HDI

HARDWOODS DISTRIBUTION INC.

2018

Annual Report

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

HDI
HARDWOODS DISTRIBUTION INC.

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 23 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 producing 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 50% of the products we sell to industrial manufacturers end up in residential construction applications, approximately 40% in the commercial/ institutional construction sector, and 10% in a diverse group of other end-markets.

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

Our Network: We operate from 63 locations across North America, with approximately 90% of our annual sales generated in the United States and 10% in Canada.

Our Strategy: As North America's largest distributor in our industry, with an unmatched network of locations and annual sales of over $1.1 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) supporting the success of our operations and our stakeholders with **operational excellence**; and iii) continuing to **pursue acquisitions** that complement our strategy.

To our Shareholders

HDI's growth story continued in 2018 as we increased revenues by 8.5% on a combination of organic and acquisition-based growth. Diluted profit per share was also up 7.2% year-over-year as we benefited from the reduction in US corporate tax rates.

These results represent our seventh consecutive year of top and bottom-line growth. Between 2012 and 2018, HDI's revenues have grown from $306 million to $1.134 billion. And this has been accretive growth, with Adjusted diluted profit per share climbing from $0.38 to $1.61 during this same time frame. This represents a compound annual growth rate of 20.6% for revenue and 22.9% for Adjusted diluted profit per share.

As we have grown our top and bottom line, investors have also benefited from an increase in our dividend. 2018 was no exception. Midway through the year we announced a 10% increase, which represented our seventh dividend increase in the past seven years. Our annual dividend is $0.32 per share, or a dividend yield of approximately 3% as at December 31, 2018.

Building on our Strengths

Our strong track record of financial performance and dividend growth speaks to the fundamental strength of HDI's brands and business model. In 2018 we continued to build on our strengths as we worked on our platform strategies and moved closer to our vision of *a world class distributor of architectural building products operating multiple brands across North America*. Here are just some of the highlights from our year:

Building Market Share in Strategic Market Segments. We achieved new market share for our decorative surfaces and composite products in 2018 as we increased our focus on this emerging, high-growth segment. We are successfully leveraging our supply chain strengths to attract some of the world's leading suppliers of these products, and we are backing our growing line-up of products with sophisticated marketing programs aimed at establishing both push demand from manufacturers and pull demand from designers and architects.

Establishing New Supply Lines for Hardwood Plywood. One of the most significant challenges we faced in 2018 was the imposition of US trade barriers on hardwood plywood imported from China. In addition to creating significant market imbalances within this product category and

negatively impacting our gross profit margin as detailed in our 2018 Management's Discussion and Analysis, the new barriers also required a reworking of our supply sources. Our product teams did an exceptional job of establishing new mill relationships for our proprietary product lines in 2018. We are now moving into 2019 with an attractive basket of product choices for our customers.

Capitalizing on our Acquisition Pipeline. We continued to grow our business through acquisition in 2018 with our purchase of certain distribution assets of Atlanta Hardwoods Corporation. "Atlanta" brought us three new operations, two in Georgia and one in Alabama, and is expected to generate annual sales of about $17 million.

Subsequent to the year-end on January 28, 2019, we followed up with the acquisition of Far West Plywood. Far West is a single site distributor located in Southern California with estimated annual sales of $16 million. The addition of Far West provides additional size and scale in the attractive and fast-growing Southern California market.

Setting New Growth Targets

Our operational strategies are designed to deliver market share. With our strategies gaining traction, we have set our sights on our next growth target and expect to achieve $1.5 billion of sales within five years.

Our revenue target is based on achieving organic and inorganic based growth targets. We will continue to pursue our robust pipeline of accretive acquisition opportunities within the highly fragmented US architectural building products industry.

We also expect to improve profitability through our continued optimization of our platform. We will further leverage our size and strength to create competitive advantages through further adopting best in class supply chain strategies and vendor rebate programs, implementing a consolidated ERP platform, and investing in our people, including providing additional internal sales and product team training, development and tools.

Over time, these and other strategies, will help drive growth in our EBITDA margin, while also enhancing our competitive position.

Share Price Performance

One of the measures of our success is the Company's share price, and in recent months we have been disappointed by the disconnect between our performance and our market value. While it can be difficult to pinpoint exact causes of market sentiment, we are aware that the broader buildings products category has been negatively affected by uneven economic data on US housing.

We believe the recent softness in US housing markets is a temporary pause and not a directional change. Housing fundamentals remain supportive and experts continue to forecast new home construction growth going forward. In addition, our exposure to US construction markets is well diversified across new residential construction, repair and remodel, non-residential construction and a range of other end-markets.

Accordingly we believe the underlying value of HDI is not currently reflected in our share price. On February 1, 2019, we received TSX approval for a normal course issuer bid which will enable us to buy back up to 1,612,147 of our common shares over a 12-month period.

Concluding Comments

Going forward, we are very excited about HDI's prospects and confident in our ability to deliver continued growth and performance improvements. As I said in my letter last year, we are not just focused on 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 2019.

Sincerely,

Rob Brown
President and Chief Executive Officer

Management's Discussion and Analysis

March 14, 2019

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of March 14, 2019. 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, 2018 and 2017. 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 non-cash Long Term Incentive Plan ("LTIP") expense, allowance related to duty deposits receivable, and transaction expenses. "Adjusted EBITDA margin" and "Adjusted net debt-to-EBITDA" (together the "Adjusted EBITDA Ratios") are as defined above, before certain items related to non-cash Long Term Incentive Plan ("LTIP") expense, allowance related to duty deposits receivable, and transaction expenses. 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 non-cash Long Term Incentive Plan ("LTIP") expense, allowance related to duty deposits receivable, and transaction expenses. 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 non-cash Long Term Incentive Plan ("LTIP") expense, allowance related to duty deposits receivable, and transaction expenses.

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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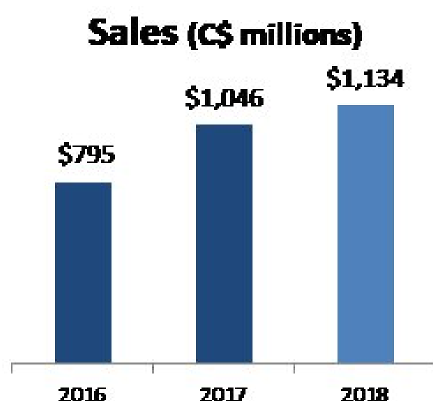
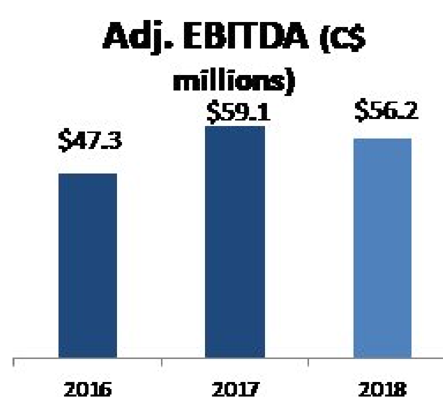
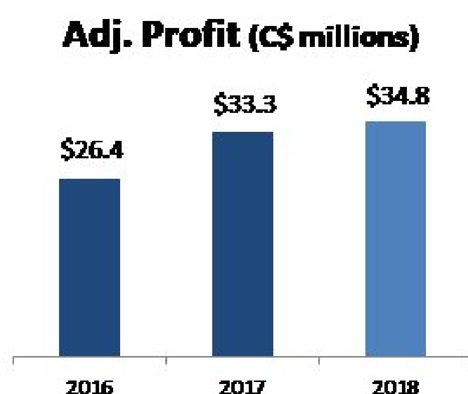
1.0 Executive Summary

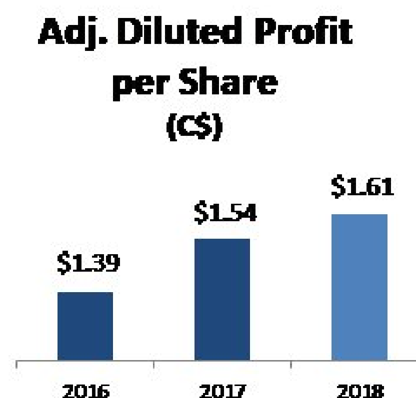
1.1 Overview

We set new sales, profit, and Adjusted profit records in 2018 as we continued to implement our business strategies, achieved organic and acquisition-based growth, and realized bottom-line benefits from the reduction in the US corporate tax rate. For the year ended December 31, 2018, our sales increased 8.5% to $1.134 billion and profit increased 7.4% to $32.2 million, compared to 2017. Adjusted profit also climbed 4.6% to $34.8 million, after adjusting for expenses associated with non-cash Long Term Incentive Plan ("LTIP") expense, allowance related to duty deposits receivable, and transaction expenses.









Strong Sales Growth

Our record 2018 top-line results were achieved despite only modest gains in the US residential construction market. Our end-market diversification and predominantly non-commodity product mix, together with our strategic initiatives and price appreciation on some of our product

lines, counteracted the impact of these conditions and helped us deliver organic sales growth of $64.1 million, or 6.1%, in 2018, including 6.6% organic sales growth in the US and 2.8% in Canada.

Acquisitions also drove our sales performance with our 2017 purchases of Eagle Plywood and Lumber, Downes & Reader Hardwood Company, and 2018 acquisition of certain distribution assets of Atlanta Hardwoods Corporation (collectively referred to as the "Acquired Businesses") contributing $26.5 million, or a 2.5%, year-over-year increase to sales.

Gross Margin

For the year ended December 31, 2018, we increased gross profit dollars by 4.5% to $200.5 million, from $191.9 million in 2017. This $8.7 million improvement reflects our higher sales, partially offset by a lower gross profit margin percentage of 17.7%, as compared to 18.3% in 2017. The decrease in gross profit margin percentage primarily relates to US trade barriers that created market imbalances in the hardwood plywood product category in 2018 (see Section 1.3).

Operating Expenses

As anticipated, operating expenses were higher year-over-year, reflecting the addition of the acquired businesses noted in Section 1.2 and added costs to support organic growth. As a percentage of revenue, operating expenses improved to 13.6% from 13.7% in 2017.

Profitability

Profit for the year ended December 31, 2018 increased by 7.4% to $32.2 million, from $30.0 million in 2017. This improvement primarily reflects the positive impact of the US corporate tax rate reduction that came into effect January 1, 2018, partially offset by lower EBITDA and an increase in net finance expense. Diluted profit per share increased 7.2% to $1.49, from $1.39 in 2017.

We generated 2018 Adjusted EBITDA of $56.2 million, as compared to $59.1 million in 2017. While sales and gross profit increased year-over-year, these gains were offset by the lower gross margin percentage.

Balance Sheet and Cash Flows

Our balance sheet continues to be responsibly managed. As at December 31, 2018 , our net debt-to-Adjusted EBITDA ratio was 2.0 times, the debt-to-capital ratio was 28.0%, and we had $78.4 million of unused borrowing capacity.

TFL Material: Egger H3154 ST36 Dark Brown Charleston Oak

Tafisa TFL M2052 Golden Light

1.2 Recent Acquisitions

Through our acquisition strategy, we continue to enhance our position as North America's #1 distributor of architectural building products, while strengthening our presence in the large US market. Recent acquisition activity includes:

Far West Plywood

On January 28, 2019, we purchased substantially all of the assets and assumed certain liabilities of Far West Plywood ("Far West") for a total value of US$3.6 million. Far West is a single site distributor located in Southern California with estimated annual sales of US$12 million. The addition of Far West represents a contiguous expansion of our current Southern California operations and provides additional size and scale in an attractive growth market.

Certain distribution assets of Atlanta Hardwoods Corporation

On June 11, 2018, we purchased certain of the distribution assets of Atlanta Hardwoods Corporation ("Atlanta") for a total value of US$3.7 million. A distributor of architectural building products, Atlanta brought us three new operations, including two in Georgia and one in Alabama. The Georgia operations will be consolidated into our existing Atlanta and Suwanee facilities, and combined with the new Alabama location, gives us important new size and scale in an attractive and growing region. The new operations are expected to generate US$13 million in annual sales and provide a strong strategic fit with complementary product lines and suppliers.

Downes & Reader Hardwood Company

On July 17, 2017, we purchased Downes & Reader Hardwood Company Inc. ("D&R") for a total value of US$5.9 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.

Eagle Plywood and Lumber

On March 13, 2017, we purchased Eagle Plywood and Lumber (“Eagle”) for a total value of US$0.5 million. Eagle was a single site wholesale distributor located in Dallas, Texas with estimated annual sales of US$5.0 million.

1.3 Trade Actions Update

The US government has continued to undertake trade actions, resulting in a shifting trade landscape. The trade actions most relevant to our business include:

Wooden Cabinets and Vanities from China

On March 6, 2019 the American Kitchen Cabinet Alliance, which is comprised of a number of significant domestic cabinet manufacturers (the "Petitioners"), announced the filing of a petition with the Department of Commerce ("Commerce") and the International Trade Commission ("ITC") for the imposition of antidumping ("AD") and countervailing ("CVD") duties on wooden cabinets and vanities from China. The Petitioners claim that China's trade practices have resulted in an over 75% increase in US imports of kitchen cabinets from China since 2015. The Petitioners estimate that the total value of imports covered by the case is approximately $4 billion and that the dumping margins are up to 259.99%. A time line for Commerce's investigation has not yet been announced.

We view the potential imposition of AD and CVD duties on cabinet products imported from China as positive, as it could increase demand from our primary customer base, domestic cabinet manufacturers.

Hardwood Plywood from China

On January 2018, AD and CVD duties relating to hardwood plywood imported from China into the US were implemented (the "Trade Case"). For a more detailed summary, see our 2017 annual report.

The Trade Case negatively impacted our margins by i) increasing sourcing costs as we purchased hardwood plywood from alternate suppliers, rather than from manufacturers in China; and ii) creating an excess market supply of lower-value hardwood plywood and substitute products in the US.

By year-end we had made excellent progress in diffusing sourcing challenges by developing proprietary product offerings with alternative suppliers of hardwood plywood. A number of these products are now in market trials with our customers and are performing well.

As volumes related to our new proprietary hardwood plywood product offerings increase and more consistent supply-demand dynamics emerge, we expect our gross margins will gradually improve.

1.4 Business Strategy

We are North America's largest distributor in our industry and are focused on leveraging our size, capabilities, and strong financial position to create a world class distribution company. We expect to achieve $1.5 billion of sales within 5 years, as well as improve profitability. 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, vendor relationships, and supporting infrastructure, and responding to evolving customer demand and end-user preferences with innovative products.

ii) 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.

iii) Continue to **pursue acquisitions** that complement our strategies: With our size, scale and strong balance sheet, we are uniquely positioned to continue pursuing growth by acquisition. The highly fragmented nature of the US architectural building products industry also provides numerous opportunities for acquisition-based growth. 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 Far West, Plywood, Eagle and D&R are all recent examples of our ability to expand our presence in existing markets.

1.5 Outlook

2019 Market Outlook

Our long-term view on US housing demand remains positive, supported by the current level of housing starts relative to the long-term average, low levels of current housing inventory due to the slow pace of the recovery, and the favourable demographic characteristics of US consumers. In the near term, most forecasters are predicting at least a modest level of growth for residential construction in 2019. In addition, Harvard's Center for Joint Housing predicts 5.2% growth for the US repair and renovation market. In the non-residential construction market, spending is expected to continue growing in 2019, with consensus growth estimates of 4.4% as per the American Institute of Architects.

In Canada, we anticipate nominal growth across our end-markets.

We note that our business in both the US and Canada is well diversified across new residential construction, repair and remodel, non-residential construction, and the wide range of other end-markets that we serve. We also benefit from a diversified and high-value mix of architectural building products, including high-value hardwood lumber, fancy hardwood plywood, decorative laminates, composite panels, hardware, coatings, doors and countertops. Our higher-value decorative products generally benefit from stable pricing.

2019 Company Outlook

We expect first quarter sales this year to be in line with the first quarter of 2018. This reflects lost sales days due to weather, and continued uneven market sentiment as it relates to certain US construction sectors.

For the balance of the fiscal year, we anticipate low-to-mid single digit organic growth in the US and nominal organic growth in Canada as we continue to implement our strategic initiatives in 2019. With a strong balance sheet and a pipeline of attractive regional acquisition opportunities, we are also well positioned to build both our top and bottom line with accretive acquisition-based growth.

Gross profit percentage is expected to remain in the 17%-18%. The potential impact of items noted in Section 1.3 on supply-demand dynamics remains to be seen.

Moving forward, we will continue to pursue our successful strategies of capturing market share in the US, gaining additional market share in strategic product categories, optimizing our platform, and capitalizing on opportunities in the fragmented US distribution market to grow through acquisition.

Capital allocation

We generate significant cash flow from operations before working capital. For the coming year, our capital allocation priorities include:

- investing in working capital to support anticipated organic growth in our sales;
- ensuring continued responsible management of the balance sheet;
- executing on our acquisitions pipeline; and,
- continuing to return value to shareholders in the form of dividends and share re-purchases.

On February 1, 2019 we announced that the TSX accepted our notice to initiate a normal course issuer bid. We believe that the underlying share value of HDI may not be reflected in the current market price of our shares and, as a result, will consider share repurchases depending upon future price movements, our capital allocation priorities, and other factors.

Project: Calgary Public Library
Millwork Trade: Executive Millwork Inc.
Designed by: Snohetta and DIALOG
Material: 455,000 LFT Hemlock FSC Certified

2.0 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 14, 2019 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, Hardwoods of Michigan, is a fully integrated producer and exporter of high quality, value-added hardwood lumber.

Approximately 22% of our 2018 sales were made up of decorative surfaces and composites, such as high pressure laminates, thermally fused laminates, medium-density fiberboard, and particleboard. Approximately 34% of our sales were of hardwood plywood, 22% of our sales were high-grade hardwood lumber, and 22% 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 suppliers manufacturing 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 primary manufacturers to get their product to thousands of fabrication 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.

Arauco TFL Taction Oak Series – Ginger

3.0 Results of Operations

3.1 Years Ended December 31, 2018 and December 31, 2017

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

	For the year ended December 31 2018	For the year ended December 31 2017	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 1,134,267	$ 1,045,840	$ 88,427	8.5 %
Sales in the US (US$)	*766,662*	*699,776*	66,886	9.6 %
Sales in Canada	*140,903*	*137,110*	3,793	2.8 %
Gross profit	200,548	191,875	8,673	4.5 %
Gross profit %	*17.7%*	*18.3%*		
Operating expenses	(154,213)	(142,790)	11,423	8.0 %
Profit from operating activities	46,335	49,085	(2,750)	(5.6)%
Add: Depreciation and amortization	6,847	6,504	343	5.3 %
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 53,182	$ 55,589	$ (2,407)	(4.3)%
EBITDA as a % of revenue	*4.7%*	*5.3%*		
Add (deduct):				
Depreciation and amortization	(6,847)	(6,504)	(343)	
Net finance income (expense)	(3,398)	(2,502)	(896)	
Income tax expense	(10,778)	(16,629)	5,851	
Profit for the period	$ 32,159	$ 29,954	$ 2,205	7.4 %
Basic profit per share	$ 1.50	$ 1.40		
Diluted profit per share	$ 1.49	$ 1.39		
Average Canadian dollar exchange rate for one US dollar	$ 1.296	$ 1.299		

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

	For the year ended December 31 2018	For the year ended December 31 2017	$ Increase (Decrease)	% Increase (Decrease)
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	$ 53,182	$ 55,589	$ (2,407)	(4.3)%
Non-cash LTIP expense	2,096	3,287	(1,191)	
Allowance for duty deposits paid	880	—	880	
Transaction expenses	89	273	(184)	
Adjusted EBITDA	$ 56,247	$ 59,149	$ (2,902)	(4.9)%
Adjusted EBITDA as a % of revenue	*5.0%*	*5.7%*		
Profit for the period, as reported	$ 32,159	$ 29,954	$ 2,205	7.4 %
Other adjustments, net of tax	2,623	3,307	(684)	
Adjusted Profit	$ 34,782	$ 33,261	$ 1,521	4.6 %
Basic profit per share, as reported	$ 1.50	$ 1.40	$ 0.10	7.1 %
Net impact of above items per share	0.12	0.15	(0.03)	
Adjusted basic profit per share	$ 1.62	$ 1.55	$ 0.07	4.5 %
Diluted profit per share, as reported	$ 1.49	$ 1.39	$ 0.10	7.2 %
Net impact of above items per share	0.12	0.15	(0.03)	
Adjusted diluted profit per share	$ 1.61	$ 1.54	$ 0.07	4.5 %

Sales

For the year ended December 31, 2018, total sales increased 8.5% to $1,134.3 million, from $1,045.8 million in 2017. Of the $88.4 million year-over-year increase, $64.1 million, representing a 6.1% increase in sales, was due to organic growth and $26.5 million, representing a 2.5% increase in sales, was due to the addition of Acquired Businesses. These gains were partially offset by a $2.2 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$66.9 million, or 9.6%, to US$766.7 million, from US$699.8 million in 2017. Organic growth provided a US$46.4 million, or 6.6%, increase in sales, and reflects increased volumes, as well as some price inflation on certain product lines. The Acquired Businesses contributed sales of US$20.4 million.

Sales in Canada increased by $3.8 million, or 2.8%, 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, 2018 increased 4.5% to $200.5 million, from $191.9 million in 2017. This $8.7 million improvement reflects higher sales, partially offset by a lower gross profit margin. As a percentage of sales, gross profit margin decreased to 17.7% in 2018, from 18.3% in 2017, primarily reflecting the impacts described in Section 1.3.

Operating Expenses

For the year ended December 31, 2018, operating expenses increased to $154.2 million, from $142.8 million in 2017. The $11.4 million increase includes $6.2 million of added costs to support organic growth, the addition of $4.8 million of operating expenses related to acquired businesses, and $0.9 million for an allowance related to duty deposits receivable. These increases were partially offset by a $0.2 million decrease in transaction costs and a $0.3 million foreign exchange impact related to a stronger Canadian dollar on translation of US operating expenses. As a percentage of sales, operating expenses decreased to 13.6% from 13.7% year-over-year

EBITDA and Adjusted EBITDA

For the year ended December 31, 2018, we reported EBITDA of $53.2 million as compared to $55.6 million for the same period in the prior year. The $2.4 million reduction includes the impact of a lower gross profit percentage on sales. Adjusted EBITDA was $56.2 million, a decrease of $2.9 million from $59.1 million in the same period in 2017.

Beginning in fiscal 2019 we will be adopting IFRS 16 - Leases, which will result in a significant change to the way certain leases are measured and presented in our financial results. The new standard includes a reclassification of a material amount of facility costs from selling and distribution expense (which is included as a cost in the calculation of EBITDA and Adjusted EBITDA), to depreciation and interest (which is excluded as a cost in the calculation of EBITDA and Adjusted EBITDA). While the new standard will impact our calculation of EBITDA and Adjusted EBITDA, it will not result in a significant change to net earnings over the life of each lease.

We will be adopting this new standard on a retrospective basis, meaning that our 2018 results will be restated for 2019. Please refer to Section 7.2 for further details.

Net Finance Income (Cost)

We recorded a net finance expense of $3.4 million in 2018 as compared to $2.5 million in 2017. The $0.9 million year-over-year increase relates primarily to interest on bank indebtedness.

Income Tax Expense

Income tax expense decreased to $10.8 million for the year ended December 31, 2018, from $16.6 million in 2017. The decrease was primarily driven by the lower effective tax rate in the US that came into effect in 2018, and a decrease in taxable income as compared to 2017.

Profit for the Period

Profit for the year ended December 31, 2018 increased 7.4% to $32.2 million, from $30.0 million in 2017. The $2.2 million improvement primarily reflects the decrease in income tax expense of $5.9 million, partially offset by the $2.4 million decrease in EBITDA, a $0.9 million increase in net finance expense, and a $0.3 million increase in depreciation and amortization. Diluted profit per share increased to $1.49 from $1.39, a 7.2% gain as compared to 2017.

3.2 Three-Month Periods Ended December 31, 2018 and December 31, 2017

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

	Three months ended December 31 2018	Three months ended December 31 2017	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 274,985	$ 249,536	$ 25,449	10.2 %
Sales in the US (US$)	*182,933*	*171,066*	11,867	6.9 %
Sales in Canada	*33,232*	*32,041*	1,191	3.7 %
Gross profit	47,440	44,503	2,937	6.6 %
Gross profit %	*17.3%*	*17.8%*		
Operating expenses	(38,920)	(35,112)	3,808	10.8 %
Profit from operating activities	8,520	9,391	(871)	(9.3)%
Add: Depreciation and amortization	1,803	1,608	195	12.1 %
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 10,323	$ 10,999	$ (676)	(6.1)%
EBITDA as a % of revenue	*3.8%*	*4.4%*		
Add (deduct):				
Depreciation and amortization	(1,803)	(1,608)	(195)	
Net finance income (expense)	(714)	(677)	(37)	
Income tax expense	(1,929)	(3,770)	1,841	
Profit for the period	$ 5,877	$ 4,944	$ 933	18.9 %
Basic profit per share	$ 0.27	$ 0.23		
Diluted profit per share	$ 0.27	$ 0.23		
Average Canadian dollar exchange rate for one US dollar	$ 1.320	$ 1.271		

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

	Three months ended December 31 2018	Three months ended December 31 2017	$ Increase (Decrease)	% Increase (Decrease)
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per the table above	$ 10,323	$ 10,999	$ (676)	(6.1)%
Non-cash LTIP expense	(261)	558	(819)	
Adjusted EBITDA	$ 10,062	$ 11,557	$ (1,495)	(12.9)%
Adjusted EBITDA as a % of revenue	*3.7%*	*4.6%*		
Profit for the period, as reported	$ 5,877	$ 4,944	$ 933	18.9 %
Other adjustments, net of tax	(268)	531	(799)	
Adjusted Profit	$ 5,609	$ 5,475	$ 134	2.4 %
Basic profit per share, as reported	$ 0.27	$ 0.23	$ 0.04	17.4 %
Net impact of above items per share	(0.01)	0.02	(0.03)	
Adjusted basic profit per share	$ 0.26	$ 0.25	$ 0.01	4.0 %
Diluted profit per share, as reported	$ 0.27	$ 0.23	$ 0.04	17.4 %
Net impact of above items per share	(0.01)	0.02	(0.03)	
Adjusted diluted profit per share	$ 0.26	$ 0.25	$ 0.01	4.0 %

Sales

For the three months ended December 31, 2018, total sales increased 10.2% to $275.0 million, from $249.5 million during the same period in 2017. Of the $25.4 million year-over-year increase, $12.3 million, representing a 4.9% increase in sales, was due to organic growth and $4.3 million, representing a 1.7% increase in sales, was due to the addition of Acquired Businesses. The remaining $8.8 million of sales gain reflects the positive foreign exchange impact resulting from a stronger US dollar when translating our US sales to Canadian dollars for reporting purposes, as compared to the same period in 2017.

Fourth quarter sales from our US operations increased by US$11.9 million, or 6.9%, to US $182.9 million, from US$171.1 million in Q4 2017. Organic growth accounted for US$8.6 million of the gain, representing a 5.0% increase in sales, and reflects increased volumes. Growth from acquired businesses contributed additional sales of US$3.3 million.

Fourth quarter sales in Canada increased by $1.2 million, or 3.7%, as compared to the same period in 2018. The increase in Canadian sales was entirely organic and reflects our success in winning new business.

Gross Profit

Gross profit for the three months ended December 31, 2018 increased 6.6% to $47.4 million, from $44.5 million in the fourth quarter of 2017. This $2.9 million improvement reflects higher sales, partially offset by a lower gross profit margin. As a percentage of sales, gross profit margin was 17.3% as compared to 17.8% in the fourth quarter of 2017, primarily reflecting the impacts described in Section 1.3.

Operating Expenses

Operating expenses increased to $38.9 million in the fourth quarter of 2018, from $35.1 million during the same period in 2017. The $3.8 million increase includes $1.9 million of added costs to support organic growth, $1.3 million related to the foreign exchange impact of a stronger US dollar on translation of US operating expenses, and the addition of $0.7 million of operating expenses related to acquired businesses. As a percentage of sales, operating expenses remained stable at 14.2% in fourth quarter as compared to 14.1% in the same period in 2017.

EBITDA and Adjusted EBITDA

For the three months ended December 31, 2018, we reported EBITDA of $10.3 million as compared to $11.0 million for the same period in the prior year. The $0.7 million reduction primarily reflects the increase in gross profit of $2.9 million, offset by the $3.8 increase in operating expenses. Adjusted EBITDA was $10.1 million, a decrease of $1.5 million from $11.6 million in the same period in 2017.

Income Tax Expense

Income tax expense decreased to $1.9 million in the fourth quarter of 2018, from $3.8 million in the same period in 2017. The decrease was primarily driven by the lower effective tax rate in the US that came into effect in 2018, together with a decrease in taxable income as compared to the fourth quarter of 2017.

Profit for the Period

Profit for the three months ended December 31, 2018 increased 18.9% to $5.9 million, from $4.9 in Q4 2017. The $0.9 million improvement primarily reflects the $1.8 million decrease in income tax expense, partially offset by the $0.7 million decrease in EBITDA and a $0.2 million increase in depreciation and amortization. Diluted profit per share increased to $0.27 from $0.23, a 17.4% gain, as compared to 2017.

4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4 2018	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017
Total sales	$ 274,985	$ 290,354	$ 298,172	$ 270,755	$ 249,536	$ 259,483	$ 277,545	$ 259,276
Profit	5,877	8,142	9,959	8,180	4,944	7,312	9,762	7,936
Basic profit per share	0.27	0.38	0.46	380.00	0.23	0.34	0.46	0.37
Diluted profit per share	0.27	0.38	0.46	380.00	0.23	0.34	0.45	0.37
EBITDA	10,322	14,010	15,877	12,974	10,999	13,356	17,216	14,003
Adjusted profit	5,609	9,205	11,249	8,691	5,475	9,046	10,593	8,048
Adjusted basic profit per share	0.26	0.43	0.52	0.40	0.25	0.42	0.50	0.38
Adjusted diluted profit per share	0.26	0.43	0.52	0.40	0.25	0.42	0.49	0.38
Adjusted EBITDA	10,061	15,182	17,432	13,540	11,557	15,225	18,118	14,135

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 and by changes in the foreign exchange rate of the Canadian and US dollars.

4.2 Annual Financial Information

(in thousands of dollars except per unit amounts)	For the year ended Dec 31 2018	For the year ended Dec 31 2017	For the year ended Dec 31 2016
Total sales	$ 1,134,267	$ 1,045,840	$ 795,467
Profit	32,159	29,954	23,862
Basic profit per share	1.50	1.40	1.27
Fully diluted profit per share	1.49	1.39	1.25
Total assets	444,760	372,903	371,076
Total non-current financial liabilities	3,255	1,513	1,877
EBITDA	53,182	55,589	43,713

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		
	2018	2017	$ change	2018	2017	$ change
Cash provided by operating activities before changes in non-cash working capital	$ 44,209	$ 42,095	$ 2,114	$ 7,073	$ 8,529	$ (1,456)
Changes in non-cash working capital	(40,195)	(24,191)	(16,004)	19,592	11,869	7,722
Net cash provided by operating activities	4,014	17,904	(13,890)	26,665	20,398	6,266
Net cash provided by (used in) investing activities	(8,900)	(9,960)	1,060	(1,962)	(828)	(1,133)
Net cash provided by (used in) financing activities	6,120	(8,397)	14,517	(23,481)	(19,580)	(3,901)
Increase (decrease) in cash	1,234	(453)	1,687	1,222	(10)	1,233
Cash, beginning of period	313	766	(453)	325	322	4
Cash, end of the period	$ 1,547	$ 313	$ 1,234	$ 1,547	$ 312	$ 1,235

Net cash used in operating activities

For the year ended December 31, 2018, net cash provided by operating activities was $4.0 million compared to $17.9 million in 2017. Cash provided by operating activities before changes in non-cash working capital increased by $2.1 million year-over-year, primarily reflecting a decrease in taxes paid of $6.9 million, partially offset by a decrease in EBITDA of $2.4 million, a decrease in share-based compensation of $1.2 million, and an increase in interest paid of $1.2 million. Investment in non-cash working capital increased by $16.0 million in 2018, compared to 2017. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2018, net cash provided by operating activities increased to $26.7 million, from $20.4 million in the same period in 2017. Cash provided by operating activities before changes in non-cash working capital decreased by $1.5 million, primarily reflecting a decrease in income taxes paid of $0.3 million, partially offset by a $0.7 million decrease in EBITDA, a $0.8 million decrease in share-based compensation expense, and an increase in interest paid of $0.4. Investment in non-cash working capital decreased by $7.7 million in the fourth quarter of 2018, compared to the fourth quarter of 2017. 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 $1.1 million to $8.9 million in 2018, from $10.0 million in 2016. This change primarily relates to a decrease in cash used for business acquisitions, partially offset by an increase in additions to property, plant and equipment.

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, 2018 cash used in investing activities increased by $1.1 million. This increase primarily relates to purchases of property, plant and equipment.

Net cash provided by financing activities

For the year ended December 31, 2018, net cash provided by financing activities increased by $14.5 million as compared to 2017. For three months ended December 31, 2018, net cash used in financing activities increased by $3.9 million as compared to the same period in 2017. 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 year the three months ended December 31, 2018.

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 $301.0 million as at December 31, 2018, compared to $236.0 million at December 31, 2017. 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 includes increased purchasing

of certain product lines to secure supply, and higher costs for certain product lines resulting from price appreciation in the market.

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, 2018 and 2017 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	2018	2017	2018	2017
Accounts receivable	$ (5,915)	$ (6,813)	$ 14,121	$ 10,833
Inventory	(33,290)	(8,685)	5,624	2,715
Prepaid expenses	932	(2,737)	4,214	(396)
Accounts payable, accrued liabilities and provisions	(1,922)	(5,956)	(4,367)	(1,282)
Increase in non-cash operating working capital	$ (40,195)	$ (24,191)	$ 19,592	$ 11,870

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

5.3 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	**As at December 31, 2018**	**As at December 31, 2017**
Cash	$ 1,547	$ 313
Bank indebtedness	112,940	91,146
Net Debt	111,393	90,833
Shareholders' equity	285,932	238,826
Total Capitalization	$ 397,325	$ 329,659
Net debt to total capitalization	28.0%	27.6%
Previous 12 months Adjusted EBITDA	$ 56,247	$ 59,149
Net debt to previous 12 months Adjusted EBITDA	2.0	1.5

We consider our capital to be bank indebtedness (net of cash) and shareholders' equity. As shown above, our net debt balance increased by $20.6 million to $111.4 million at December 31, 2018, from $90.8 million at December 31, 2017. Overall net debt compared to total capitalization was 28.0% as at December 31, 2018, as compared 27.6% at December 31, 2017. Our ratio of

net debt-to-Adjusted EBITDA for the previous 12 months was 2.0 times, compared to 1.5 times at December 31, 2017.

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, 2018 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	$ 170.5 million (US$125.0 million)
Credit facility expiry date	August 5, 2021	July 14, 2021
Available to borrow	$ 22.5 million	$ 167.8 million (US$123.1 million)
Credit facility borrowings	$ 10.6 million	$ 101.3 million (US$74.4 million)
Unused credit facility	$ 11.9 million	$ 66.5 million (US$48.7 million)
Financial covenants:	Covenants do not apply when the unused credit facility available exceeds $2.0 million	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

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, 2018. Accordingly, there were no restrictions on dividends arising from non-compliance with financial covenants.

We have a US credit facility ("the USLP II Credit Facility") and a Canadian credit facility ("the LP Credit Facility"). The USLP II Credit Facility 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 unused availability under the USLP II Credit Facility falls below US$12.5 million 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. We were in compliance with these covenants as at December 31, 2018.

The LP Credit Facility 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 unused 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, 2018.

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, 2018. These obligations relate to leases on various premises and automobiles and become due in the fiscal years indicated.

(in thousands of dollars)						
2019	**2020**	**2021**	**2022**	**2023**	**thereafter**	**Total**
$23,472	$21,507	$19,488	$17,269	$14,139	$28,988	$124,863

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 14, 2019, the date of this MD&A, we had 21,539,116 common shares issued and outstanding. In addition, at March 14, 2019, we had outstanding 88,535 performance shares and 128,514 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 2018, we declared a quarterly dividend of $0.08 per share, which was paid on January 25, 2019 to shareholders of record as at January 14, 2019. On March 14, 2019 we declared a quarterly dividend of $0.08 per share, payable on April 26, 2019 to shareholders of record as at April 15, 2019. 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, capital utilized under our normal course issuer bid, 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, 2018 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

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

Effective January 1, 2018, we adopted IFRS 15 which replaced 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 did not significantly impact the measurement of revenue generated from the sale of our products to customers and therefore, had no impact on earnings. The adoption of this standard did impact the presentation of freight recovered, which is now included in sales instead of cost of goods sold on the consolidated statements of comprehensive income. For the years ended December 31, 2018 and December 31, 2017 the freight recovered was $9.4 million and $8.8 million respectively. Comparative figures have been reclassified to conform with the current period presentation.

IFRS 9, Financial Instruments ("IFRS 9")

Effective January 1, 2018, we adopted IFRS 9 which replaced 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. IFRS 9 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 adoption of IFRS 9 did not have an impact on the consolidated financial statements given the nature of our operations and the types of financial instruments that we currently hold. There was no change in the classification or measurement of our financial assets and liabilities with the exception of the use of the expected credit loss model to determine the allowance for credit loss for trade accounts receivable. The application of the expected credit loss model to determine the allowance for credit loss had a nominal effect on the December 31, 2017 consolidated financial statements and therefore prior period amounts have not been restated.

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. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. Upon adoption of IFRS 16, our operating leases, which are principally comprised of our warehouse facilities and automobiles, will be recorded in the statement of financial position with a right-of-use asset and a corresponding lease obligation.

We have determined that the adoption of IFRS 16 will have a material impact on our consolidated financial statements. We expect to apply IFRS 16 retroactively on January 1, 2019. The impact is expected to result in the following changes for the periods noted.

Statement of Financial Position		As at January 1, 2019
Right of use asset	increase to assets	$ 93.4
Lease obligation	increase to liabilities	$ 108.9
Other liabilities	decrease to liabilities	$ 1.1
Retained earnings	decrease to equity	$ 10.8
Deferred tax asset, net	increase to assets	$ 3.6
Statement of Comprehensive Income		**Year Ended December 31, 2018**
Selling and distribution	decrease	$ (2.7)
Cost of goods sold	decrease	$ (0.7)
Finance expense	increase	$ 4.6
Net profit	decrease	$ 0.9
Net profit per share	decrease	$ 0.04
Statement of Cash Flows		**Year Ended December 31, 2018**
Cash provided by operating activities	increase	$ 22.1
Cash provided by financing activities	decrease	$ (22.1)
Other		**Year Ended December 31, 2018**
EBITDA and Adjusted EBITDA	increase	$ 22.1

The figures presented may change as a result of finalizing adjustments required on transition during the first quarter of 2019. Application of the new standard is not expected to have a negative impact on any bank covenant calculations.

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, 2018. 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, 2018.

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, 2018. 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, 2018.

There have not been any changes in our ICFR during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our ICFR.

10.0 Note Regarding Forward Looking Information

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

The forward-looking information in this MD&A includes, but is not limited to: we view the potential imposition of AD and CVD duties on cabinet products imported from China as positive, as it could increase demand from our primary customer base, domestic cabinet manufacturers; as volumes related to our new proprietary hardwood plywood product offerings increase and more consistent supply-demand dynamics emerge, we expect our gross margins will gradually improve; we expect to achieve $1.5 billion of sales within 5 years, as well as improve profitability; our long-term view on housing demand remains positive; in the near term, most forecasters are predicting at least a modest level of growth for residential construction in 2019; Harvard's Center for Joint Housing predicts 5.2% growth for the US repair and renovation market; in the non-residential construction market, spending is expected to continue growing in 2019, with consensus growth estimates of 4.4% as per the American Institute of Architects; in Canada, we anticipate nominal growth across our end-markets; we expect first quarter sales this year to be in line with the first quarter of 2018; for the balance of the fiscal year, we anticipate low-to-mid single digit organic growth in the US and nominal organic growth in Canada as we continue to implement our strategic initiatives in 2019; with a strong balance sheet and a pipeline of attractive regional acquisition opportunities, we are also well positioned to build both our top and bottom line with accretive acquisition-based growth; gross profit percentage is expected to remain in the 17%-18% range until more consistent supply-demand dynamics in the hardwood plywood market emerge; moving forward, we will continue to pursue our successful strategies of capturing market share in the US, gaining additional market share in strategic product categories, optimizing our platform, and capitalizing on opportunities in the fragmented US distribution market to grow through acquisition; historically, the first and fourth quarters have been seasonally slower periods for our business; capital expenditures in our distribution business have historically been low; we believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment; our investment in working capital fluctuates from quarter-to-quarter; 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; we intend to issue common shares from treasury to settle the portion of the obligation not paid to employees in cash; As it relates to IFRS 16 disclosures the figures presented may change as a result of finalizing adjustments required on transition during the first quarter of 2019; and application of IFRS 16 is not expected to have a negative impact on any bank covenant calculations.

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 Hardwoods Distribution Inc.

Opinion

We have audited the consolidated financial statements of Hardwoods Distribution Inc. (the Entity), which comprise:

- the consolidated statements of financial position as at December 31, 2018 and December 31, 2017;
- the consolidated statements of comprehensive income for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2018 and December 31, 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other Information

Management is responsible for the other information. Other information comprises:

- the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions
- the information, other than the financial statements and the auditors' report thereon, included in the "2018 Hardwoods Distribution Annual Report".

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis and the 2018 Hardwoods Distribution Annual Report filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Entity to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

KPMG LLP

Chartered Professional Accountants

The engagement partner on the audit resulting in this auditors' report is Andrew James.

Vancouver, Canada

March 14, 2019

Consolidated Financial Statements
(Expressed in Canadian dollars)

HARDWOODS DISTRIBUTION INC.

Years ended December 31, 2018 and 2017

HARDWOODS DISTRIBUTION INC.

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

	Note	December 31, 2018	December 31, 2017
Assets			
Current assets:			
Cash		$ 1,547	$ 313
Accounts and other receivables	7	112,005	97,263
Income taxes receivable		789	1,582
Inventories	8	223,785	172,106
Prepaid and other assets		4,594	5,268
Total current assets		342,720	276,532
Non-current assets:			
Non-current receivables	7	1,857	1,359
Property, plant and equipment	9	24,184	20,650
Intangible assets	10	16,828	17,215
Deferred income taxes	14	3,051	5,477
Goodwill		56,120	51,670
Total non-current assets		102,040	96,371
Total assets		$ 444,760	$ 372,903
Liabilities			
Current liabilities:			
Bank indebtedness	11	$ 112,940	$ 91,146
Accounts payable and accrued liabilities	13(b)	39,387	38,254
Finance lease obligation	12(a)	1,529	1,281
Dividend payable	5	1,717	1,549
Total current liabilities		155,573	132,230
Non-current liabilities:			
Finance lease obligation	12(a)	2,018	1,068
Other liabilities	13(b)	1,237	779
Total non-current liabilities		3,255	1,847
Total liabilities		158,828	134,077
Shareholders' equity			
Share capital	13(a)	116,524	113,788
Contributed surplus		104,467	105,426
Retained earnings		35,530	9,919
Accumulated other comprehensive income		29,411	9,693
Shareholders' equity		285,932	238,826
Total liabilities and shareholders' equity		$ 444,760	$ 372,903

Subsequent event (note 4 and 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, 2018 and 2017

	Note	2018	2017
Sales	16	$ 1,134,267	$ 1,045,840
Cost of goods sold	8	(933,719)	(853,965)
Gross profit		200,548	191,875
Operating expenses:			
Selling and distribution		(118,215)	(106,402)
Administration		(35,998)	(36,388)
		(154,213)	(142,790)
Profit from operations		46,335	49,085
Finance expense	15	(4,350)	(3,018)
Finance income	15	952	516
Net finance expense		(3,398)	(2,502)
Profit before income taxes		42,937	46,583
Income tax expense:			
Current	14	(8,287)	(10,781)
Deferred	14	(2,491)	(5,848)
		(10,778)	(16,629)
Net profit		32,159	29,954
Other comprehensive income:			
Exchange differences translating foreign operations		19,718	(13,869)
Total comprehensive income		$ 51,877	$ 16,085
Basic net profit per share	13(c)	$ 1.50	$ 1.40
Diluted net profit per share	13(c)	$ 1.49	$ 1.39

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, 2018 and 2017

	Note	Share capital	Contributed surplus	Accumulated other comprehensive income - translation reserve	Retained earnings (deficit)	Total
Balance at January 1, 2017		$ 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
Share based compensation expense	13 (b)	—	2,593	—	—	2,593
Shares issued pursuant to LTIP	13 (b)	2,736	(2,736)	—	—	—
Shares reclassified to liabilities		—	(816)	—	—	(816)
Profit for the year		—	—	—	32,159	32,159
Dividends declared		—	—	—	(6,548)	(6,548)
Translation of foreign operations		—	—	19,718	—	19,718
Balance at December 31, 2018		$ 116,524	$ 104,467	$ 29,411	$ 35,530	$ 285,932

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, 2018 and 2017

	Note	2018	2017
Cash flow from operating activities:			
Profit for the year		$ 32,159	$ 29,954
Adjustments for:			
Depreciation and amortization	9,10	6,847	6,504
Gain on sale of property, plant and equipment	9	(156)	(204)
Gain on bargain purchase	4(b)	(92)	—
Share-based compensation expense	13(b)	2,096	3,287
Income tax expense	14	10,778	16,629
Net finance expense	15	3,398	2,502
Interest received		513	451
Interest paid		(3,938)	(2,736)
Income taxes paid		(7,396)	(14,292)
		44,209	42,095
Changes in non-cash working capital:			
Accounts receivable		(5,915)	(6,813)
Inventories		(33,290)	(8,685)
Prepaid expenses		932	(2,737)
Accounts payable and accrued liabilities		(1,922)	(5,956)
		(40,195)	(24,191)
Net cash provided by operating activities		4,014	17,904
Cash flow from financing activities:			
Increase (decrease) in bank indebtedness		13,955	(1,173)
Principle payments on finance lease obligation		(1,396)	(1,197)
Note repayment		(60)	(467)
Dividends paid to shareholders	5	(6,379)	(5,560)
Net cash provided by (used in) financing activities		6,120	(8,397)
Cash flow from investing activities:			
Additions to property, plant and equipment	9	(4,076)	(2,257)
Proceeds on disposal of property, plant and equipment		452	458
Business acquisitions	4	(4,843)	(8,210)
Additions to internally generated software	10	(280)	(329)
Payments (made) received on non-current receivables		(153)	378
Net cash used in investing activities		(8,900)	(9,960)
Increase (decrease) in cash		1,234	(453)
Cash, beginning of year		313	766
Cash, end of year		$ 1,547	$ 313
Supplementary information:			
Property, plant and equipment acquired under finance leases, net of disposals		$ 2,396	$ 1,689
Future cash settlement of LTIP's in accrued liabilities and non-current liabilities		816	287
Transfer of accounts receivable to non-current customer notes receivable		136	632

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

1. Nature of operations:

Hardwoods Distribution Inc. (the "Company") is incorporated under the Canada Business Corporations Act and trades on the Toronto Stock Exchange under the symbol "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 14, 2019.

(b) Basis of measurement:

These consolidated financial statements have been prepared on the historical cost basis. Certain comparative figures have been restated to conform with the current years presentation.

(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(j) - 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; and
- Note 14 - the valuation of deferred income taxes and utilization of tax loss carry forwards.

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 and valuation of lease obligations.

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

2. Basis of preparation (continued):

(d) Use of estimates and judgment (continued):

expiry. In making such a determination, the Company considers the carry forward periods of losses and the Company's projected future taxable income.

3. Significant accounting policies:

The significant accounting policies that have been used in the preparation of these consolidated financial statements are summarized below. These accounting policies have been applied consistently by the Company and its subsidiaries to all years presented in these consolidated financial statements.

(a) Principles of consolidation and business acquisitions:

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

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. Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated to the functional currency at the exchange rate when the fair value was determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated at the exchange rate at the date of the transaction. Foreign currency differences are generally recognized in the profit or loss and presented within 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.

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 based on the consideration specified in the invoice with a customer and excludes amounts collected on behalf of third parties. The Company recognizes revenue at a point in time when control of the goods is transferred to the customer. The Company satisfies its performance obligation and control of the goods is transferred to the customer generally when the customer has taken delivery of the goods. No component of the transaction price is allocated to unsatisfied performance obligations.

(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 control 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.

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 begins when the software is substantially completed and ready for use. Costs capitalized for internally generated software are amortized on a straight-line basis over their estimated useful life of 10 years and are measured at cost less accumulated amortization.

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

(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 balance of $56.1 million (US$41.1 million) as at December 31, 2018 (December 31, 2017 - $51.2 million (US$41.1 million)) 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 3.5%. The growth rate is consistent with past experience, market conditions and actual operating results for the Rugby operations.

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 9.79% 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, 2018, 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.

The allowance for credit loss is determined using both specific identification of customer accounts and the expected credit loss model. The Company uses an estimate of the net recoverable amount for specific customer accounts it has identified and the expected credit loss model for the remaining customer accounts based on historical experience of uncollectable amounts. Accounts that are considered uncollectable are written off.

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.

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.

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.

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

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 policies:

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

Effective January 1, 2018, the Company adopted IFRS 15 which replaced 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 did not significantly impact the measurement of revenue generated from the sale of the Company's products to customers and therefore, had no impact on earnings. The adoption of this standard did impact the presentation of freight recovered which is now included in sales instead of cost of goods sold on the consolidated statements of comprehensive income. For the year ended December 31, 2018, the freight recovered was $9.4 million (December 31, 2017 - $8.8 million). Comparative figures have been reclassified to conform with the current period presentation.

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

Effective January 1, 2018, the Company adopted IFRS 9 which replaced 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. IFRS 9 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 adoption of IFRS 9 did not have an impact on the consolidated financial statements given the nature of the Company's operations and the types of financial instruments that it currently holds. There was no change in the classification or measurement of the Company's financial assets and liabilities with the exception of the use of the expected credit loss model to determine the allowance for credit loss for trade accounts receivable. The application of the expected credit loss model to determine the allowance for credit loss had a nominal effect on the December 31, 2017 consolidated financial statements and therefore prior period amounts have not been restated.

The Company's new policy is the allowance for credit loss is determined using both specific identification of customer accounts and the expected credit loss model. The Company uses an estimate of the net recoverable amount for specific customer accounts it has identified and the expected credit loss model for the remaining customer accounts based on historical experience of uncollectable amounts. Accounts that are considered uncollectable are written off.

(s) Future accounting pronouncement:

A number of new standards, amendments to standards and interpretations, are not yet effective for the year ended December 31, 2018, and have not been applied in preparing these consolidated financial statements. The following pronouncement is considered by the Company to be the most significant of several pronouncements that may affect the consolidated financial statements in future periods.

3. Significant accounting policies (continued):

(s) Future accounting pronouncement (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 right-of-use asset and a corresponding lease obligation.

The Company has determined the adoption of IFRS 16 will have a material impact on the consolidated financial statements. The Company expects to apply IFRS 16 retroactively on January 1, 2019. The impact on the opening balance sheet at January 1, 2018, is estimated to be an increase to property, plant and equipment of $105.5 million, increase to finance lease obligations of $118.9 million, increase to net deferred tax assets of $3.3 million, and decrease to retained earnings of $10.1 million. The impact on the consolidated statement of comprehensive income for the year ended December 31, 2018 is estimated to be a decrease to cost of goods sold of $0.7 million, decrease to selling and distribution expenses of $2.7 million, increase to finance expense of $4.6 million, and a decrease to net profit of $0.9 million.

4. Business acquisitions:

(a) Atlanta Hardwood Corporation acquisition

On June 11, 2018, the Company acquired through one of its wholly owned subsidiaries certain of the distribution assets and assumed certain liabilities of Atlanta Hardwoods Corporation ("Atlanta") for a total value of $4.8 million (US$3.7 million). The fair value of Atlanta's identified assets acquired consisted of accounts and other receivables of $1.4 million (US$1.1 million), inventories of $3.3 million (US$2.6 million), property, plant and equipment of $0.4 million (US$0.3 million) and accrued liabilities of $0.2 million (US$0.1 million). The fair value of the assets acquired exceeded the purchase price by $0.1 million (US$0.1 million) and this excess has been recorded as income in the consolidated interim statement of comprehensive income.

The distribution assets acquired include Hardwoods of Atlanta, LLC, Hardwoods of North Georgia and Hardwoods of Alabama, LLC, operating under the trade name Hardwoods Incorporated. The Atlanta acquisition was accounted for as a business combination using the acquisition method, with the Company being the acquirer and Atlanta being the acquiree, and where the assets acquired and liabilities assumed were recorded at their fair values at the acquisition date.

(b) 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 Downs & 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 acquired and liabilities assumed 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 was 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 were recorded at their fair values at the acquisition date.

4. Business acquisitions (continued):

(c) 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 $0.6 million (US$0.5 million).

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 was 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 were recorded at their fair values at the acquisition date.

(d) Far West Plywood Company acquisition

On January 28, 2019, the Company acquired through one of its wholly owned subsidiaries substantially all of the assets and assumed certain liabilities of Far West Plywood Company ("Far West") for a total value of $4.8 million (US$3.6 million). The fair value of Far West's identified assets acquired consisted of accounts and other receivables of $0.5 million (US$0.4 million), inventories of $1.3 million (US$0.9 million), property, plant and equipment of $0.1 million (US$0.1 million) and accrued liabilities of $0.4 million (US$0.3 million). Goodwill of $3.4 million (US$2.5 million) was recognized as part of this acquisition and is attributable to the skills and talent of Far West's workforce, value of the customer base, and an increase in market share. The goodwill is deductible for tax purposes.

Far West is a single site wholesale distributer located in Northridge, California that distributes architectural building products to customers that fabricate end-products to commercial, industrial, retail, residential, and institutional construction markets. The Far West acquisition was accounted for as a business combination using the acquisition method, with the Company being the acquirer and Far West being the acquiree, and where the assets acquired and liabilities assumed were 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, 2018	December 31, 2017
Cash	$ (1,547)	$ (313)
Bank indebtedness	112,940	$ 91,146
Shareholder's equity	285,932	238,826
Total capitalization	$ 397,325	$ 329,659

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, 2018 and December 31, 2017, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Dividends and share re-purchases are some of the ways 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.

5. Capital management (continued):

On November 5, 2018, the Company declared a cash dividend of $0.08 per common share to shareholders of record as of January 14, 2019. The dividend was paid to shareholders on January 25, 2019. On March 14, 2019, the Company declared a cash dividend of $0.08 per common share to shareholders of record as of April 15, 2019, to be paid on April 26, 2019.

6. Financial instruments:

Financial instrument assets include cash and current and non-current receivables, which are designated as subsequently 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 subsequently measured at amortized cost.

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, other liabilities 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 $115.4 million at December 31, 2018 (December 31, 2017 - $98.9 million), represents the Company's maximum exposure to credit risk.

6. Financial instruments (continued):

Financial risk management (continued):

Trade accounts receivable

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The Company is exposed to credit risk in the event it is unable to collect in full amounts receivable from its customers. The Company employs established credit approval practices and engages credit attorneys when appropriate to mitigate credit risk. 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 2.0% (December 31, 2017 - 2.2%) of trade accounts receivable and customer notes receivable at December 31, 2018. 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.

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.

(*ii*) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it will have sufficient cash available to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation. At December 31, 2018, 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 $170.5 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

6. Financial instruments (continued):

Financial risk management (continued):

(*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, 2018 bank indebtedness balance of $112.9 million, a 1% increase or decrease in the interest rates charged would result in a decrease or increase to profit after tax by approximately $0.7 million.

Currency risk

As the Company conducts business in both Canada and the United States it is exposed to currency risk. Most of the products sold by the Company in Canada are purchased in U.S. dollars from suppliers in the United States. Although the Company reports its financial results in Canadian dollars, approximately 85% of its sales are generated in the United States. Changes in the currency exchange rates of the Canadian dollar against the U.S. dollar will affect the results presented in the Company's financial statements and cause its earnings to fluctuate. Changes in the costs of products purchased by the Company in the United States as a result of the changing value of the Canadian dollar against the U.S. dollar are usually absorbed by the Canadian market. When the products are resold in Canada it is generally sold at a 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, 2018, 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 (2018 - US$0.5 million, 2017 - US$0.7 million) and accounts payable to U.S. suppliers (2018 - US$0.2 million, 2017 - US$0.3 million).

Based on the Company's Canadian subsidiaries exposure to foreign denominated financial instruments, the Company estimates a $0.05 weakening or strengthening in the Canadian dollar as compared to the U.S. dollar would not have a material effect on net income for the years ended December 31, 2018 or December 31, 2017.

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, 2018 and December 31, 2017 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.

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, 2018	December 31, 2017
Trade accounts receivable - Canada	$ 13,131	$ 13,458
Trade accounts receivable - United States	97,907	79,880
Sundry receivable (note 20)	4,973	6,745
Current portion of non-current receivables	802	1,360
	116,813	101,443
Less:		
Allowance for credit loss	4,808	4,180
	$ 112,005	$ 97,263
Non-current receivables:		
Employee housing loans	$ 136	$ 257
Customer notes	570	921
Security deposits	1,953	1,541
	2,659	2,719
Less:		
Current portion, included in accounts receivable	802	1,360
	$ 1,857	$ 1,359

The aging of trade receivables is:

	December 31, 2018	December 31, 2017
Current	$ 76,206	$ 65,635
1 - 30 days past due	22,549	19,075
31 - 60 days past due	7,037	5,204
60+ days past due	5,246	3,424
	$ 111,038	$ 93,338

The Company determines its allowance for credit loss using both specific identification of customer accounts and the expected credit loss model. The Company uses an estimate of the net recoverable amount for specific customer accounts it has identified and the effective credit loss model for the remaining customer accounts based on historical experience of uncollectable amounts. Accounts that are considered uncollectable are written off. The total allowance at December 31, 2018 was $4.8 million (December 31, 2017 - $4.2 million). The amount of the allowance is considered sufficient based on the past experience of the business, current and expected collection trends, the security the Company has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

7. Accounts and other receivables (continued):

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

	2018	2017
Balance as at January 1	$ 4,180	$ 5,038
Additions during the year	599	61
Use during the year	(337)	(588)
Changes due to currency rate fluctuations	366	(331)
Balance as at December 31	$ 4,808	$ 4,180

Bad debt expense, net of recoveries, for the year ended December 31, 2018 was $0.6 million which equates to 0.05% of sales (year ended December 31, 2017 - $0.1 million, being 0.01% of sales).

8. Inventories:

	December 31, 2018	December 31, 2017
Raw materials	$ 780	$ 1,306
Work in process	4,584	4,950
Goods in-transit	12,630	7,947
Finished goods:		
Lumber	55,223	47,807
Sheet goods	110,060	77,922
Specialty	40,508	32,174
	$ 223,785	$ 172,106

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:

	2018	2017
Inventory write-downs, included in cost of goods sold	$ 2,065	$ 1,909
Cost of inventory sold	884,405	808,832
Other cost of goods sold	49,579	45,133
Total cost of goods sold	$ 933,984	$ 853,965

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, 2017	$ 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
Additions	—	2,545	3,696	380	6,621
Acquisition of Atlanta (note 4(a))	—	—	390	—	390
Disposals	—	(1,138)	(896)	(31)	(2,065)
Adjustments:					
Foreign currency transaction	68	340	2,567	74	3,049
Balance at December 31, 2018	$ 838	$ 5,969	$ 36,134	$ 1,722	$ 44,663
Accumulated depreciation					
Balance at January 1, 2017	$ —	$ 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
Depreciation	—	1,256	3,387	131	4,774
Disposals	—	(850)	(740)	(29)	(1,619)
Adjustments:					
Foreign currency transaction	—	120	1,146	40	1,306
Balance at December 31, 2018	$ —	$ 2,142	$ 17,272	$ 1,065	$ 20,479
Net book value:					
December 31, 2017	$ 770	$ 2,606	$ 16,898	$ 376	$ 20,650
December 31, 2018	$ 838	$ 3,827	$ 18,862	$ 657	$ 24,184

9. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the year ended December 31, 2018 was $4.8 million (2017 - $4.5 million) and is included in the statement of comprehensive income as follows:

	2018	2017
Cost of sales	$ 1,614	$ 1,596
Selling and distribution	2,936	2,610
Administration	224	254
	$ 4,774	$ 4,460

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2018 was a net gain of $156,000 (2017 - net gain of $204,000) and is included in selling and distribution in the statement of comprehensive income.

10. Intangible assets:

	Internally generated software	Customer relationships	Total
Cost			
Balance at January 1, 2017	$ —	$ 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
Additions	280	—	280
Adjustments:			
Foreign currency transaction	38	1,729	1,767
Balance at December 31, 2018	$ 636	$ 21,504	$ 22,140
Accumulated amortization			
Balance at January 1, 2017	$ —	$ 966	$ 966
Amortization	—	2,044	2,044
Adjustments:			
Foreign currency transaction	—	(132)	(132)
Balance at December 31, 2017	—	2,878	2,878
Amortization	6	2,067	2,073
Adjustments:			
Foreign currency transaction	—	$ 361	$ 361
Balance at December 31, 2018	$ 6	$ 5,306	$ 5,312
Net book value:			
December 31, 2017	$ 318	$ 16,897	$ 17,215
December 31, 2018	$ 630	$ 16,198	$ 16,828

Amortization of intangible assets for the year ended December 31, 2018 was $2.1 million (2017 - $2.0 million) and is included in selling and distribution expenses in the statement of comprehensive income.

11. Bank indebtedness:

		December 31, 2018		December 31, 2017
Cheques issued in excess of funds on deposit	$	1,011	$	866
Credit facility, Hardwoods LP		10,626		7,270
Credit facility, Hardwoods USLP II (December 31, 2018 - US$74,369 December 31, 2017 - US$66,323)		101,303		83,010
	$	112,940	$	91,146

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, 2018, the LP Credit Facility has unused availability of $11.9 million, before cheques issued in excess of funds on deposit of $1.0 million (December 31, 2017 - $13.5 million, cheques issued in excess of funds on deposit - $0.9 million).

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

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 USLP II Credit Facility matures in July 2021. The USLP II Credit Facility is guaranteed by certain of the Company's subsidiaries.

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.

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.

At December 31, 2018, the USLP II Credit Facility has unused availability of $66.5 million (US$48.7 million), before cheques issued in excess of funds on deposit of nil. At December 31, 2017, the USLP II Credit Facility had unused availability of $53.2 million (US$42.4 million), before cheques issued in excess of funds on deposit of nil.

The Company has letters of credit outstanding at December 31, 2018 totaling $2.6 million (US$1.9 million) (2017 - $1.3 million (US$1.0 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, 2018 were 3.5% and 3.6% (2017 - 3.0% and 2.7%) 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, 2018:			
Future minimum lease payments	$ 1,699	$ 2,288	$ 3,987
Interest	170	270	440
Present value of minimum payments	$ 1,529	$ 2,018	$ 3,547
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

The present value of the lease payments is calculated using the interest rate implicit in the lease, which range from 2.6% - 8.1%.

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, 2018	$	23,471	$	83,264	$	18,128	$	124,863

Minimum lease payments recognized as an expense during the year ended December 31, 2018 amounted to $22.2 million (2017 - $20.8 million). Sublease payments received during the year were $0.3 million (2017 - $0.1 million) and are recognized as a reduction to selling and distribution costs in the statement of comprehensive income.

The Company's warehouse leases are combined leases of the land and building; however both the land and building elements are considered operating leases as the risk and reward of ownership remains with the landlord. The Company's operating lease agreements do not contain any contingent rent clauses. Some operating warehouse lease agreements contain renewal options. 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, 2018, 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, 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
Issued pursuant to long term incentive plan	119,131		2,736
Balance at December 31, 2018	21,539,116	$	116,524

13. Share capital (continued):

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

The Company has an approved long term incentive plan which authorizes the issuance of a maximum of 2,100,000 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. Grantees have 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, 2018 the fair value of the Restricted Shares and Performance Shares estimated to be settled in the future in cash was $0.4 million (December 31, 2017 - $1.4 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.

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, 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
LTIP shares issued during the year	55,079	94,373
LTIP shares forfeited during the year	—	—
LTIP shares settled	(88,050)	(82,509)
Balance at December 31, 2018	88,535	128,514

During the year ended December 31, 2018, 88,050 (December 31, 2017 - 13,714) Performance Shares and 82,509 (December 31, 2017 - 83,089) Restricted Shares became fully vested and were settled by the issuance of 119,131 (December 31, 2017 - 69,413) Shares and $0.9 million in cash (December 31, 2017 - $0.6 million). On issuance of the Shares, the accumulated share-based compensation expense of $2.7 million (December 31, 2017 - $1.4 million) associated with the settled Performance Shares and Restricted Shares was transferred from contributed surplus to share capital.

LTIP compensation expense of $2.1 million was recognized in the consolidated statement of comprehensive income for the year ended December 31, 2018 (2017 - $3.3 million). The equity classified portion of the LTIP compensation expense was $2.6 million (December 31, 2017 - $2.8 million) and the liability classified portion was a recovery of $0.5 million as at December 31, 2018 (December 31, 2017 - expense of $0.5 million).

The key estimate in determining the compensation in any period is whether the performance criteria have been met and the amount of the payout multiplier on the Performance Shares. The payout multiplier is reviewed and approved by the Company's compensation committee on an annual basis. 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.

(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, 2018 of $32.2 million (December 31, 2017 - $30.0 million). The weighted average number of common shares outstanding in each of the reporting years was as follows:

	December 31, 2018	December 31, 2017
Issued ordinary shares at beginning of year	21,419,985	21,350,572
Effect of shares issued during the year		
Pursuant to long-term incentive plan	34,863	3,594
Weighted average common shares - basic	21,454,848	21,354,166
Effect of dilutive securities:		
Long-term incentive plan	124,331	119,373
Weighted average common shares - diluted	21,579,179	21,473,539

14. Income taxes:

	2018	2017
Current tax expense	$ (8,287)	$ (10,781)
Deferred tax expense	(2,491)	(5,848)
	$ (10,778)	$ (16,629)

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, 2018 is 26.9% (2017 - 26.4%) and in the United States is 26.0% (2017 - 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:

	2018	2017
Profit before income tax	$ 42,937	$ 46,583
Statutory rate	26.0%	39.4%
Computed tax expense at statutory rate	(11,164)	(18,354)
Effect of tax rate differentials and other restructuring	962	3,271
Non-deductible expenses	350	(164)
Prior year tax true-ups	300	222
Change in unrecognized deferred tax assets	(1,081)	(1,839)
Other	(145)	235
Income tax expense	$ (10,778)	$ (16,629)

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, 2018	December 31, 2017
Deferred tax assets:		
Accounts receivable	$ 1,115	$ 1,014
Accounts payable and provisions	764	532
Inventory	2,672	1,867
Finance lease obligations	929	616
Goodwill and intangibles	1,047	3,088
Tax loss carry forwards and future interest deductions	115	252
Share and debt issuance costs	518	746
Other	91	104
	7,251	8,219
Deferred tax liabilities:		
Prepaid expenses	(72)	(80)
Property, plant and equipment	(4,128)	(2,662)
	(4,200)	(2,742)
Deferred tax asset	$ 3,051	$ 5,477

14. Income taxes (continued):

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 Federal 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, 2018, the Company and its subsidiaries have operating loss carry forwards for income tax purposes of approximately $0.4 million in Canada that may be utilized to offset future taxable income (December 31, 2017 - $0.9 million). These losses, if not utilized, expire between 2030 and 2031. The Company's US subsidiaries have no operating loss carry forwards.

At December 31, 2018, the Company and its Canadian subsidiaries have capital losses of approximately $24.7 million (December 31, 2017 - $25.0 million), and suspended capital losses of approximately $44.7 million (December 31, 2017 - $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 $12.7 million (December 31, 2017 - $8.6 million) associated with these capital losses has not been recorded because it is not probable that future taxable capital gains will be generated to utilize the benefit.

15. Finance income and expense:

	Note	2018	2017
Finance expense:			
Interest on bank indebtedness	11	$ (4,106)	$ (2,823)
Accretion of finance lease obligation		(244)	(195)
Total finance expense		(4,350)	(3,018)
Finance income:			
Interest on trade receivables, customer notes, and employee loans	7	513	451
Foreign exchange gain		439	65
Total finance income		952	516
Net finance expense		$ (3,398)	$ (2,502)

16. Segment reporting:

Information about geographic areas is as follows:

	2018	2017
Revenue from external customers:		
Canada	$ 140,903	$ 137,110
United States	993,364	908,730
	$ 1,134,267	$ 1,045,840

	December 31, 2018	December 31, 2017
Non-current assets[1]:		
Canada	$ 1,972	$ 1,616
United States	95,160	87,919
	$ 97,132	$ 89,535

[1] Excludes financial instruments and deferred income taxes.

17. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are summarized below.

	2018	2017
Wages, salaries and benefits	$ 112,419	$ 103,578
Pensions - defined contribution plans	1,399	1,307
LTIP share based compensation	2,096	3,287
	$ 115,914	$ 108,172

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

	2018	2017
Cost of sales	$ 24,571	$ 21,696
Selling and distribution	66,054	59,864
Administration	25,289	26,612
	$ 115,914	$ 108,172

(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, 2018, Hardwoods USLP, Rugby Holdings LLC and Paxton Hardwoods LLC contributed and expensed $1.0 million (US $0.8 million) (2017 - $0.9 million (US $0.7 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.

17. Employee remuneration (continued):

(b) Pensions (continued):

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, 2018, Hardwoods LP contributed and expensed $0.4 million (2017 - $0.4 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:

	2018	2017
Short-term employee benefits:		
Salaries and benefits including bonuses	$ 3,732	$ 4,265
Automobile benefit	40	21
LTIP Share compensation	1,595	2,124
Total remuneration	$ 5,367	$ 6,410

(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, 2018 or December 31, 2017.

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, 2018.

20. Contingency:

On December 1, 2017, the International Trade Commission (a US government body) affirmed final countervailing duties ("CVD") and antidumping duties ("AD") of 22.98% and 183.36%, respectively on hardwood plywood imported from China. In 2017 the Company had paid $3.5 million in AD deposits to US Customs and Border Patrol ("CBP").

As at December 31, 2018 the Company has received $2.1 million in refunded AD deposits, and expects to receive another $0.5 million during 2019. As at December 31, 2018, $0.5 million in AD deposits are included within accounts and other receivables.

As it relates to the remaining $0.9 million, subsequent to the second quarter of 2018 CBP indicated that these amounts may not be refunded. The Company is investigating possible courses of action to recover these deposits. In the meantime, an allowance of $0.9 million has been recorded in these financial statements relating to this receivable.

Corporate Information

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E. Lawrence Sauder
Chair, Interfor Corporation

William Sauder
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Peter M. Bull
President, Blenheim Realty Ltd.

Jim C. Macaulay
Chief Financial Officer, Marvin Companies

Michelle Lewis
Principal, CapStreet Group

Officers

Robert J. Brown
President & Chief Executive Officer

Lance R. Blanco
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Faiz H. Karmally
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