combination using the acquisition method, with the Company being the acquirer and Eagle being the acquiree, and where the assets acquired and liabilities assumed are recorded at their fair values at the acquisition date.

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4. Business acquisitions (continued):

(c) Downes & Reader Hardwood Company Inc. acquisition

On July 17, 2017, the Company acquired through one of its wholly owned subsidiaries substantially all of the assets and assumed certain liabilities of Downes & Reader Hardwood Company Inc. ("D&R") for a total value of \$7.4 million (US\$5.9 million). The fair value of D&R's identified assets and liabilities assumed in accordance with the acquisition consisted of accounts and other receivables of \$1.4 million (US\$1.1 million), inventories of \$7.8 million (US\$6.2 million), property, plant and equipment of \$1.9 million (US\$1.5 million) and accounts payable and accrued liabilities of \$3.7 million (US\$2.9 million).

D&R is a distributor of hardwood lumber with four locations in the US Northeast and services both the wholesale and retail customer segments. The D&R acquisition has been accounted for as a business combination using the acquisition method, with the Company being the acquirer and D&R being the acquiree, and where the assets acquired and liabilities assumed are recorded at their fair values at the acquisition date.

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, 2017	December 31, 2016
Cash	\$ (313)	\$ (766)
Bank indebtedness	91,146	\$ 97,886
Shareholder's equity	238,826	225,999
Total capitalization	\$ 329,659	\$ 323,119

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, 2017 and December 31, 2016, 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, 2017.

On November 10, 2017, the Company declared a cash dividend of \$0.0725 per common share to shareholders of record as of January 15, 2018. The dividend was paid to shareholders on January 26, 2018. On March 15, 2018, the Company declared a cash dividend of \$0.0725 per common share to shareholders of record as of April 16, 2018, to be paid on April 27, 2018.

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.

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6. Financial instruments (continued):

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.

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 taxes receivable, income taxes 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 \$98.9 million at December 31, 2017 (December 31, 2016 - \$96.7 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 2.2% (December 31, 2016 - 2.5%) of trade accounts receivable and customer notes receivable at December 31, 2017. No one customer represents more than 1.0% of sales.

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

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6. Financial instruments (continued):

Financial risk management (continued):

Employee housing loans:

Employee loans are non-interest bearing and are granted to employees who are relocated. Employee loans are secured by a deed of trust or mortgage depending upon the jurisdiction. Employee loans are repaid in accordance with the loan agreement. These loans are measured at their fair market value upon granting the loan and subsequently measured at amortized cost.

Customer notes:

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

(i) 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, 2017, in Canada, a subsidiary of the Company had a revolving credit facility of up to \$25.0 million, and, in the US, a subsidiary of the Company had a revolving credit facility of up to \$156.8 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

(ii) Liquidity risk (continued):

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, 2017 bank indebtedness balance of \$91.1 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.

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6. Financial instruments (continued):

Financial risk management (continued):

(iii) Market risk (continued):

Currency risk

As the Company conducts business in both Canada and the United States it is exposed to currency risk. Most of the 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 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, 2017, 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 (2017 - US\$0.7 million, 2016 - US\$0.2 million) and accounts payable to U.S. suppliers (2017 - US\$0.3 million, 2016 - US\$0.4 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, 2017 or December 31, 2016.

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, 2017 and December 31, 2016 and does not take into account the effect 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.

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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, 2017	December 31, 2016
Trade accounts receivable - Canada	\$ 13,458	\$ 14,246
Trade accounts receivable - United States	79,880	81,776
Sundry receivable (note 20)	7,263	2,417
Current portion of non-current receivables	842	1,133
	101,443	99,572
Less:		
Allowance for credit loss	4,180	5,038
	\$ 97,263	\$ 94,534
Non-current receivables:		
Employee housing loans	\$ 257	\$ 424
Customer notes	403	758
Security deposits	1,541	1,329
	2,201	2,511
Less:		
Current portion, included in accounts receivable	842	1,133
	\$ 1,359	\$ 1,378

The aging of trade receivables is:

	December 31, 2017	December 31, 2016
Current	\$ 65,635	\$ 70,936
1 - 30 days past due	19,075	17,467
31 - 60 days past due	5,204	4,957
60+ days past due	3,424	2,662
	\$ 93,338	\$ 96,022

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, 2017 was \$4.2 million (December 31, 2016 - \$5.0 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.

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7. Accounts and other receivables (continued):

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

	2017	2016
Balance as at January 1	\$ 5,038	\$ 4,844
Additions during the year	1,279	1,764
Use during the year	(1,806)	(1,426)
Changes due to currency rate fluctuations	(331)	(144)
Balance as at December 31	\$ 4,180	\$ 5,038

Bad debt expense, net of recoveries, for the year ended December 31, 2017 was \$0.1 million which equates to 0.01% of sales (year ended December 31, 2016 - \$0.8 million, being 0.1% of sales).

8. Inventories:

	December 31, 2017	December 31, 2016
Raw materials	\$ 1,306	\$ 1,779
Work in process	4,950	5,021
Goods in-transit	7,947	10,927
Finished goods:		
Lumber	47,807	43,279
Sheet goods	77,922	74,253
Architectural and other	32,174	27,317
	\$ 172,106	\$ 162,576

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:

	2017	2016
Inventory write-downs, included in cost of goods sold	\$ 1,909	\$ 1,972
Cost of inventory sold	808,832	620,115
Other cost of goods sold	36,334	25,428
Total cost of goods sold	\$ 845,166	\$ 645,543

HARDWOODS DISTRIBUTION INC.

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9. Property, plant and equipment:

	Land	Leased vehicles and forklifts (note 12(a))	Buildings, machinery and equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2016	\$ 692	\$ 3,693	\$ 22,725	\$ 909	\$ 28,019
Additions	151	1,656	3,124	113	5,044
Acquisition of Rugby (note 4(a))	—	—	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
Additions	—	1,832	2,106	151	4,089
Acquisition of Eagle and D&R (note 4(b,c))	—	—	1,994	13	2,007
Disposals	—	(1,185)	(721)	(95)	(2,001)
Adjustments:					
Foreign currency transaction	(54)	(240)	(1,798)	(42)	(2,134)
Balance at December 31, 2017	\$ 770	\$ 4,222	\$ 30,377	\$ 1,299	\$ 36,668
Accumulated depreciation					
Balance at January 1, 2016	\$ —	\$ 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
Depreciation	—	1,027	3,246	187	4,460
Disposals	—	(907)	(599)	(96)	(1,602)
Adjustments:					
Foreign currency transaction	—	(118)	(695)	(24)	(837)
Balance at December 31, 2017	\$ —	\$ 1,616	\$ 13,479	\$ 923	\$ 16,018
Net book value:					
December 31, 2016	\$ 824	\$ 2,201	\$ 17,269	\$ 416	\$ 20,710
December 31, 2017	\$ 770	\$ 2,606	\$ 16,898	\$ 376	\$ 20,650

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9. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the year ended December 31, 2017 was \$4.5 million (2016 - \$3.8 million) and is included in the statement of comprehensive income as follows:

	2017	2016
Cost of sales	\$ 1,596	\$ 1,477
Selling and distribution	2,610	2,195
Administration	254	150
	\$ 4,460	\$ 3,822

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2017 was a net gain of \$204,000 (2016 - net gain of \$171,000) and is included in selling and distribution in the statement of comprehensive income.

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10. Intangible assets:

		Internally generated software	Customer relationships	Total
Cost				
Balance at January 1, 2016	\$	—	\$ 57	\$ 57
Acquisition of Rugby (note 4(a))		—	20,371	20,371
Eliminate fully amortized intangibles		—	(57)	(57)
Adjustments:				
Foreign currency transaction		—	709	709
Balance at December 31, 2016		—	21,080	21,080
Acquired through acquisitions		—	82	82
Additions		329	—	329
Adjustments:				
Foreign currency transaction		(11)	(1,387)	(1,398)
Balance at December 31, 2017	\$	318	\$ 19,775	\$ 20,093
Accumulated amortization				
Balance at January 1, 2016	\$	—	\$ 21	\$ 21
Amortization		—	984	984
Eliminate fully amortized intangibles		—	(57)	(57)
Adjustments:				
Foreign currency transaction		—	18	18
Balance at December 31, 2016		—	966	966
Amortization		—	2,044	2,044
Adjustments:				
Foreign currency transaction		—	(132)	(132)
Balance at December 31, 2017	\$	—	\$ 2,878	\$ 2,878
Net book value:				
December 31, 2016	\$	—	\$ 20,114	\$ 20,114
December 31, 2017	\$	318	\$ 16,897	\$ 17,215

Amortization of intangible assets for the year ended December 31, 2017 was \$2.0 million (2016 - \$0.9 million) and is included in selling and distribution expenses in the statement of comprehensive income.

HARDWOODS DISTRIBUTION INC.

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11. Bank indebtedness:

	December 31, 2017	December 31, 2016
Cheques issued in excess of funds on deposit	\$ 866	\$ 480
Credit facility, Hardwoods LP	7,270	12,546
Credit facility, Hardwoods USLP II (December 31, 2017 - US\$66,323 December 31, 2016 - US\$63,398)	83,010	84,860
	<u>\$ 91,146</u>	<u>\$ 97,886</u>

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 II ("Hardwoods USLP II").

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 II is secured by a first security interest in all of the present and after acquired property of Hardwoods Specialty Products US LP ("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 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. The LP Credit Facility matures in August 2021. 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, 2017, the LP Credit Facility has unused availability of \$13.5 million, before cheques issued in excess of funds on deposit of \$0.9 million (December 31, 2016 - \$6.9 million, cheques issued in excess of funds on deposit - \$0.5 million).

Hardwoods USLP II Credit Facility ("USLP II Credit Facility")

In July 2016, in connection with the closing of the Rugby Acquisition, a subsidiary of the Company entered into a new USLP II Credit Facility with its lender for US\$125.0 million. The USLP II Credit Facility has a five year term and can be prepaid at any time with no prepayment penalty. The USLP II 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 II Credit Facility include, among others, a springing fixed charge coverage ratio of 1.0 to 1, triggered if unused availability under the USLP II Credit Facility falls below US\$12.5 million at any time.

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11. Bank indebtedness (continued):

Hardwoods USLP II Credit Facility ("USLP II Credit Facility") (continued):

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 II Credit Facility, in 2016 the Company incurred, \$0.3 million in fees, which are netted against bank indebtedness in the consolidated statement of financial position. These fees are being amortized over the term of the USLP II Credit Facility.

At December 31, 2017, the USLP II Credit Facility has unused availability of \$53.2 million (US\$42.4 million), before cheques issued in excess of funds on deposit of nil. At December 31, 2016, the USLP II Credit Facility had unused availability of \$50.9 million (US\$37.9 million), before cheques issued in excess of funds on deposit of nil.

The Company has a letter of credit outstanding at December 31, 2017 totaling \$1.3 million (US\$1.0 million) (2016 - \$0.8 million (US\$0.6 million)) against the USLP II 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, 2017 were 3.0% and 2.7% (2016 - 3.2% and 2.8%) for the LP and USLP II Credit Facilities, respectively.

12. Leases:

(a) Finance leases as lessee:

Subsidiaries of the Company lease vehicles and forklifts with terms ranging from 24 to 72 months. In Canada, the Company guarantees the residual value under the terms of the vehicle leases, and any difference between the amount realized and the guaranteed residual value is either paid to or paid by the Company. In the US, the vehicle 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 the Company. These vehicle and forklift leases are considered finance leases and are recorded on the statement of financial position.

Finance lease liabilities are payable as follows:

Minimum lease payments due	Within one year	One to three years	Total
December 31, 2017:			
Future minimum lease payments	\$ 1,378	\$ 1,128	\$ 2,506
Interest	97	60	157
Present value of minimum payments	\$ 1,281	\$ 1,068	\$ 2,349
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

The present value of the lease payments is calculated using the interest rate implicit in the lease, which range from 2.6% - 8.0%.

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12. Leases (continued):

(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, 2017	\$ 19,082	\$ 55,472	\$ 9,377	\$ 83,931

Minimum lease payments recognized as an expense during the year ended December 31, 2017 amounted to \$20.8 million (2016 - \$13.5 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, 2017, the authorized share capital of the Company comprised an unlimited number of common shares without par value ("Shares").

A continuity of share capital is as follows:

	Shares	Total
Balance at December 31, 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(a))	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
Issued pursuant to long term incentive plan	69,413	1,426
Balance at December 31, 2017	21,419,985	\$ 113,788

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 Rugby Acquisition (note 4(a)) and issued 3,966,350 common shares as part of the financing arrangement related to the Rugby 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).

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13. Share capital (continued):

(a) Share capital (continued):

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 Rugby 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.

(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 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, 2017 the fair value of the Restricted Shares and Performance Shares estimated to be settled in the future in cash was \$1.4 million (December 31, 2016 - \$1.2 million) 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.

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13. Share capital (continued):

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

A continuity of the LTIP Shares outstanding is as follows:

	Performance Shares	Restricted Shares
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
LTIP shares issued during the year	87,594	128,197
LTIP shares forfeited during the year	(10,975)	(2,119)
LTIP shares settled	(13,714)	(83,089)
Balance at December 31, 2017	121,506	116,650

During the year ended December 31, 2017, 13,714 (December 31, 2016 - 8,347) Performance Shares and 83,089 (December 31, 2016 - 58,040) Restricted Shares became fully vested and were settled by the issuance of 69,413 (December 31, 2016 - 58,607) Shares and \$0.6 million in cash (December 31, 2016 - \$0.3 million). On issuance of the Shares, the accumulated share-based compensation expense of \$1.4 million (December 31, 2016 - \$1.2 million) associated with the settled Performance Shares and Restricted Shares was transferred from contributed surplus to share capital.

LTIP compensation expense of \$3.3 million was recognized in the consolidated statement of comprehensive income for the year ended December 31, 2017 (2016 - \$1.1 million). The equity classified portion of the LTIP compensation expense was \$2.8 million (December 31, 2016 - \$1.1 million) and the liability classified portion was \$0.5 million as at December 31, 2017 (December 31, 2016 - nil).

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. The liability associated with the cash-settled awards is recorded in accounts payable and accrued liabilities, for amounts expected to be settled within one year, and in other liabilities for amounts to be settled in excess of one year.

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13. Share capital (continued):

(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, 2017 of \$30.0 million (December 31, 2016 - \$23.9 million). The weighted average number of common shares outstanding in each of the reporting years was as follows:

	December 31, 2017	December 31, 2016
Issued ordinary shares at beginning of year	21,350,572	16,762,071
Effect of shares issued during the year		
Pursuant to long-term incentive plan	3,594	13,322
Pursuant to Bought Deal Financing	—	1,817,910
Pursuant to Rugby acquisition	—	258,290
Weighted average common shares - basic	21,354,166	18,851,593
Effect of dilutive securities:		
Long-term incentive plan	119,373	166,377
Weighted average common shares - diluted	21,473,541	19,017,970

14. Income taxes:

	2017	2016
Current tax expense	\$ (10,781)	\$ (13,600)
Deferred tax expense	(5,848)	20
	\$ (16,629)	\$ (13,580)

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, 2017 is 26.4% (2016 - 26.4%) and in the United States is 39.4% (2016 - 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.

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:

	2017	2016
Profit before income tax	\$ 46,583	\$ 37,442
Statutory rate	39.4%	39.4%
Computed tax expense at statutory rate	(18,354)	(14,752)
Effect of lower tax rates in Canada, other rate changes and restructuring	3,271	1,798
Non-deductible expenses	(164)	(73)
Prior year tax true-ups	222	—
Change in unrecognized deferred tax assets	(1,839)	(363)
Other	235	(190)
Income tax expense	\$ (16,629)	\$ (13,580)

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14. Income taxes (continued):

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

	December 31, 2017	December 31, 2016
Deferred tax assets:		
Accounts receivable	\$ 1,014	\$ 2,838
Accounts payable and provisions	532	1,629
Inventory	1,867	1,985
Finance lease obligations	616	681
Goodwill and intangibles	3,088	5,711
Tax loss carry forwards and future interest deductions	252	810
Share and debt issuance costs	746	1,122
Other	104	—
	<u>8,219</u>	<u>14,776</u>
Deferred tax liabilities:		
Prepaid expenses	(80)	(325)
Property, plant and equipment	(2,662)	(2,725)
Other	—	(95)
	<u>(2,742)</u>	<u>(3,145)</u>
Deferred tax asset	<u>\$ 5,477</u>	<u>\$ 11,631</u>

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. As at December 31, 2017, the US deferred tax assets reflect the new US corporate tax rate of 21.0% compared to 35.0% in 2016. The revaluation of the US deferred tax assets to account for the change in the US corporate tax rate from 35.0% to 21.0% resulted in an increase of \$1.0 million in deferred tax expense for the year ended December 31, 2017.

At December 31, 2017, the Company and its subsidiaries have operating loss carry forwards for income tax purposes of approximately \$0.9 million in Canada that may be utilized to offset future taxable income (December 31, 2016 - \$3.1 million). These losses, if not utilized, expire between 2027 and 2031. The Company's US subsidiaries have no operating loss carry forwards.

At December 31, 2017, the Company and its Canadian subsidiaries have capital losses of approximately \$25.0 million (December 31, 2016 - \$23.1 million), and suspended capital losses of approximately \$44.7 million (December 31, 2016 - \$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 \$8.6 million (December 31, 2016 - \$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.

HARDWOODS DISTRIBUTION INC.

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Years ended December 31, 2017 and 2016

15. Finance income and expense:

	Note	2017	2016
Finance expense:			
Interest on bank indebtedness	11	\$ (2,823)	\$ (1,675)
Accretion of finance lease obligation		(195)	(137)
Foreign exchange losses		—	(11)
Total finance expense		(3,018)	(1,823)
Finance income:			
Interest on trade receivables, customer notes, and employee loans	7	451	358
Foreign exchange gain		65	—
Total finance income		516	358
Net finance expense		\$ (2,502)	\$ (1,465)

16. Segment reporting:

Information about geographic areas is as follows:

	2017	2016
Revenue from external customers:		
Canada	\$ 136,038	\$ 129,935
United States	901,003	659,386
	\$ 1,037,041	\$ 789,321
	December 31, 2017	December 31, 2016
Non-current assets ⁽¹⁾ :		
Canada	\$ 1,616	\$ 1,552
United States	87,919	93,979
	\$ 89,535	\$ 95,531

⁽¹⁾ Excludes financial instruments and deferred income taxes.

17. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are summarized below.

	2017	2016
Wages, salaries and benefits	\$ 103,578	\$ 73,699
Pensions - defined contribution plans	1,307	1,078
LTIP share based compensation	3,287	1,130
	\$ 108,172	\$ 75,907

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17. Employee remuneration (continued):

(a) Employee benefits expense (continued):

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

	2017	2016
Cost of sales	\$ 21,696	\$ 14,967
Selling and distribution	59,864	43,883
Administration	26,612	17,057
	\$ 108,172	\$ 75,907

(b) Pensions:

Hardwoods USLP, Rugby Holdings LLC, Paxton Hardwoods LLC and HMI Hardwoods LLC maintain defined contribution 401(k) retirement savings plans ("Plans"). The assets of these Plans are held and related investment transactions are executed by the Plan's Trustees who are third parties and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2017, Hardwoods USLP, Rugby Holdings LLC and Paxton Hardwoods LLC contributed and expensed \$0.9 million (US \$0.7 million) (2016 - \$0.7 million (US \$0.6 million)) in relation to these Plans. There is no requirement for an employer contribution to the plan maintained by HMI Hardwood LLC 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 who is a third party, and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2017, Hardwoods LP contributed and expensed \$0.4 million (2016 - \$0.3 million) in relation to the LP plan.

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:

	2017	2016
Short-term employee benefits:		
Salaries and benefits including bonuses	\$ 4,265	\$ 4,260
Automobile benefit	21	38
LTIP Share compensation	2,124	896
Total remuneration	\$ 6,410	\$ 5,194

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Years ended December 31, 2017 and 2016

18. Related party transactions (continued):

(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, 2017 or December 31, 2016.

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, 2017.

Decommissioning

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

20. Contingency:

On November 18, 2016, a trade case was filed in the United States seeking the imposition of countervailing duties ("CVD") and antidumping duties ("AD") against imported hardwood plywood produced in China.

On April 19, 2017, the Department of Commerce ("Commerce") announced a preliminary CVD of 9.89%, and on June 20, 2017 Commerce announced a preliminary AD of 57.36%. The duties applied to most Chinese producers, including those that the Company does business with. On November 13, 2017 Commerce announced final CVD and AD rates of 22.98% and 183.36% respectively.

The concluding phase of this trade case then passed to a separate US government body, the International Trade Commission ("ITC"), to rule on whether final CVD and AD duties determined by Commerce would be affirmed or rejected. On December 1, 2017, the ITC voted affirmatively that the final CVD and AD rates determined by Commerce will be implemented (the "Final Determination").

As at December 31, 2017, the Company had paid for approximately \$3.4 million in CVD and AD duty deposits which were paid in 2017 during periods when duties were not in effect. The Company expects these amounts will be refunded in 2018. The \$3.4 million in CVD and AD duty deposits are included within accounts and other receivables.

Corporate Information

Directors

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Director

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Chair, Interfor Corporation

William Sauder
President, Omax Investments Ltd.

Peter M. Bull
President, Blenheim Realty Ltd.

Jim C. Macaulay
Chief Financial Officer, Marvin Companies

Michelle Lewis
Chief Strategy Officer, NOW Inc.

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

Drew Dickinson
Chief Operating Officer, Rugby

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Listings

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Trades under **HDI**

Transfer Agent

Computershare Trust



HDI
HARDWOODS DISTRIBUTION INC.