

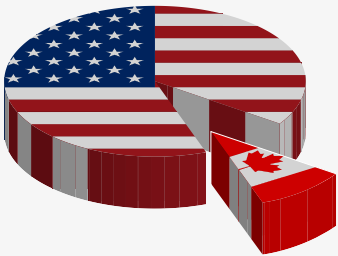




A WORLD-CLASS DISTRIBUTOR OF ARCHITECTURAL BUILDING PRODUCTS



North American leader in the distribution of architectural building products



90%
of the business operates in the US

Trusted partner to a diverse base of leading suppliers in the industry

With whom we have built long lasting relationships

Provides us with a wide offering of products, including proprietary and exclusive offerings

Bringing value to **40,000** customers



1,350 employees

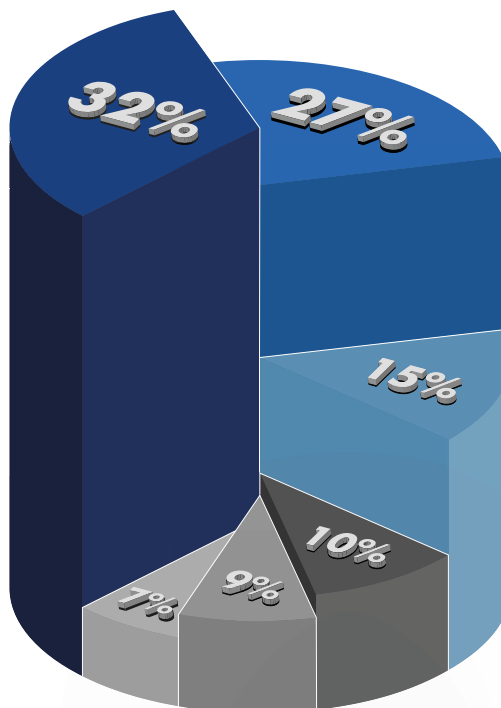


500 in sales and marketing

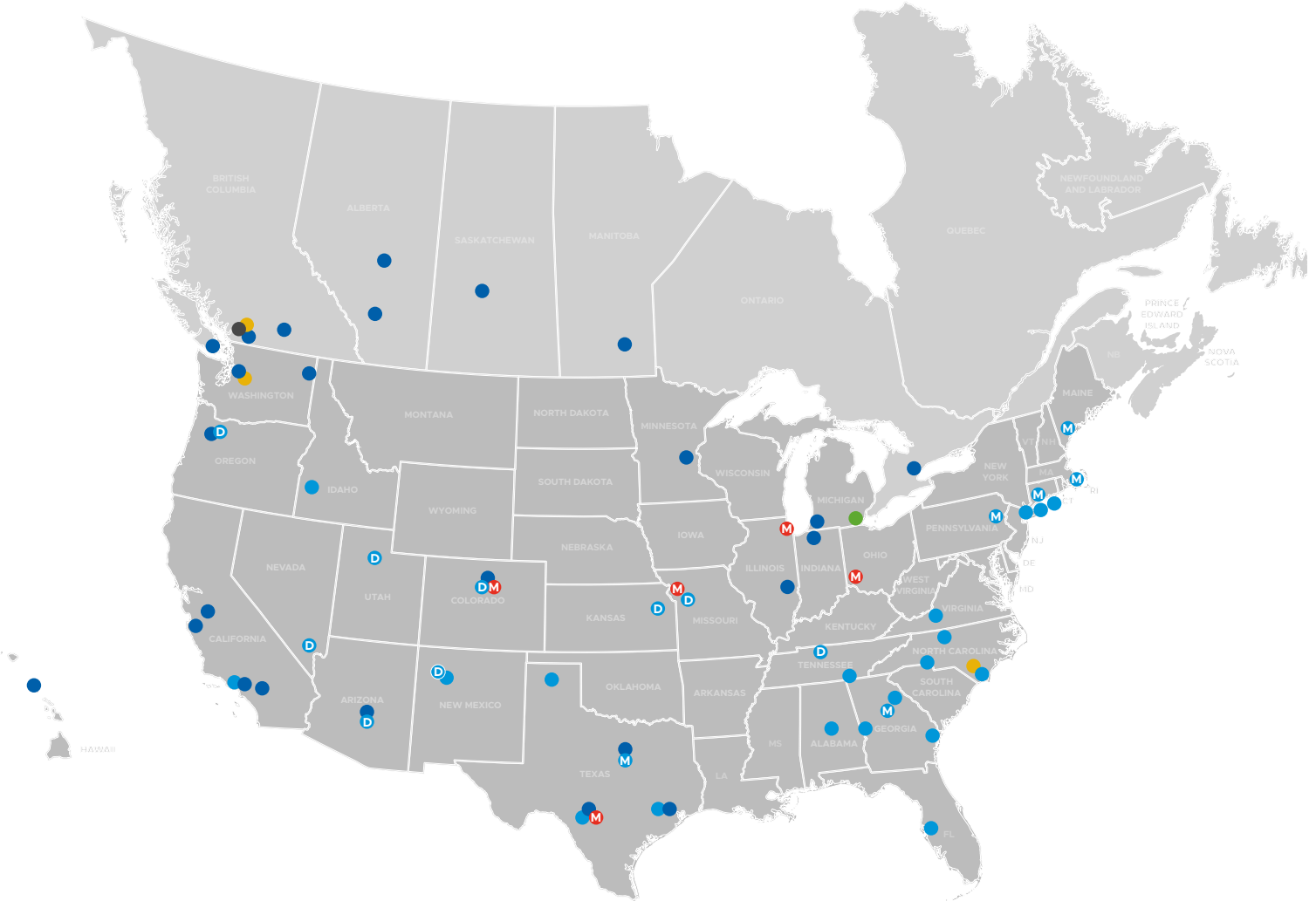
Industrial manufacturers use our products to make end-use applications for the commercial, residential, repair and remodel, and diversified construction markets

Customers rely on us for tailored and unique material supply solutions, best-in-class service, and top quality products

2019
Sales



- Hardwood Plywood
- Hardwood Lumber
- Decorative Surfaces
- Doors and Related Millwork
- Diversified
- Composite Panels



Multi-brand strategy, a differentiator in the marketplace



34 LOCATIONS

- | | | |
|----------------------|---------------------|----------------------------|
| ATLANTA, GA (M) | DALLAS, TX (M) | BLAKESLEE, PA (M) |
| BIRMINGHAM, AL (M) | HOUSTON, TX (M) | BOSTON - STOUGHTON, MA (M) |
| CHARLOTTE, NC (M) | SAN ANTONIO, TX (M) | BRONX, NY (M) |
| CHATTANOOGA, TN (M) | ALBUQUERQUE, NV (M) | GORHAM, ME (M) |
| COLUMBUS, GA (M) | AMARILLO, TX (M) | LONG ISLAND, NY (M) |
| KERNERSVILLE, NC (M) | LOS ANGELES, CA (M) | MILFORD, CT (M) |
| ROANOKE, VA (M) | PHOENIX, AZ (D) | MOONACHIE, NJ (M) |
| SAVANNAH, GA (M) | KANSAS CITY, MO (D) | BOISE, ID (M) |
| SUWANEE, GA (M) | NASHVILLE, TN (D) | DENVER, CO (D) |
| TAMPA, FL (M) | OLATHE, KS (D) | LAS VEGAS, NV (D) |
| WILMINGTON, NC (M) | | PORTLAND, OR (D) |
| | | SALT LAKE CITY, UT (D) |



17 US LOCATIONS

- | | | |
|-----------------------|-----------------------|----------------|
| LOS ANGELES, CA (M) | KAPOLEI, OAHU, HI (M) | DENVER, CO (M) |
| NORTHridge, CA (M) | PORTLAND, OR (M) | |
| PHOENIX, AZ (M) | SEATTLE, WA (M) | |
| SACRAMENTO, CA (M) | SPOKANE, WA (M) | |
| SAN FRANCISCO, CA (M) | ELKHART, IN (M) | |
| DALLAS, TX (M) | GRAND RAPIDS, MI (M) | |
| HOUSTON, TX (M) | MATTOON, IL (M) | |
| SAN ANTONIO, TX (M) | MINNEAPOLIS, MN (M) | |

8 CANADIAN LOCATIONS

- | | | |
|-------------------|-------------------|------------------|
| CALGARY, AB (M) | KELOWNA, BC (M) | TORONTO, ON (M) |
| EDMONTON, AB (M) | VANCOUVER, BC (M) | WINNIPEG, MB (M) |
| SASKATOON, SK (M) | VICTORIA, BC (M) | |



5 LOCATIONS

- | | | |
|--------------------|---------------------|---------------------|
| CINCINNATI, OH (M) | DENVER, CO (M) | SAN ANTONIO, TX (M) |
| CHICAGO, IL (M) | KANSAS CITY, MO (M) | |



HEAD OFFICE
VANCOUVER (LANGLEY), BC



HDI IMPORT DIVISION VANCOUVER, BC
HDI IMPORT LUMBER DIVISION LELAND, NC
HDI IMPORT PANEL DIVISION RENTON, WA

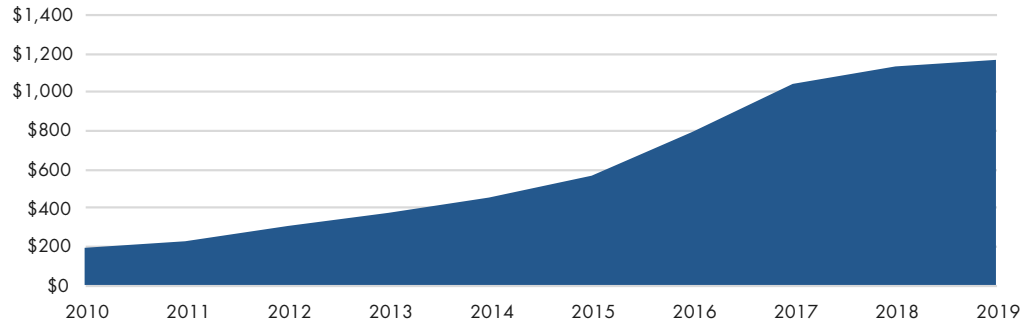


CLINTON, MI

Sales Growth

Sales of **\$1.2 billion**, **\$625 million** from acquired businesses. Compound annual sales growth rate of **22%** since 2010.

Sales (in \$ millions)

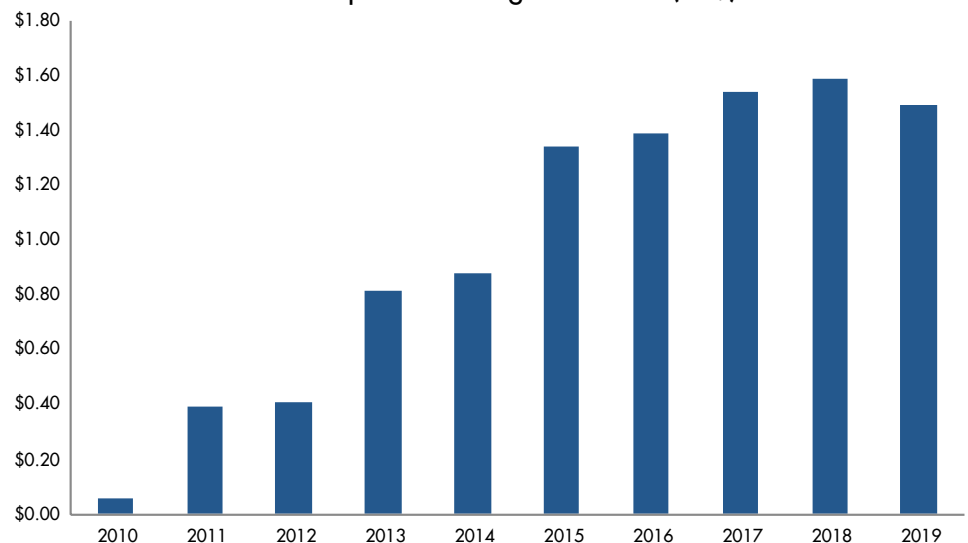


Adjusted Earnings Per Share (in \$)

Growth leads to strong earnings per share, and **accretive growth** for shareholders.

Compound annual growth rate of **43%** since 2010.

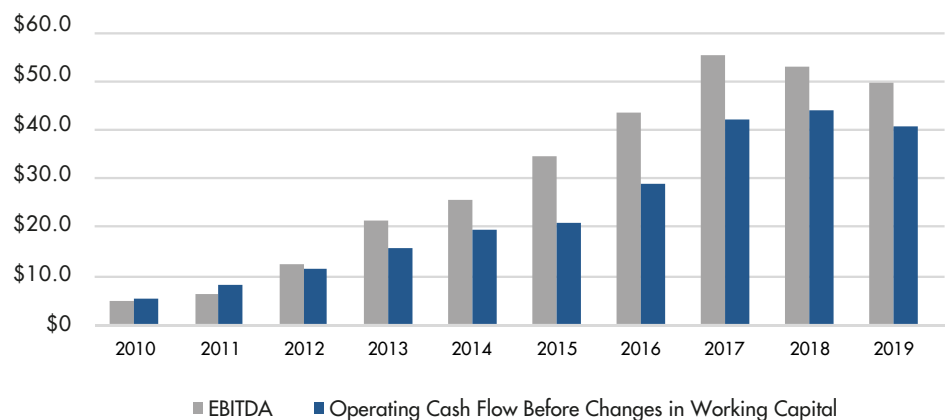
Adjusted Earnings Per Share (in \$)



Cash Flow Generation

Significant **cash flow generation**, and conversion of EBITDA to cash flow before changes in working capital has averaged **85%**.

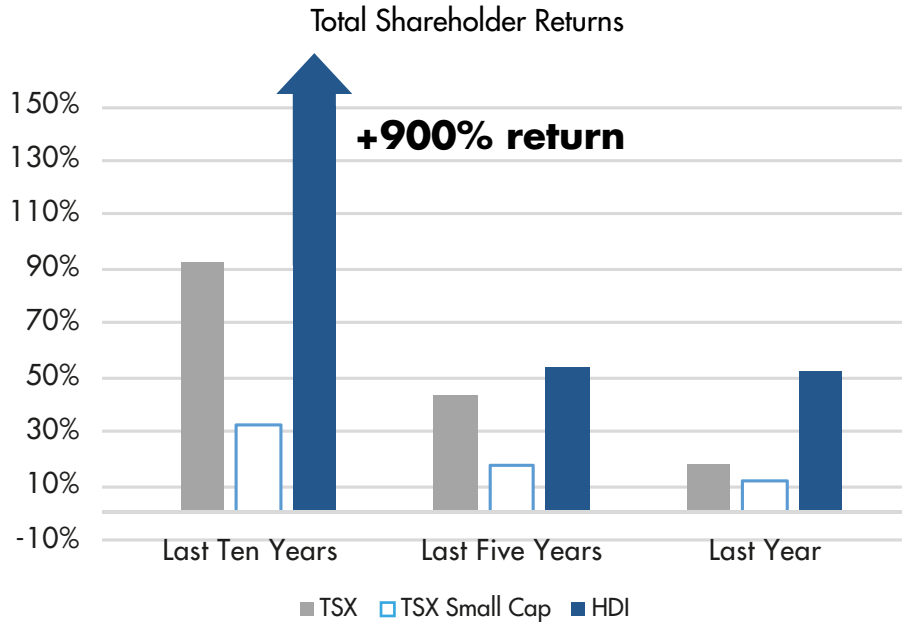
EBITDA and Cash Flows (in \$ millions)¹



¹ Excludes the effects of IFRS 16

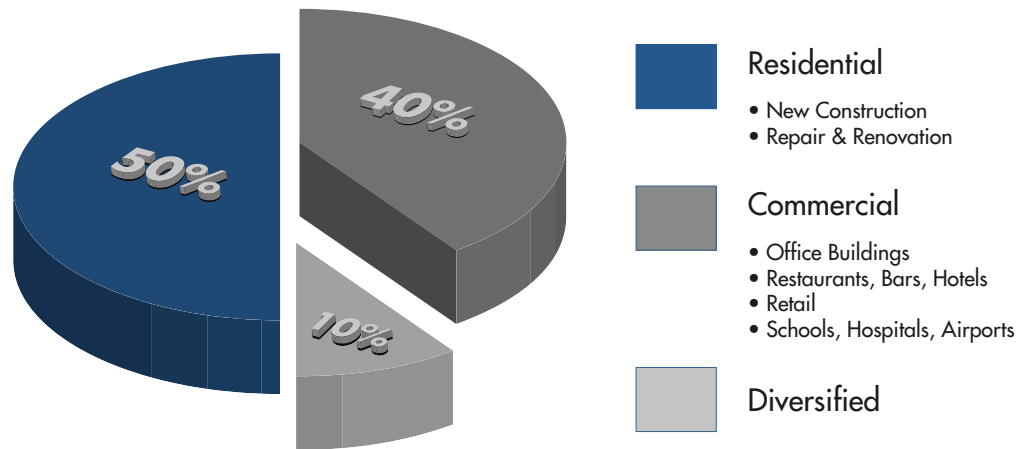
Total Shareholder Returns

Our **shareholder returns** have generally exceeded the TSX and TSX small cap indices. Share returns include **share repurchases** and **dividends**, which have been increased every year for the last seven years.



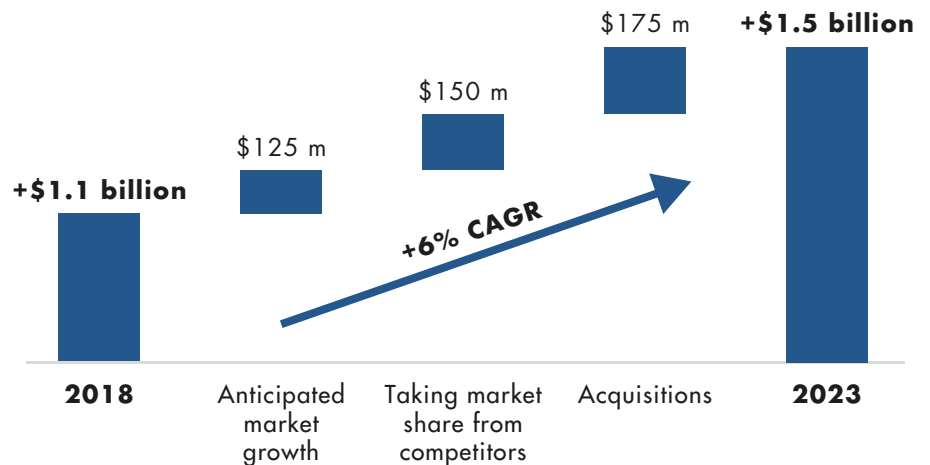
End Markets

We are **diversified** by end market, participate in all major **architectural building products** categories, and have no significant customer or supplier concentration.



Growth

We are the largest distributor of architectural building products in North America and have **10% market share**. Significant opportunity exists for both **organic and inorganic growth**, and we are strategically positioned to achieve it.



To our Shareholders,

We continued to execute our growth strategy in 2019, leveraging our strong financial position and significant acquisition capabilities to complete two new transactions. The addition of Pacific Mutual Door Company and Far West Plywood added approximately \$90 million of annualized sales to our top line, while also strengthening our presence across the US Midwest and in California.

These additions now bring the total number of locations we have acquired to 47, representing \$625 million of acquired annual revenues. HDI is now North America's largest distributor of architectural building products with impressive five-year compound annual growth rates of 21% for sales, 15% for adjusted EBITDA, and 11% for adjusted earnings per share. And growth has strengthened HDI in other fundamental ways:

We are a more stable business with significantly increased geographic, end-market and product diversification. We saw the steadying benefits of diversification in 2019 - a year that brought a late start to the construction season and significant headwinds in the domestic hardwood lumber segment. Despite these challenges, we increased sales by 3.3% or \$37.7 million year-over-year, improved our gross profit margin to 18.1%, generated record cash flow from operating activities of \$92.8 million and achieved profit per share of \$1.38.

We have gained hard-to-match competitive and supply chain advantages. Our size and North American-wide distribution network enable us to attract the industry's most sought-after products. Our global sourcing capabilities allow us to provide proprietary and customized solutions for our customers. These represent critical strengths in an industry evolving to more design-oriented materials, many of which are branded. We also have the resources to provide industry-leading sales support to our customers. For example we boast an elite team of specification selling reps who work directly with architects and designers to assist with decorative and engineered panel choices.

We are better positioned to reward investors. Our business model features significant cash generating efficiency, meaning that as we have grown, cash flow from operating activities has grown as well. This has enabled us to reinvest in our business, strengthen our balance sheet and reward investors. In 2019 we increased our dividend by another 6%, representing our seventh dividend increase in as many years. We also returned cash to investors via share buybacks. In total, our cash returns to shareholders for the 2019 year totaled \$10.3 million, including \$6.9 million in dividends and \$3.4 million in shares repurchased.

We Will Continue to Pursue Successful Growth

Growth has been good for HDI - and for our investors - and it will remain a priority as we move forward. We have set a goal of achieving \$1.5 billion of sales by 2023 and one of the ways we will do this is through continued acquisitions. Our goal is to add 3%-5% of revenues in acquired sales, and our run rate in 2019 exceeds this goal. Given our strong balance sheet and excellent pipeline of opportunities, we expect our success in this area to continue.

While we do not expect to see significant near-term growth in market demand given economic uncertainties related to the COVID-19 situation, we will continue to aggressively pursue market share growth. The business is well positioned as our model converts a significant amount of EBITDA to operating cash flow, we maintain efficient working capital, and have no term debt.

We have proved that we can leverage our opportunities, resources and know-how to transform HDI into a world class distributor at the top of the North American architectural building products industry. Importantly, we have also demonstrated that we can grow successfully - strengthening our business, enhancing our performance and rewarding investors. I am proud of what we have accomplished, and with our platform, strategies, and 10% market share today, we see significant opportunity to continue our growth trajectory.



Rob Brown
President & CEO

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of March 19, 2020. 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, 2019 and 2018. Results are reported in Canadian dollars unless otherwise noted. 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 bank debt-to-EBITDA after rents (net bank debt as described in section 5.3 as compared to EBITDA after rent payments), and certain Liquidity Ratios such as working capital (as defined in section 5.2 of this report) and net bank debt-to-capitalization (net bank debt as compared to 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 non-cash Long Term Incentive Plan (LTIP) expense, transaction expenses, and allowance for duty deposits. "Adjusted EBITDA margin" and "net bank debt-to-Adjusted EBITDA after rent" (together the "Adjusted EBITDA Ratios") are as defined above, before non-cash LTIP expense, transaction expenses, and allowance for duty deposits. 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 non-cash LTIP expense, transaction expenses, and allowance for duty deposits. 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 non-cash LTIP expense, transaction expenses, and allowance for duty deposits.

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, 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 achieved our tenth consecutive year of sales growth in 2019 with sales of \$1.172 billion up \$37.7 million or 3.3% from 2018. We also improved our gross profit margin to 18.1% from 17.7% in 2018, generated a record \$92.8 million of cash flow from operating activities, and achieved \$1.38 profit per share and \$1.49 adjusted profit per share.

Our results were achieved despite a number of external challenges, including severe winter weather that contributed to lost sales days in the first quarter and delayed the start of the construction season, as well as uneven market sentiment affecting some US construction markets. In addition, while we realized sales growth across the majority of our product lines in 2019, we were negatively impacted by significantly lower market prices for hardwood lumber as a result of excess industry supply and a shift in demand to lower-valued species. Hardwood lumber represents approximately 27% of our sales mix.

Our performance in light of these conditions reflects a number of strengths, including the significant diversification in our business. We benefit from a broad North American-wide geographic footprint; a large base of suppliers and customers with no significant concentration in either; diverse end-markets including residential, commercial, repair & remodel, and other construction sectors; and a diverse product mix made up of a wide array of architectural building products. This diversification helps to offset downward shifts in any one product category or end-market.

The continued successful execution of our acquisition strategy was also an important contributor to our performance, with the addition of new businesses (described in Section 1.2 below) contributing \$36.3 million of the sales growth achieved in 2019. Our 2019 results also benefited from the favorable foreign exchange impact of a stronger US dollar when translating our US sales to Canadian dollars for reporting purposes. The positive foreign exchange impact contributed \$23.4 million to sales in 2019, helping to offset a \$22.1 million decline in organic sales primarily related to the lower prices in the hardwood lumber product category.

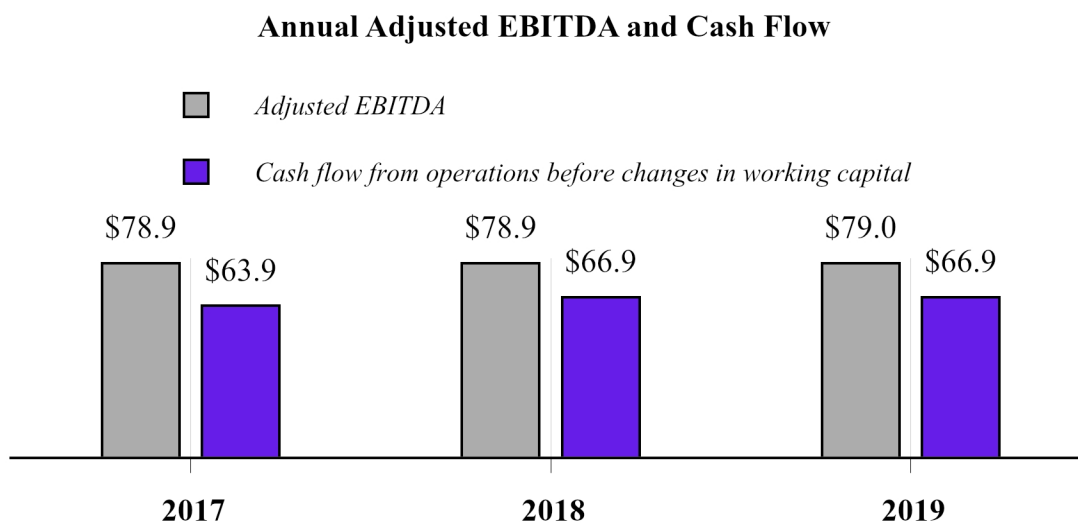
The improvement in our gross profit percentage to 18.1% was achieved, in part, as our new import supply lines began to gain traction, particularly in the second half of 2019. Our gross profit percentage performance in the third and fourth quarters of 2019, at 18.2% and 18.3%

respectively, was our best since Q3 2017. Gross profit percentage in the fourth quarter was also positively impacted by our newly acquired Pacific Mutual Door business, which carries a higher-margin product mix.

Our very strong operating cash flow performance reflects both the inherent efficiency of cash flow conversion in our business model, as well as a reduction in working capital in 2019 as our new import supply lines gained momentum and enabled us to release extra inventory stocked to guard against supply disruptions.

Profit per share of \$1.38 for the 2019 year was \$0.10 lower than the \$1.48 we achieved in 2018, primarily due to lower organic sales, as well as higher operating expenses. Operating expenses for 2019 reflect the impact of a stronger US dollar on translation of US operating expenses to Canadian dollars for reporting purposes, together with the addition of expenses from the two new businesses acquired in 2019 and continued investments in support of our business strategies. Additionally, 2019 saw a return to a more typical level of bad debt expense after a historically low level the previous year.

Adjusted EBITDA was \$79.0 million, slightly higher than the \$78.9 million we generated in 2018, and our ratio of operating cash flow before changes in working capital to Adjusted EBITDA was 85% in 2019. As indicated in the table below, it is historically normal for a majority of our Adjusted EBITDA to convert to operating cash flow before changes in working capital.



Historical figures in the table above have been restated to comply with IFRS 16 - leases (see Section 6.0).

Balance Sheet

We maintain a strong balance sheet which enables us to enjoy excellent financial stability, pursue our growth strategies, and return value to shareholders in the form of dividends and share repurchases. As at December 31, 2019, our net debt-to-Adjusted EBITDA ratio was 2.0 times, the debt-to-capital ratio was 27.0%, and we had \$69.8 million of unused borrowing capacity.

1.2 Recent Acquisitions

Through our acquisition strategy, we are enhancing our position as North America's #1 distributor of architectural building products, while strengthening our presence in the large US market. Recent acquisition activity (the "Acquired Businesses") includes:

Diamond Hardwoods

On March 9, 2020 we purchased substantially all of the assets and assumed certain liabilities of Diamond Hardwoods ("Diamond") for a total value of US\$3.0 million. Diamond is a wholesale distributor with annual sales of US\$6 million and locations in Fresno and Bakersfield, California. The addition of Diamond broadens our service capabilities in Northern California, while adding bench strength to our team and a customer set with minimal overlap.

Pacific Mutual Door Company

On October 28, 2019, we purchased substantially all of the assets and assumed certain liabilities of Pacific Mutual Door Company ("Pacific") for a total value of US\$36.2 million. Pacific is a multi-site distributor located in mid-west with estimated annual sales of US\$58 million. The addition of Pacific complements our existing door and related millwork business, and provides an entry point into the attractive Tennessee market.

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, and it represents a contiguous expansion of our current Southern California operations.

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. Atlanta brought us three new operations and is expected to generate US\$13 million in annual sales.

1.3 Outlook

While the outlook for US construction markets coming into 2020 was positive, the rapidly evolving COVID-19 situation is having a significant impact on global economies and could influence near-term demand levels and disrupt supply chains. We are monitoring this situation closely.

Over the longer term our business remains well positioned for success. As the only North American-wide distributor in the industry, we benefit from a large and diverse geographic network and a comprehensive suite of architectural building products, including proprietary offerings from a diverse global supply chain. In addition, we have a robust pipeline of accretive acquisition targets, maintain a strong balance sheet, and benefit from a business model that generates significant cash from operations with exceptional cash flow conversion efficiency.

Moving forward, we will continue to pursue our business strategies, which include:

- **capturing market growth and market share** as we leverage our professional platform and significant resources to create competitive advantages;
- capitalizing on our strong balance sheet and the significant opportunities in the fragmented distribution market to continue **growing through acquisitions**; and
- **improving profitability** as we enhance and leverage our supply chain and partner management strengths, employ technology-enabled solutions, and optimize our strategic human resources capabilities.

Our capital allocation priorities for 2020 include:

- **Maintaining sufficient capital reserves** to weather the impacts of a potential economic slowdown;
- **executing on our acquisitions pipeline**;
- continuing to **return value to shareholders** in the form of dividends and share repurchases; and
- ensuring continued **strong management of the balance sheet**.

On January 8, 2020 we renewed our normal course issuer bid for the coming year. 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.



2.0 Business and Industry Overview

Serving customers for over 60 years, HDI is North America's largest distributor of architectural building products to the residential, repair and remodel and commercial construction markets. As at March 19, 2020 we operated 66 distribution facilities across North America. Certain of these facilities include light manufacturing capabilities, which enable us to create custom moulding and millwork packages for our customers.

Approximately 22% of our 2019 sales were made up of decorative surfaces and composites, such as high pressure laminates, thermally fused laminates, medium-density fiberboard, and particleboard. Approximately 32% of our sales were of hardwood plywood, 27% of our sales were high-grade hardwood lumber, 10% of our sales were doors, and 10% were comprised of other ancillary architectural building products. Many of our product lines are complementary, and our customers, industrial manufacturers, 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 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 terms.

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 and repair and remodel, 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 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, composites, and doors are generally supplied by large manufacturers in North America. Hardwood plywood is produced in North America by large manufacturers using domestic hardwoods and other materials, as well as by overseas hardwood plywood manufacturers. The majority of the high-grade hardwood lumber we distribute is harvested from North American hardwood forests, located principally in the Eastern United States, and is milled by hundreds of small mills. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. A majority of other architectural building products are generally sourced from North American mills or manufacturers, of varying sizes depending on the product. Principally third parties such as us distribute the majority of the products we carry.



3.0 Results of Operations

3.1 Years ended December 31, 2019 and December 31, 2018

Selected Consolidated Financial Information (in thousands of Canadian dollars)					
	For the year		Restated ⁽¹⁾		
	ended Dec 31		ended Dec 31		
	2019	2018	\$ Increase (Decrease)	% Increase (Decrease)	
Total sales	\$ 1,171,921	\$ 1,134,267	\$ 37,654	3.3 %	
<i>Sales in the US (US\$)</i>	779,203	766,662	12,541	1.6 %	
<i>Sales in Canada</i>	138,100	140,903	(2,803)	(2.0)%	
Gross profit	211,979	201,263	10,716	5.3 %	
<i>Gross profit %</i>	18.1%	17.7%			
Operating expenses	(163,721)	(150,931)	12,790	8.5 %	
Profit from operating activities	48,258	50,332	(2,074)	(4.1)%	
Add: Depreciation and amortization	27,953	25,537	2,416	9.5 %	
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	\$ 76,211	\$ 75,869	\$ 342	0.5 %	
<i>EBITDA as a % of revenue</i>	6.4%	6.7%			
Add (deduct):					
Depreciation and amortization	(27,953)	(25,537)	(2,416)		
Net finance income (expense)	(9,158)	(7,979)	(1,179)		
Income tax expense	(9,520)	(10,634)	1,114		
Profit for the period	\$ 29,581	\$ 31,719	\$ (2,138)	(6.7)%	
Basic profit per share	\$ 1.38	\$ 1.48			
Diluted profit per share	\$ 1.38	\$ 1.47			
Average Canadian dollar exchange rate for one US dollar	\$ 1.327	\$ 1.296			

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)					
	For the year		Restated ⁽¹⁾		
	ended Dec 31		ended Dec 31		
	2019	2018	\$ Increase (Decrease)	% Increase (Decrease)	
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per table above	\$ 76,221	\$ 75,869	\$ 352	0.5 %	
Non-cash LTIP expense	\$ 2,249	\$ 2,096	\$ 153		
Transaction expenses	509	89	420		
Allowance related to duty deposits receivable	—	880	(880)		
Adjusted EBITDA	78,979	78,934	45		
<i>Adjusted EBITDA as a % of revenue</i>	6.7%	7.0%			
Profit for the period, as reported	29,581	31,719	(2,138)	(6.7)%	
Adjustments, net of tax	\$ 2,360	\$ 2,623	\$ (263)		
Adjusted profit for the period	31,941	34,342	(2,401)	(7.0)%	
Basic profit per share, as reported	\$ 1.38	\$ 1.48	(0.10)	(6.8)%	
Net impact of above items per share	0.11	0.12	(0.01)		
Adjusted basic profit per share	\$ 1.49	\$ 1.60	(0.11)	(6.9)%	
Diluted profit per share, as reported	\$ 1.38	\$ 1.47	(0.09)	(6.1)%	
Net impact of above items per share	\$ 0.11	\$ 0.12	(0.01)		
Adjusted diluted profit per share	\$ 1.49	\$ 1.59	(0.10)	(6.3)%	

(1) Restated for the adoption of IFRS 16 - leases. See Section 7.2

Sales

For the year ended December 31, 2019, total sales increased 3.3% to \$1,171.9 million, from \$1,134.3 million in 2018, a year-over-year improvement of \$37.7 million. The addition of Acquired Businesses contributed \$36.3 million of this growth, representing a 3.2% increase in total sales, and \$23.4 million of the increase related to a favorable foreign exchange impact from a stronger Canadian dollar when translating our US sales to Canadian dollars for reporting purposes. These gains were partially offset by a year-over-year organic sales decrease of \$22.1 million, which represents a 1.9% decrease in total sales.

Sales from our US operations increased by US\$12.5 million, or 1.6%, to US\$779.2 million, from US\$766.7 million in 2018. The Acquired Businesses contributed sales growth of US\$27.4 million, which was partially offset by a US\$14.8 million reduction in organic sales. Organic sales were impacted by softer market conditions in 2019 and lower prices for hardwood lumber products.

Sales in Canada decreased by \$2.8 million, or 2.0%, year-over-year. Demand-supply dynamics and government policy aimed at cooling the housing market continued to moderate Canadian construction markets.

Gross Profit

Gross profit for the year ended December 31, 2019 increased 5.3% to \$212.0 million, from \$201.3 million in 2018. This \$10.7 million improvement primarily reflects the increased sales and a higher gross profit margin, which improved year-over-year to 18.1%, from 17.7%. The gross margin percentage improvement includes the benefit we realized in the second half of the year relating to our re-established import supply lines.

Operating Expenses

For the year ended December 31, 2019, operating expenses were \$163.7 million as compared to \$150.9 in 2018. The \$12.8 million increase includes \$7.1 million of operating expenses from the Acquired Businesses net of transaction costs, \$3.3 million of expenses related to the impact of a stronger US dollar on translation of US operating expenses, \$2.2 million of increased expense related to a return to a more typical level of bad debt expense in our business, and \$0.2 million of added costs to support our growth strategy. As a percentage of sales, operating expenses were 14.0%, compared to 13.3% in the same period last year.

Adjusted EBITDA

For the year ended December 31, 2019, we reported Adjusted EBITDA of \$79.0 million, as compared to \$78.9 million in 2018. Contributing to the results this year is a \$10.7 million increase in gross profit, offset by a \$10.6 million increase in operating expenses (before changes in depreciation and amortization, non-cash LTIP expense, allowance related to duty deposits receivable, and transaction expenses).

Our EBITDA and Adjusted EBITDA results also reflect our 2019 adoption of IFRS 16 - leases, which affects our calculation of Adjusted EBITDA by converting rent expense to depreciation and interest (see Section 7.0).

Net Finance Income (Expense)

For the year ended December 31, 2019, net finance expense increased to \$9.2 million, from \$8.0 million in 2018. The year-over-year increase primarily relates to higher interest expense on bank indebtedness.

Income Tax Expense

Income tax expense decreased to \$9.5 million for the year ended December 31, 2019, from \$10.6 million during the same period in 2018. The decrease was primarily driven by a lower taxable income as compared to 2018.

Profit for the Period

Profit for the year ended December 31, 2019 was \$29.6 million, as compared to \$31.7 million in 2018. The \$2.1 million decrease primarily reflects the \$12.8 million increase in operating expenses and a \$1.2 million increase in net finance expense, partially offset by the \$10.7 million increase in gross profit and the \$1.1 million decrease in income tax expense. Diluted profit per share was \$1.38 as compared to \$1.47 in 2018.

Adjusted profit for the year ended December 31, 2019 was \$31.9 million, as compared to \$34.3 million in 2018. Adjusted diluted profit per share was \$1.49, as compared to \$1.60 in 2018.

3.2 Three Months Ended December 31, 2019 and December 31, 2018

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)						
	Three months		Restated⁽¹⁾			
	ended Dec 31		ended Dec 31			
	2019	2018	\$ Increase	% Increase		
				(Decrease)	(Decrease)	
Total sales	\$	287,830		274,986	\$ 12,844	4.7 %
<i>Sales in the US (US\$)</i>		193,260		182,933	10,327	5.6 %
<i>Sales in Canada</i>		32,845		33,231	(386)	(1.2)%
Gross profit		52,647		47,627	5,020	10.5 %
<i>Gross profit %</i>		18.3%		17.3%		
Operating expenses		(42,167)		(38,041)	4,126	10.8 %
Profit from operating activities		10,480		9,586	894	9.3 %
Add: Depreciation and amortization		7,686		6,641	1,045	15.7 %
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	\$	18,165		16,227	\$ 1,938	11.9 %
<i>EBITDA as a % of revenue</i>		6.3%		5.9%		
Add (deduct):						
Depreciation and amortization		(7,686)		(6,641)	(1,045)	
Net finance income (expense)		(2,756)		(1,877)	(879)	
Income tax expense		(1,142)		(1,905)	763	
Profit for the period	\$	6,582	\$	5,804	\$ 778	13.4 %
Basic profit per share	\$	0.31	\$	0.27		
Diluted profit per share	\$	0.31	\$	0.27		
Average Canadian dollar exchange rate for one US dollar	\$	1.320	\$	1.320		

Analysis of Specific Items Affecting Comparability (in thousands of Canadian dollars)						
	Three months		Restated⁽¹⁾			
	ended Dec 31		ended Dec 31			
	2019	2018	\$ Increase	% Increase		
				(Decrease)	(Decrease)	
Earnings before interest, taxes, depreciation and amortization ("EBITDA"), per table above	\$	18,175	\$	16,227	\$ 1,948	12.0 %
Non-cash LTIP expense	\$	529	\$	(261)	\$ 790	
Transaction expenses	\$	433	\$	—	\$ 433	
Adjusted EBITDA		19,137		15,966	3,171	19.9 %
<i>Adjusted EBITDA as a % of revenue</i>		6.6%		5.8%		
Profit for the period, as reported		6,582		5,804	778	13.4 %
Adjustments, net of tax	\$	780	\$	(267)	\$ 1,047	
Adjusted profit for the period		7,362		5,537	1,825	33.0 %
Basic profit per share, as reported	\$	0.31	\$	0.27	0.04	14.8 %
Net impact of above items per share		0.04		(0.01)	0.05	
Adjusted basic profit per share	\$	0.35	\$	0.26	0.09	34.6 %
Diluted profit per share, as reported	\$	0.31	\$	0.27	0.04	14.8 %
Net impact of above items per share	\$	0.04	\$	(0.01)	0.05	
Adjusted diluted profit per share	\$	0.35	\$	0.26	0.09	34.6 %

(1) Restated for the adoption of IFRS 16 - leases. See Section 7.2

Sales

For the three months ended December 31, 2019, total sales increased 4.7% to \$287.8 million, from \$275.0 million during the same period in 2018, a year-over-year increase of \$12.8 million. The addition of Acquired Businesses contributed \$16.8 million of this increase, representing a 6.1% increase in total sales. These gains were partially offset by a year-over-year organic sales decrease of \$3.9 million, which represents a 1.4% decrease in total sales.

Fourth quarter sales from our US operations increased to US\$193.3 million, from US\$182.9 million in the same period in 2018, an increase of US\$10.3 million, or 5.6%. The Acquired Businesses contributed sales growth of US\$12.7 million, partially offset by a US\$2.4 million reduction in organic sales. Organic sales were negatively impacted by the softer hardwood lumber market conditions noted in Section 1.1.

Fourth quarter sales in Canada decreased by \$0.4 million, or 1.2% , year-over-year. Demand-supply dynamics and government policy aimed at cooling the housing market continued to moderate Canadian construction markets.

Gross Profit

Gross profit for the three months ended December 31, 2019 increased 10.5% to \$52.6 million, from \$47.6 million during the same period in 2018. This \$5.0 million improvement primarily reflects the higher sales and a higher gross profit margin. As a percentage of sales, fourth quarter gross profit margin increased to 18.3%, from 17.3% year-over-year as we benefited from our re-established import supply lines and the inclusion of sales from our newly acquired Pacific Mutual Door operations, which carry a higher gross profit margin relative to the rest of the business.

Operating Expenses

For the three months ended December 31, 2019, operating expenses were \$42.2 million as compared to \$38.0 million during the same period in 2018. The \$4.2 million increase includes \$3.9 million of operating expenses from the Acquired Business and transaction costs of \$0.4 million. As a percentage of sales, fourth quarter operating expenses were 14.6%, compared to 13.8% in Q4 2018.

Adjusted EBITDA

For the three months ended December 31, 2019, we increased Adjusted EBITDA to \$19.1 million, from \$16.0 million during the same period in 2018. The \$3.1 million improvement primarily reflects the \$5.0 million increase in gross profit, partially offset by the \$1.9 million increase in operating expenses (before changes in depreciation and amortization, non-cash LTIP expense, and transaction expenses).

Included in our EBITDA results for the quarter is a \$0.6 million reversal of bad debt expense, and a \$0.6 million contribution from the Pacific business.

Our EBITDA and Adjusted EBITDA results also reflect our 2019 adoption of IFRS 16 - leases, which affects our calculation of Adjusted EBITDA by converting rent expense to depreciation and interest (see Section 7.0).

Profit for the Period

Profit for the three months ended December 31, 2019 was \$6.6 million, as compared to \$5.8 million in the same period in 2018. The \$0.8 million or 13.4% increase primarily reflects the \$5.0 million increase in gross profit partially offset by the \$4.2 million increase in operating expenses. Fourth quarter diluted profit per share was \$0.31, as compared to \$0.27 in Q4 2018.

Adjusted profit for the three months ended December 31, 2019 increased 33.0% to \$7.4 million, from \$5.5 million in the same period in 2018. Fourth quarter Adjusted diluted profit per share was \$0.35 as compared to \$0.26 in Q4 2018.



4.0 Selected Financial Information and Seasonality

4.1 Quarterly Financial Information

(in thousands of dollars)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	2019	2019	2019	2019	2018	2018	2018	2018
					Restated to comply with IFRS 16 - leases. See section 7.2 for further details			
Total sales	\$287,830	\$292,459	\$304,545	\$287,087	\$274,986	\$290,354	\$298,172	\$270,755
Profit	6,582	8,854	8,165	5,980	5,804	7,962	9,838	8,153
Basic profit per share	0.31	0.42	0.38	0.28	0.27	0.37	0.45	0.38
Fully diluted profit per share	0.31	0.41	0.38	0.28	0.27	0.37	0.45	0.38
EBITDA	18,165	20,723	20,626	16,696	16,227	19,734	21,553	18,361
Adjusted profit	7,362	9,364	8,661	6,494	5,537	9,030	11,128	8,664
Adjusted basic profit per share	0.35	0.44	0.40	0.30	0.26	0.42	0.51	0.40
Adjusted diluted profit per share	0.35	0.43	0.40	0.30	0.26	0.42	0.51	0.40
Adjusted EBITDA	19,137	21,297	21,185	17,282	15,966	20,847	23,111	18,927

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		For the year
	ended Dec 31	ended Dec 31	ended Dec 31
	2019	2018 (Restated ⁽¹⁾)	2017 (Restated ⁽¹⁾)
Total sales	\$ 1,171,921	\$ 1,134,267	\$ 1,045,840
Profit	29,581	31,719	29,153
Basic profit per share	1.38	1.48	1.37
Fully diluted profit per share	1.38	1.47	1.36
Total assets	569,971	541,967	456,546
Total non-current financial liabilities	84,391	88,282	79,811
Adjusted EBITDA	78,979	78,934	78,923

(1) Restated for the adoption of IFRS 16 - leases. See Section 7.2

5.0 Liquidity and Capital Resources

5.1 Cash Flows from Operating, Investing and Financing Activities

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)						
	Year ended Dec 31			Three months ended Dec 31		
	2019	2018 Restated ⁽¹⁾	\$ change	2019	2018 Restated ⁽¹⁾	\$ change
Cash provided by operating activities before changes in non-cash working capital	\$ 66,860	\$ 66,897	\$ (37)	\$ 14,272	\$ 12,979	\$ 1,293
Changes in non-cash working capital	25,944	(40,824)	66,768	19,074	19,556	(482)
Net cash provided (used in) by operating activities	92,804	26,073	66,731	33,346	32,535	811
Net cash used in investing activities	(55,907)	(8,900)	(47,007)	(48,177)	(1,962)	(46,215)
Net cash provided by (used in) financing activities	(23,326)	(15,939)	(7,387)	22,601	(29,351)	51,952
Increase (decrease) in cash	13,571	1,234	12,337	7,770	1,222	6,548
Cash and cash equivalents, beginning of period	1,547	313	1,234	7,348	325	7,023
Cash and cash equivalents, end of the period	\$ 15,118	\$ 1,547	\$ 13,571	\$ 15,118	\$ 1,547	\$ 13,571

(1) Restated for the adoption of IFRS 16 - leases. See Section 7.2

Net cash used in operating activities

For the year ended December 31, 2019, net cash provided by operating activities increased to \$92.8 million, from \$26.1 million in 2018, an increase of \$66.7 million. Cash provided by operating activities before changes in non-cash working capital was \$66.9 million, the same as in 2018. Investment in non-cash working capital decreased by \$66.8 million in 2019, as compared to 2018. An analysis of changes in working capital is provided in section 5.2 of this report.

For the three months ended December 31, 2019, net cash provided by operating activities increased to \$33.3 million, from \$32.5 million in the same period in 2018, an increase of \$0.8 million. Cash provided by operating activities before changes in non-cash working capital was \$14.3 million, compared to \$13.0 million in the same period in 2018. Fourth quarter investment in non-cash working capital increased by \$0.5 million year-over-year. 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 for the year and three months ended December 31, 2019 increased by \$47.0 million and \$46.2 million, respectively, as compared to the same periods in 2018. The increases primarily relate to the purchase of Acquired Businesses during the year.

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.

Net cash provided by (used in) financing activities

For the year ended December 31, 2019, net cash used in financing activities increased by \$7.4 million as compared to 2018. This change primarily reflects an increase in share re-purchase activities and principle payments on finance lease obligations.

For the three months ended December 31, 2019, net cash provided by financing activities increased by \$52.0 million as compared to the same period in 2018. This primarily relates to an increase in bank indebtedness, which was required to finance the purchase of Pacific in the fourth quarter of 2019.

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 short-term credit provided by suppliers in the form of accounts payable and accrued liabilities.

Investments in working capital in 2019 decreased by \$66.8 million as compared to 2018. The decrease primarily relates to the reduction in organic sales, and management of our balance sheet including a reduction in inventory to normal levels in 2019, following increased purchasing of certain product lines in 2018 to secure supply.

Our investment in working capital may fluctuate from quarter-to-quarter based on factors such as sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers. Historically the first and fourth quarters are seasonally slower periods for construction activity, resulting in reduced demand for architectural building products. A summary of changes in our non-cash operating working capital during the year and three months ended December 31, 2019 and 2018 is provided below.

(in thousands of Canadian dollars)				
	Year	Restated ⁽¹⁾	Three months	Restated ⁽¹⁾
	ended Dec 31	ended Dec 31	ended Dec 31	ended Dec 31
Source (use) of funds	2019	2018	2019	2018
Accounts receivable	\$ 3,180	\$ (5,915)	\$ 12,902	\$ 14,121
Inventories	16,107	(33,290)	581	5,624
Prepaid expenses	(5,442)	932	(3,397)	4,214
Accounts payable and accrued liabilities	12,099	(2,551)	8,988	(4,403)
Change in non-cash operating working capital	\$ 25,944	\$ (40,824)	\$ 19,074	\$ 19,556

(1) Restated for the adoption of IFRS 16 - leases. See Section 7.2

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		Restated
	December 31, 2019		As at
			December 31, 2018
Cash	\$	(15,118)	\$ (1,547)
Bank indebtedness		121,548	112,940
Net bank debt		106,430	111,393
Shareholders' equity		283,445	275,439
Capitalization	\$	389,875	\$ 386,832
Net bank debt to capitalization		27%	29%
Previous 12 months Adjusted EBITDA	\$	78,979	\$ 78,934
Rental payments related to warehousing and trucks		(24,700)	(22,558)
Previous 12 months Adjusted EBITDA after rent		54,279	56,376
Net bank debt to previous 12 months Adjusted EBITDA after rent		2.0	2.0

We consider our capital to be bank indebtedness (net of cash) and shareholders' equity. Overall net bank debt compared to total capitalization stood at 27% as at December 31, 2019, compared to 29% at December 31, 2018. At December 31, 2019, our ratio of net debt-to-Adjusted-EBITDA after rent for the year was 2.0 times, in line with 2.0 times at December 31, 2018. Net debt-to-Adjusted-EBITDA after rent and net bank debt-to-total capitalization serve as indicators of our financial leverage, however they are not measures prescribed by IFRS and our method of calculating these measures may differ from methods used by other issuers.

We have independent credit facilities in both Canada and the US. 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, 2019 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	\$ 194.6 million (US\$150.0 million)
Credit facility expiry date	August 5, 2021	July 14, 2021
Available to borrow	\$ 23.3 million	\$ 165.5 million (US\$127.6 million)
Credit facility borrowings	\$ 13.0 million	\$ 106.0 million (US\$81.7 million)
Unused credit facility	<u>\$ 10.3 million</u>	<u>\$ 59.5 million (US\$45.8 million)</u>
Financial covenants:	Covenant does not apply when the unused credit facility available exceeds \$2.0 million	Covenant does not apply when the unused credit facility available exceeds 10% of the maximum borrowings under the credit facility or US\$15.0 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, 2019. 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\$150.0 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\$15.0 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, 2019.

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, 2019.

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

There were no significant changes in our contractual commitments outside the normal course of business, compared with those set forth in our 2019 Annual Report, available on SEDAR at www.sedar.com.

5.5 Off-Balance Sheet Arrangements

We have no material 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, other liabilities 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 19, 2020, the date of this MD&A, we had 21,355,327 common shares issued and outstanding. In addition, at March 19, 2020, we had outstanding 114,068 performance shares and 158,475 restricted shares under the terms of our long-term incentive plan. The performance and restricted shares can be settled in common shares of the Company issued from treasury, common shares purchased by us in the market, or in an amount of cash equal to the fair value of our common shares, or any combination of the foregoing. The restricted and performance shares vest over periods of up to three years and employees have the option, when the restricted and performance share vest, to receive up to half the fair value in cash and the remainder in common shares. We intend to issue common shares from treasury to settle the portion of the obligation not paid to employees in cash.

5.8 Dividends

In the fourth quarter of 2019, we declared a quarterly dividend of \$0.085 per common share, which was paid on January 31, 2020 to shareholders of record as at January 20, 2020. On March 19, 2020, we declared a quarterly dividend of \$0.085 per share, payable on April 30, 2020 to shareholders of record as at April 16, 2020.

6.0 Related-Party Transactions

There were no material related-party transactions during the three and twelve-month periods ended December 31, 2019 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:

Adoption of IFRS 16 - leases: We are required to make estimates and assumptions related to adoption of IFRS 16 - leases, including the discount rates used for each lease, determining the lease term, and consideration of lease renewal options.

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 16, Leases ("IFRS 16")

Effective January 1, 2019 we adopted IFRS 16, and elected to apply this new standard using the full retrospective approach. The adoption of IFRS 16 had a material impact on our

consolidated financial statements, including the comparative information. For a summary of the financial statement line items affected, see our consolidated financial statements.

The main impact of IFRS 16 was the recognition of lease assets and lease liabilities on the balance sheet for those leases that were previously classified as operating leases. As it relates to the Company, our operating leases were principally comprised of our warehouse facilities and automobiles. Under IFRS 16, we are 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 adoption of IFRS 16 did not have a significant impact on profit. The adoption of IFRS 16 however did have a material impact on the balance sheet related to the recording of a right-of-use asset and related lease liability (see Consolidated Financial Statements for a summary of the impact).

The adoption of IFRS 16 also had a material impact on EBITDA and Adjusted EBITDA since the rental payments related to the operating leases described above are now reclassified as either interest expense or depreciation. As a result of IFRS 16, EBITDA and Adjusted EBITDA increased by \$6.8 million and \$5.8 million, respectively, in the three months ended December 31, 2019 as compared to the amounts that would have otherwise been recorded under previous standards. For the year ended December 31, 2019, as a result of IFRS 16, EBITDA and Adjusted EBITDA increased by \$24.7 million and \$22.6, respectively, as compared to the amounts that would have otherwise been recorded under previous standards.

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 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, 2019. 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, 2019.

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, 2019. 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, 2019.

There have not been any changes in our ICFR during the quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, our ICFR.

The CEO and CFO have limited the scope of their design of disclosure controls and procedures and internal control over financial reporting to exclude controls, policies and procedures of the Pacific business, which we acquired on October 28, 2019. Summary financial information about the acquired Pacific business can be found in note 4 of the Consolidated Financial Statements.

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 benefit from a broad North American-wide geographic footprint; a large base of suppliers and customers with no significant concentration in either; diverse end-markets including residential, commercial, repair & remodel, and other construction sectors; and a diverse product mix made up of a wide array of architectural building products; this diversification helps to offset downward shifts in any one product category or end-market; it is historically normal for a majority of our Adjusted EBITDA to convert to operating cash flow before changes in working capital; we maintain a strong balance sheet which enables us to enjoy excellent financial stability, pursue our growth strategies, and return value to shareholders in the form of dividends and share repurchases; we are enhancing our position as North America's #1 distributor of architectural building products, while strengthening our presence in the large US market; While the outlook for US construction markets coming into 2020 was positive, the rapidly evolving COVID-19 situation is having a significant impact on global economies and could influence near-term demand levels and disrupt supply chains; over the longer term our business remains well positioned for success; we benefit from a comprehensive suite of architectural building products, including proprietary offerings from a diverse global supply chain; we have a robust pipeline of accretive acquisition targets, maintain a strong balance sheet, and benefit from a business model that generates significant cash from operations with exceptional cash flow conversion efficiency; Moving forward, we will continue to pursue our business strategies, which include capturing market growth and market share as we leverage our professional platform and significant resources to create competitive advantages, capitalizing on our strong balance sheet and the significant opportunities in the fragmented distribution market to continue growing through acquisitions, and improving profitability as we enhance and leverage our supply chain and partner management strengths, employ technology-enabled solutions, and optimize our strategic human resources capabilities; our capital allocation priorities for 2020 include maintaining sufficient capital reserves to weather the impacts of a potential economic slowdown,

executing on our acquisitions pipeline, continuing to return value to shareholders in the form of dividends and share re-purchases, and ensuring continued strong management of the balance sheet; 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; 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; our investment in working capital may fluctuate from quarter-to-quarter based on factors such as sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers; historically the first and fourth quarters are seasonally slower periods for construction activity, resulting in reduced demand for architectural building products; 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.

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.

Consolidated Financial Statements
(Expressed in Canadian dollars)

HARDWOODS DISTRIBUTION INC.

Years ended December 31, 2019 and 2018



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Hardwoods Distributions Inc.

Opinion

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

- the consolidated statements of financial position as at December 31, 2019, December 31, 2018 and January 1, 2018
- the consolidated statements of comprehensive income for the years ended December 31, 2019 and December 31, 2018
- the consolidated statements of changes in shareholders' equity for the years ended December 31, 2019 and December 31, 2018
- the consolidated statements of cash flows for the years ended December 31, 2019 and December 31, 2018
- 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, 2019, December 31, 2018 and January 1, 2018, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2019 and December 31, 2018 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.

Emphasis of Matter – Comparative Information

We draw attention to Note 3(q) to the financial statements (“Note 3(q)”), which explains that certain comparative information presented:

- for the year ended December 31, 2018 has been restated.
- as at January 1, 2018 has been derived from the financial statements for the year ended December 31, 2017 which have been restated (not presented herein).

Note 3(q) explains the reason for the restatement and also explains the adjustments that were applied to restate certain comparative information.

Our opinion is not modified in respect of this matter.

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 “2019 Hardwoods Distribution Inc. 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 and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management’s Discussion and Analysis and 2019 Hardwoods Distribution Inc. 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 19, 2020

HARDWOODS DISTRIBUTION INC.

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

	Note	December 31, 2019	Restated (Note 3(q)) December 31, 2018	Restated (Note 3(q)) January 1, 2018
Assets				
Current assets:				
Cash and cash equivalents		\$ 15,118	\$ 1,547	\$ 313
Accounts and other receivables	7	113,740	112,005	97,263
Income taxes receivable	14	820	789	1,582
Inventories	8	207,935	223,785	172,106
Prepaid and other assets		9,887	4,594	5,268
Total current assets		347,500	342,720	276,532
Non-current assets:				
Non-current receivables	7	2,376	1,857	1,359
Property, plant and equipment	9	20,430	20,357	18,044
Right of use assets	3(q)	93,982	97,241	82,816
Intangible assets	10	28,248	16,828	17,215
Deferred income taxes	14	4,461	6,844	8,910
Goodwill	11	72,974	56,120	51,670
Total non-current assets		222,471	199,247	180,014
Total assets		\$ 569,971	\$ 541,967	\$ 456,546
Liabilities				
Current liabilities:				
Bank indebtedness	12	\$ 121,548	\$ 112,940	\$ 91,146
Accounts payable and accrued liabilities		53,805	39,216	38,056
Lease obligation	3(q)	24,973	24,373	16,595
Dividend payable	5	1,809	1,717	1,549
Total current liabilities		202,135	178,246	147,346
Non-current liabilities:				
Lease obligation	3(q)	83,726	88,100	79,366
Other liabilities		665	182	445
Total non-current liabilities		84,391	88,282	79,811
Total liabilities		286,526	266,528	227,157
Shareholders' equity				
Share capital	13(a)	113,837	116,524	113,788
Contributed surplus		104,850	104,467	105,426
Retained earnings		48,288	25,653	482
Accumulated other comprehensive income		16,470	28,795	9,693
Shareholders' equity		283,445	275,439	229,389
Total liabilities and shareholders' equity		\$ 569,971	\$ 541,967	\$ 456,546

Subsequent events (note 4, 5)

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

Approved on behalf of the board of directors:

(Signed) JIM C. MACAULAY Director

(Signed) WILLIAM R. SAUDER Director

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2019 and 2018

	Note		2019	Restated (Note 3(q)) 2018
Sales	16	\$	1,171,921	\$ 1,134,267
Cost of goods sold	8		(959,941)	(933,004)
Gross profit			211,980	201,263
Operating expenses:				
Selling and distribution			(124,782)	(114,933)
Administration			(38,939)	(35,998)
			(163,721)	(150,931)
Profit from operations			48,259	50,332
Finance expense	15		(9,784)	(8,931)
Finance income	15		626	952
Net finance expense			(9,158)	(7,979)
Profit before income taxes			39,101	42,353
Income tax expense:				
Current	14		(7,227)	(8,287)
Deferred	14		(2,293)	(2,347)
			(9,520)	(10,634)
Net profit			29,581	31,719
Other comprehensive income:				
Exchange differences translating foreign operations			(12,325)	19,102
Total comprehensive income		\$	17,256	\$ 50,821
Basic net profit per share	13(c)	\$	1.38	\$ 1.48
Diluted net profit per share	13(c)	\$	1.38	\$ 1.47

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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31, 2019 and 2018

	Note	Share capital	Contributed surplus	Accumulated other comprehensive income - translation reserve	Retained earnings	Total
Balance at January 1, 2019		\$ 116,524	\$ 104,467	\$ 29,411	\$ 35,530	\$ 285,932
Impact of changes in accounting policy	3(q)	—	—	(616)	(9,877)	(10,493)
Restated balance at January 1, 2019	3(q)	116,524	104,467	28,795	25,653	275,439
Share based compensation expense	13(b)	—	1,399	—	—	1,399
Shares issued pursuant to LTIP	13(a)	1,016	(1,016)	—	—	—
Shares repurchased	13(a)	(3,703)	—	—	—	(3,703)
Profit for the period		—	—	—	29,581	29,581
Dividends declared		—	—	—	(6,946)	(6,946)
Translation of foreign operations		—	—	(12,325)	—	(12,325)
Balance at December 31, 2019		\$ 113,837	\$ 104,850	\$ 16,470	\$ 48,288	\$ 283,445
Balance at January 1, 2018		\$ 113,788	\$ 105,426	\$ 9,693	\$ 9,919	\$ 238,826
Impact of changes in accounting policy	3(q)	—	—	—	(9,437)	(9,437)
Restated balance at January 1, 2018	3(q)	113,788	105,426	9,693	482	229,389
Share based compensation expense	13(b)	—	2,593	—	—	2,593
Shares issued pursuant to LTIP	13(a)	2,736	(2,736)	—	—	—
Shares reclassified to liabilities		—	(816)	—	—	(816)
Profit for the period		—	—	—	31,719	31,719
Dividends declared		—	—	—	(6,548)	(6,548)
Translation of foreign operations		—	—	19,102	—	19,102
Balance at December 31, 2018		\$ 116,524	\$ 104,467	\$ 28,795	\$ 25,653	\$ 275,439

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)

	Note	2019	Restated (Note 3) 2018
Cash flow from operating activities:			
Profit for the year		\$ 29,581	\$ 31,719
Adjustments for:			
Depreciation and amortization		27,953	25,537
Gain on sale of property, plant and equipment	9	(635)	(156)
Gain on bargain purchase		—	(92)
Share-based compensation expense	13(b)	2,249	2,096
Income tax expense	14	9,520	10,634
Net finance expense	15	9,158	7,980
Interest received		626	513
Interest paid		(4,293)	(3,938)
Income taxes paid		(7,299)	(7,396)
		66,860	66,897
Changes in non-cash working capital:			
Accounts receivable		3,180	(5,915)
Inventories		16,107	(33,290)
Prepaid expenses		(5,442)	932
Accounts payable and accrued liabilities		12,099	(2,551)
		25,944	(40,824)
Net cash provided by operating activities		92,804	26,073
Cash flow from financing activities:			
Increase in bank indebtedness		13,317	13,955
Principle payments on finance lease obligation		(26,346)	(23,454)
Note repayment		—	(60)
Repurchase of common shares	13(a)	(3,443)	—
Dividends paid to shareholders	5	(6,854)	(6,379)
Net cash used in financing activities		(23,326)	(15,938)
Cash flow from investing activities:			
Additions to property, plant and equipment	9	(3,321)	(4,076)
Proceeds on disposal of property, plant and equipment		664	452
Business acquisitions	4	(52,850)	(4,843)
Additions to internally generated software	10	(282)	(280)
Payments (made) received on non-current receivables		(118)	(153)
Net cash used in investing activities		(55,907)	(8,900)
Increase in cash		13,571	1,234
Cash, beginning of year		1,547	313
Cash, end of year		\$ 15,118	\$ 1,547
Supplementary information:			
Property, plant and equipment acquired under finance leases, net of disposals		\$ 18,352	\$ 27,644
Future cash settlement of LTIP's in accrued liabilities and non-current liabilities		1,208	816
Transfer of accounts receivable to non-current customer notes receivable		573	136

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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

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 64 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 19, 2020.

(b) Basis of measurement:

These consolidated financial statements have been prepared a going concern basis under on the historical cost basis. Comparative figures have been restated for IFRS 16 as discussed in note 3(q).

(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 consolidated financial statements, with the exception of per share amounts, has been rounded to the nearest thousand dollar unless otherwise stated.

(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 consolidated 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 consolidated 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;
- Note 7 - the collectability of accounts receivable and the determination of the allowance for credit loss;
- Note 8 - the valuation of inventories; and
- Note 14 - the recognition 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 3 - the classification and valuation of lease obligations.

In assessing the Company's 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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

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.

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 expense.

Translation of foreign operations for consolidation

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

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

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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

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 accounted for as a reduction of the cost of the related inventory and are earned when inventory is sold.

(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:

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

(h) Property, plant and equipment (continued):

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") and Pacific Mutual Door Company ("Pacific", see Note 4(a)) have been determined to be the cash generating units to which the goodwill balance 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.

Impairment testing was performed as at December 31, 2019 and the recoverable amount determined based on value-in-use calculations which requires 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 3.0%. The growth rate is consistent with past experience, market conditions and actual operating results.

Key assumptions used are based on industry sources as well as management estimates. A post-tax discount rate of 10.0% 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, 2019, was determined to be higher than the related carrying amount and no impairment has been recognized.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

(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.

(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 including transaction costs.

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

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

(l) Financial instruments (continued):

Financial assets

Cash

The Company considers deposits in banks as cash and cash equivalents.

Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial recognition these are measured at amortized cost using the effective interest method, less 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, payables, and lease obligations 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.

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.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

(n) 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.

(o) 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.

(p) Share based compensation:

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

The Company is accounting for half of the Restricted Shares and Performance Shares as employee equity settled awards whereby the compensation cost is determined based on the grant date fair value and is recognized as an expense with a corresponding increase to contributed surplus in equity over the period that the employees unconditionally become entitled to payment. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met. For the remaining 50% of Restricted and Performance Shares that can be settled in either cash or common shares at the employees option, the Company accounts for the award as cash-settled share based compensation. Compensation expense is recorded over the vesting period based on the estimated fair value at the date of grant. The fair value of this 50% portion of the Restricted and Performance Shares is subsequently re-measured at each reporting date with any change in fair value reflected in share based compensation expense in the statement of comprehensive income. The liability associated with cash-settled awards is recorded in accounts payable and accrued liabilities, for amounts expected to be settled within one year, and in non-current liabilities for amounts to be settled in excess of one year.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

(q) New accounting policies

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

Effective January 1, 2019, the Company adopted IFRS 16, eliminating the dual accounting model for lessees which distinguished 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 (ROU) 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. As a result of adopting IFRS 16, the Company's operating leases, which are principally comprised of its warehouse facilities and automobiles, are recorded in the statements of financial position as a lease obligation with a corresponding ROU asset.

At inception of a contract, the Company assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Company assess whether:

- the contract involves the use of an identified asset - this may be specified explicitly or implicitly, and should be physically distinct or represent substantially all of the capacity of a physically distinct asset. If the supplier has a substantive substitution right, then the asset is not identified;
- the Company has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use; and
- the Company has the right to direct the use of the asset. The Company has this right when it has the decision-making rights that are most relevant to changing how and for what purpose the asset is used.

The Company has applied this approach to contracts entered into or changed on or after January 1, 2019.

The Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of the right-of-use assets are determined on the same basis as those of property, plant and equipment. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain re-measurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate.

Lease payments included in the measurement of the lease liability comprise:

- fixed lease payments;
- amounts expected to be payable under a residual value guarantee;
- the exercise price under a purchase option that the Company is reasonably certain to exercise;
- lease payments in an optional renewal period if the Company is reasonably certain to exercise an extension option; and
- penalties for early termination of a lease unless the Company is reasonably certain not to terminate early.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

New accounting policy (continued)

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

Some of the Company's leases of office buildings contain extension options exercisable up to one year before the end of the non-cancellable contract period. The extension options held are exercisable only by the Company and not by the lessors. The Company assesses at lease commencement whether it is reasonably certain to exercise the extension options. The Company reassesses whether it is reasonably certain to exercise the options if there is a significant event or significant change in circumstances within its control. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right-of-use assets recognized.

The Company leases many assets including buildings, automobiles and forklifts. Information about leases for which the Company is a lessee is presented below.

Right-of-use assets

	Buildings	Automobiles	Forklifts	Total
2018 restated				
Balance at January 1	69,553	12,793	470	82,816
Additions	20,941	6,343	509	27,793
Disposals	—	(291)	—	(291)
Depreciation charge for the year	(15,147)	(4,600)	(196)	(19,943)
Foreign currency transaction	5,673	1,135	58	6,866
Balance at December 31 restated	81,020	15,380	841	97,241
2019				
Balance at January 1	81,020	15,380	841	97,241
Additions	18,698	2,775	—	21,473
Acquisition (Note 4)	4,493	—	—	4,493
Disposals	(2,857)	(274)	—	(3,131)
Depreciation charge for the year	(16,693)	(4,913)	(222)	(21,828)
Foreign currency transaction	(3,579)	(654)	(33)	(4,266)
Balance at December 31	81,082	12,314	586	93,982

HARDWOODS DISTRIBUTION INC.

Notes to the Consolidated Financial Statements
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Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

New accounting policy (continued)

Lease liabilities

	December 31, 2019	Restated December 31, 2018	Restated January 1, 2018
Maturity analysis - contractual undiscounted cash flows			
Less than one year	25,504	25,171	20,607
One to five years	82,442	85,552	72,640
More than five years	13,734	18,128	16,809
Total undiscounted lease liabilities	121,680	128,850	110,056
Lease liabilities included in the statement of financial position	108,699	112,473	95,961
Current	24,973	24,373	16,595
Non-current	83,726	88,100	79,366

Transition

The Company has applied IFRS 16 using the retrospective approach, under which the comparative information presented for 2018 has been restated.

At transition, for leases classified as operating leases, lease liabilities were measured at the present value of the lease payments, discounted at the Company's incremental borrowing rate at the lease commencement date. Right-of-use assets are measured at their carrying amount as if IFRS 16 had been applied since the commencement date, discounted using the Company's incremental borrowing rate at the lease commencement date.

On transition to IFRS 16, the Company elected to apply the practical expedient to use hindsight when determining the lease term if the contract contained options to extend or terminate the lease.

The Company leases a number of automobiles and forklifts. These leases were classified as finance leases under IAS 17. For these finance leases, the carrying amount of the right-of-use asset and the lease liability at January 1, 2019 were determined at the carrying amount of the lease asset and lease liability under IAS 17 immediately before that date.

Impacts on transition

On transition to IFRS 16, the Company recognized additional right-of-use assets and additional lease liabilities, recognizing the difference in retained earnings. The line items that were restated on transition to IFRS 16 are summarized below:

HARDWOODS DISTRIBUTION INC.

Notes to the Consolidated Financial Statements
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Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

Impacts on transition (continued)

Consolidated Statements of Financial Position

	As Filed December 31, 2018	IFRS 16 Adjustments	Restated December 31, 2018
Non-current assets:			
Property, plant and equipment	24,184	(3,827)	20,357
Right of use assets	—	97,241	97,241
Deferred income taxes	3,051	3,793	6,844
Total non-current assets	102,040	97,207	199,247
Total assets	444,760	97,207	541,967
Current Liabilities			
Accounts payable and accrued liabilities	39,387	(171)	39,216
Lease obligation	1,529	22,844	24,373
Total current liabilities	155,573	22,673	178,246
Non-current liabilities			
Lease obligation	2,018	86,082	88,100
Other liabilities	1,237	(1,055)	182
Total non-current liabilities	3,255	85,027	88,282
Total Liabilities	158,828	107,700	266,528
Shareholder's Equity			
Retained Earnings	35,530	(9,877)	25,653
Accumulated other comprehensive income	29,411	(616)	28,795
Shareholders' equity	285,932	(10,493)	275,439
Total shareholders' equity and liabilities	444,760	97,207	541,967

HARDWOODS DISTRIBUTION INC.

Notes to the Consolidated Financial Statements
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Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

Impacts on transition (continued)

Consolidated Statements of Financial Position

	As Filed January 1, 2018	IFRS 16 Adjustments	Restated January 1, 2018
Non-current assets:			
Property, plant and equipment	20,650	(2,606)	18,044
Right of use assets	—	82,816	82,816
Deferred income taxes	5,477	3,433	8,910
Total non-current assets	96,371	83,643	180,014
Total assets	372,903	83,643	456,546
Current Liabilities			
Accounts payable and accrued liabilities	38,254	(198)	38,056
Lease obligation	1,281	15,314	16,595
Total current liabilities	132,230	15,116	147,346
Non-current liabilities			
Lease obligation	1,068	78,298	79,366
Other liabilities	779	(334)	445
Total non-current liabilities	1,847	77,964	79,811
Total Liabilities	134,077	93,079	227,157
Shareholder's equity			
Retained earnings	9,919	(9,437)	482
Accumulated other comprehensive income	9,693	—	9,693
Shareholders' equity	238,826	(9,437)	229,389
Total shareholders' equity and liabilities	372,903	83,643	456,546

HARDWOODS DISTRIBUTION INC.

Notes to the Consolidated Financial Statements
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Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

Impacts on transition (continued)

Consolidated Statements of Comprehensive Income

	As Filed December 31, 2018	IFRS 16 Adjustments	Restated December 31, 2018
Cost of goods sold	(933,719)	715	(933,004)
Gross Profit	200,548	715	201,263
Operating expenses			
Selling and distribution	(118,215)	3,282	(114,933)
Total operating expenses	(154,213)	3,282	(150,931)
Finance expense	(4,350)	(4,581)	(8,931)
Net finance expense	(3,398)	(4,581)	(7,979)
Profit before income taxes	42,937	(584)	42,353
Income tax expense:			
Deferred	(2,491)	144	(2,347)
Total income tax expense	(10,778)	144	(10,634)
Profit for the period	32,159	(440)	31,719
Other comprehensive income(loss):			
Exchange differences translating foreign operations	19,718	(616)	19,102
Total comprehensive income for the period	51,877	(1,056)	50,821
Basic profit per share	1.50	(0.02)	1.48
Diluted profit per share	1.49	(0.02)	1.47

HARDWOODS DISTRIBUTION INC.

Notes to the Consolidated Financial Statements
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Years ended December 31 2019 and 2018

3. Significant accounting policies (continued):

Impacts on transition (continued)

Consolidated Statements of Cash Flows

	As Filed December 31, 2018	IFRS 16 Adjustments	Restated December 31, 2018
Cash flow from operating activities:			
Profit for the period	32,159	(440)	31,719
Adjustments for:			
Depreciation and amortization	6,847	18,690	25,537
Income tax expense	10,778	(144)	10,634
Net finance expense	3,398	4,582	7,980
	44,209	22,688	66,897
Changes in non-cash working capital:			
Accounts payable and accrued liabilities	(1,922)	(629)	(2,551)
	(40,195)	(629)	(40,824)
Net cash provided by (used in) operating activities	4,015	22,058	26,073
Cash flow from financing activities:			
Principle payments on finance lease obligation	(1,396)	(22,058)	(23,454)
Net cash provided by (used in) financing activities	6,120	(22,058)	(15,938)

Impacts for the period

In relation to those leases under IFRS 16, the Company recognized depreciation and interest costs, instead of operating lease expense. During the year ended December 31, 2019 the Company recognized \$20.2 million (2018 - \$18.6) of depreciation expense and \$4.5 million (2018 - \$4.6 million) of interest expense from leases.

4. Business acquisitions:

(a) Diamond Hardwoods acquisition

On March 9, 2020, the Company acquired through one of its wholly owned subsidiaries substantially all of the assets and assumed certain liabilities of Diamond Hardwoods ("Diamond") for total estimated consideration for \$4.0 million (US\$3.0 million). Diamond operates two locations in Northern California and is engaged in the distribution of architectural building products to contractors, industrial manufacturers, and retail customers. The acquisition will be accounted for as a business combination using the acquisition method, with the Company being the acquirer and Diamond being the acquiree, and where the assets acquired and liabilities assumed are recorded at their fair values at the acquisition date.

(b) Pacific Mutual Door Company acquisition

On October 28, 2019, the Company acquired through one of its wholly owned subsidiaries substantially all of the assets and assumed certain liabilities of Pacific for total estimated consideration for \$48.0 million (US\$36.2 million). Pacific operates four distribution centers in the US and is engaged in the distribution of interior and exterior doors, custom millwork, and other ancillary architectural building products to customers that supply end products to the residential and commercial construction markets.

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

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4. Business acquisitions (continued):

(b) Pacific Mutual Door Company acquisition (continued)

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

	US\$	CAD\$
Cash consideration	\$36,199	\$48,028
Assets acquired and liabilities assumed:		
Accounts and other receivables	7,332	9,728
Inventories	6,349	8,424
Prepaid expenses	87	114
Property plant and equipment	1,059	1,405
Right of use asset	3,387	4,493
Intangible assets - customer relationships	11,000	14,595
Accounts payable and accrued liabilities	(2,137)	(2,837)
Lease obligation	(3,387)	(4,493)
Identifiable net assets acquired	23,690	31,429
Goodwill	12,510	16,599
Net assets acquired	\$36,200	\$48,028

The goodwill of \$16.6 million (US\$12.5 million) is attributable primarily to the skills and talent of Pacific's workforce, and synergies expected to be achieved in respect of purchasing power with vendors, increases in market share, and operational efficiencies related to the combined operations. The goodwill is deductible for tax purposes.

The intangible assets of \$14.6 million (US\$11.0 million) primarily represent the value of customer relationships acquired and are being amortized over 10 years, which is the period the Company expects to benefit from these relationships. The intangible asset is deductible for tax purposes.

The purchase price was financed by the Company's US credit facility. In connection with the acquisition, the Company amended its US credit facility, see note 12 for further details.

Had the Pacific Acquisition occurred on January 1, 2019 management estimates that the Company's consolidated sales would have been approximately \$1,249.2 million and profit before income tax would have been approximately \$45.1 million for the year ended December 31, 2019. Included in these consolidated financial statements for the year ended December 31, 2019 are sales of \$12.7 million (US\$9.6 million) and profit before income tax of \$0.5 million (US\$0.4 million) relating to Pacific.

Transaction costs of \$0.4 million were incurred in connection with the acquisition, and have been expensed in the consolidated statements of comprehensive income.

(c) Other acquisitions

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.

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).

HARDWOODS DISTRIBUTION INC.

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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, 2019	December 31, 2018	January 1, 2018
Cash	\$ (15,118)	\$ (1,547)	\$ (313)
Bank indebtedness	121,548	\$ 112,940	\$ 91,146
Shareholder's equity	283,445	275,439	229,389
Total capitalization	\$ 389,875	\$ 386,832	\$ 320,222

The terms of the Company's US and Canadian credit facilities are described in note 12. 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, 2019 and December 31, 2018, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Dividends and share repurchases are some of the ways the Company manages its capital. Dividends are declared and shares are repurchased after consideration of a variety of factors including the outlook for the business and financial leverage.

On November 8, 2019, the Company declared a cash dividend of \$0.085 per common share to shareholders of record as of January 20, 2020. The dividend was paid to shareholders on January 31, 2020. On March 19, 2020, the Company declared a cash dividend of \$0.085 per common share to shareholders of record as of April 16, 2020, to be paid on April 30, 2020.

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's cash and cash equivalents are classified as level 1 and all other financial instruments are classified as level 2 of the fair value hierarchy.

Fair values of financial instruments

The carrying values of cash and cash equivalents, accounts and other receivables, income taxes receivable, 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.

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6. Financial instruments (continued):

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 \$131.0 million at December 31, 2019 (December 31, 2018 - \$115.2 million, January 1, 2018 - \$96.4 million), represents the Company's maximum exposure to credit risk.

Trade accounts receivable

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. The Company is exposed to credit risk in the event it is unable to collect in full amounts receivable from its customers. The Company employs established credit approval practices and engages credit attorneys when appropriate to mitigate credit risk. The Company attempts to secure credit advanced to customers whenever possible by registering security interests in the assets of the customer and by obtaining personal guarantees. Credit limits are established for each customer and are regularly reviewed. In some instances the Company may choose to transact with a customer on a cash-on-delivery basis. The Company's largest individual customer balance amounted to 2.0% (December 31, 2018 - 2.0%) of trade accounts receivable and customer notes receivable at December 31, 2019. 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%.

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6. Financial instruments (continued):

Financial risk management (continued):

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.

(i) Credit risk (continued):

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, 2019, 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 \$194.8 million (US\$150.0 million). These credit facilities can be drawn down to meet short-term financing requirements, including fluctuations in non-cash working capital. The amount made available under the revolving credit facilities is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Company, as well as by continued compliance with credit ratios and certain other terms under the credit facilities. See note 12 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 3 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, 2019 bank indebtedness balance of \$121.6 million, a 1% increase or decrease in the interest rates charged would result in a decrease or increase to profit after tax by approximately \$0.9 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 90% 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.

At December 31, 2019, the primary exposure to foreign denominated financial instruments was in the Company's Canadian subsidiaries and relates to U.S. dollar cash balances, accounts receivable from U.S. customers (2019 - US\$0.9 million, 2018 - US\$0.5 million) and accounts payable to U.S. suppliers (2019 - US\$1.3 million, 2018 - US\$0.2 million).

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6. Financial instruments (continued):

Currency risk (continued):

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 profit for the years ended December 31, 2019 or December 31, 2018.

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, 2019 and December 31, 2018 and does not take into account the effect a change in currency rates will have on the translation of the balance sheet and operations of the Company's U.S. subsidiaries nor is it intended to estimate the potential impact changes in currency rates would have on the Company's sales and purchases.

Commodity price risk:

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

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7. Accounts and other receivables:

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

	December 31, 2019	December 31, 2018	January 1, 2018
Trade accounts receivable - Canada	\$ 13,401	\$ 13,131	\$ 13,458
Trade accounts receivable - United States	98,877	97,907	79,880
Sundry receivable	4,386	4,973	6,745
Current portion of non-current receivables	1,257	802	1,360
	117,921	116,813	101,443
Less:			
Allowance for credit loss	4,182	4,808	4,180
	\$ 113,740	\$ 112,005	\$ 97,263
Non-current receivables:			
Employee housing loans	\$ 120	\$ 136	\$ 257
Customer notes	1,065	570	921
Security deposits	2,448	1,953	1,541
	3,633	2,659	2,719
Less:			
Current portion, included in accounts receivable	1,257	802	1,360
	\$ 2,376	\$ 1,857	\$ 1,359

The aging of trade receivables is:

	December 31, 2019	December 31, 2018	January 1, 2018
Current	\$ 77,922	\$ 76,206	\$ 65,635
1 - 30 days past due	20,016	22,549	19,075
31 - 60 days past due	8,061	7,037	5,204
60+ days past due	6,280	5,246	3,424
	\$ 112,279	\$ 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, 2019 was \$4.2 million (December 31, 2018 - \$4.8 million, January 1, 2018 - \$4.2 million). The amount of the allowance is determined 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.

Bad debt expense, net of recoveries, for the year ended ended December 31, 2019 was \$2.2 million which equates to 0.2% of sales (for the year ended December 31, 2018 - \$0.6 million, being 0.05% of sales).

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8. Inventories:

	December 31, 2019	December 31, 2018	January 1, 2018
Raw materials	\$ 1,171	\$ 780	\$ 1,306
Work in process	3,821	4,584	4,950
Goods in-transit	8,442	12,630	7,947
Finished goods	194,501	205,791	157,903
	<u>\$ 207,935</u>	<u>\$ 223,785</u>	<u>\$ 172,106</u>

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 statements of comprehensive income as follows:

	2019	2018
Inventory write-downs, included in cost of goods sold	\$ 2,453	\$ 2,065
Cost of inventory sold	913,363	883,425
Other cost of goods sold	46,578	49,579
Total cost of goods sold	<u>\$ 959,941</u>	<u>\$ 933,004</u>

HARDWOODS DISTRIBUTION INC.

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9. Property, plant and equipment:

	Land	Leased vehicles and forklifts	Buildings, machinery and equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2018	\$ 770	\$ 4,222	\$ 30,377	\$ 1,299	\$ 36,668
Impact of changes in accounting (Note 3)	—	(4,222)	—	—	(4,222)
Balance at January 1, 2018, restated	770	—	30,377	1,299	32,446
Additions	—	—	3,696	380	4,076
Acquisition of Atlanta	—	—	390	—	390
Disposals	—	—	(896)	(31)	(927)
Adjustments:					
Foreign currency translation	68	—	2,567	74	2,709
Balance at December 31, 2018	838	—	36,134	1,722	38,694
Additions	18	—	2,952	351	3,321
Acquisition of Far West and Pacific (note 4)	—	—	1,520	—	1,520
Disposals	—	—	(1,530)	(131)	(1,661)
Adjustments:					
Foreign currency translation	(40)	—	(1,672)	(53)	(1,765)
Balance at December 31, 2019	\$ 816	\$ —	\$ 37,404	\$ 1,889	\$ 40,109
Accumulated depreciation					
Balance at January 1, 2018	\$ —	\$ 1,616	\$ 13,479	\$ 923	\$ 16,018
Impact of changes in accounting (Note 3)	—	(1,616)	—	—	(1,616)
Balance at January 1, 2018, restated	—	—	13,479	923	14,402
Depreciation	—	—	3,387	131	3,518
Disposals	—	—	(740)	(29)	(769)
Adjustments:					
Foreign currency translation	—	—	1,146	40	1,186
Balance at December 31, 2018	—	—	17,272	1,065	18,337
Depreciation	—	—	3,558	173	3,731
Disposals	—	—	(1,456)	(124)	(1,580)
Adjustments:					
Foreign currency translation	—	—	(770)	(39)	(809)
Balance at December 31, 2019	\$ —	\$ —	\$ 18,604	\$ 1,075	\$ 19,679
Net book value:					
January 1, 2018	\$ 770	\$ —	\$ 16,898	\$ 376	\$ 18,044
December 31, 2018 restated (Note 3(q))	\$ 838	\$ —	\$ 18,862	\$ 657	\$ 20,357
December 31, 2019	\$ 816	\$ —	\$ 18,800	\$ 814	\$ 20,430

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9. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the year ended December 31, 2019 was \$3.7 million (2018 - \$4.8 million) and is included in the statement of comprehensive income as follows:

	2019	2018
Cost of sales	\$ 1,766	\$ 1,614
Selling and distribution	1,708	2,936
Administration	257	224
	\$ 3,731	\$ 4,774

Gains and losses on disposal of property, plant and equipment for the year ended December 31, 2019 was a net gain of \$0.2 million (2019 - net gain of \$0.2 million) 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, 2018	\$ 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
Additions	282	—	282
Acquisition of Pacific (Note 4(a))	—	14,595	14,595
Adjustments:			
Foreign currency transaction	(28)	(1,339)	(1,367)
Balance at December 31, 2019	\$ 890	\$ 34,760	\$ 35,650
Accumulated amortization			
Balance at January 1, 2018	\$ —	\$ 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
Amortization	36	2,358	2,394
Adjustments:			
Foreign currency transaction	(2)	\$ (302)	(304)
Balance at December 31, 2019	\$ 40	\$ 7,362	\$ 7,402
Net book value:			
January 1, 2018	\$ 318	\$ 16,897	\$ 17,215
December 31, 2018	\$ 630	\$ 16,198	\$ 16,828
December 31, 2019	\$ 850	\$ 27,398	\$ 28,248

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10. Intangible assets (continued):

Amortization of intangible assets for the year ended December 31, 2019 was \$2.4 million (2018 - \$2.1 million) and is included in selling and distribution expenses in the statement of comprehensive income.

11. Goodwill:

Balance at January 1, 2018	\$	51,670
Adjustments:		
Foreign currency translation		4,450
Balance at December 31, 2018		56,120
Acquired through acquisitions (Note 4)		19,966
Adjustments:		
Foreign currency translation		(3,112)
Balance at December 31, 2019	\$	72,974

12. Bank indebtedness:

	December 31, 2019	December 31, 2018	January 1, 2018
Cheques issued in excess of funds on deposit	\$ 2,489	\$ 1,011	\$ 866
Credit facility, Hardwoods LP	13,013	10,626	7,270
Credit facility, Hardwoods USLP II (December 31, 2019 - US\$81,650 December 31, 2018 - US\$74,369 January 1, 2018 - US\$66,323)	106,047	101,303	83,010
	\$ 121,548	\$ 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").

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")

The LP Credit Facility consists of a revolving credit facility of \$25.0 million with the amount made available 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. The LP Credit Facility matures in August 2021 and can be prepaid anytime with no prepayment penalty. 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, 2019, the LP Credit Facility has unused availability of \$10.3 million, before cheques issued in excess of funds on deposit of \$2.5 million (December 31, 2018 - \$11.9 million, cheques issued in excess of funds on deposit - \$1.0 million).

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12. Bank indebtedness (continued):

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

In connection with the acquisition of Pacific (note 4), on October 28, 2019 the Company amended The USLP II Credit Facility. The amendment included an increase to the revolver from US\$125 million to US\$150 million, and lowered borrowing rates. The amount made available under the credit facility is limited to 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 October 2024 and can be prepaid at any time with no prepayment penalty. 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\$15.0 million at any time.

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

At December 31, 2019, the USLP II Credit Facility has unused availability of \$59.5 million (US\$45.8 million), before cheques issued in excess of funds on deposit of nil. At December 31, 2018, the USLP II Credit Facility had unused availability of \$66.5 million (US\$48.7 million), before cheques issued in excess of funds on deposit of nil.

The Company has letters of credit outstanding at December 31, 2019 totaling \$3.6 million (US\$2.8 million) (December 31, 2018 - \$2.6 million (US\$1.9 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, 2019 were 4.1% and 4.4% (2018 - 3.5% and 3.6%) for the LP and USLP II Credit Facilities, respectively.

13. Share capital:

(a) Share capital

At December 31, 2019, 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, 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
Issued pursuant to long term incentive plan	87,491	1,016
Share repurchase	(271,280)	(3,703)
Balance at December 31, 2019	21,355,327	\$ 113,837

At December 31, 2019 the Company had \$260,000 (December 31, 2018 and January 1, 2018 - nil) accrued in accounts payable related to share repurchase obligations. This amount was settled in January 2020.

(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.

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13. Share capital (continued):

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

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, 2019 the fair value of the Restricted Shares and Performance Shares estimated to be settled in the future in cash was \$1.1 million (December 31, 2018 - \$0.4 million) and this value has been 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 or employees pursuant to the plan and other Share compensation arrangements of the Company within a one year period, or at any one time, may not exceed 10% of the issued and outstanding Shares.

A continuity of the LTIP Shares outstanding is as follows:

	Performance Shares	Restricted Shares
Balance at December 31, 2017	121,506	116,650
LTIP shares issued during the year	55,079	94,373
LTIP shares settled	(88,050)	(82,509)
Balance at December 31, 2018	88,535	128,514
LTIP shares issued during the period	67,181	136,763
LTIP shares forfeited during the period	(41,648)	(1,375)
LTIP shares settled	—	(105,427)
Balance at December 31, 2019	114,068	158,475

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13. Share capital (continued):

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

LTIP compensation expense of \$2.2 million was recognized in the consolidated statements of comprehensive income for year ended December 31, 2019 (December 31, 2018 - \$2.1 million). The equity classified portion of the LTIP compensation expense was \$1.4 million for year ended December 31, 2019 (December 31, 2018 - \$2.6 million, January 1, 2018 - \$1.4) and the liability classified expense was \$0.8 million (December 31, 2018 - recovery of \$0.5 million, January 1, 2018 - \$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 after 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, 2019 of \$29.6 million (December 31, 2018 - \$31.7 million). The weighted average number of common shares outstanding in each of the reporting years was as follows:

	December 31, 2019	December 31, 2018
Issued ordinary shares at beginning of year	21,539,116	21,419,985
Effect of shares repurchased	(160,085)	—
Effect of shares issued during the year:		
Pursuant to long-term incentive plan	240	34,863
Weighted average common shares - basic	21,379,271	21,454,848
Effect of dilutive securities:		
Long-term incentive plan	109,652	124,331
Weighted average common shares - diluted	21,488,923	21,579,179

14. Income taxes:

	2019	2018
Current tax expense	\$ (7,227)	\$ (8,287)
Deferred tax expense	(2,293)	(2,347)
	\$ (9,520)	\$ (10,634)

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, 2019 is 26.9% (2018 - 26.9%) and in the United States is 26.0% (2018 - 26.0%). 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:

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14. Income taxes (continued):

	2019		2018	
Profit before income tax	\$	39,101	\$	42,353
Statutory rate		26.0%		26.0%
Computed tax expense at statutory rate		(10,166)		(11,011)
Effect of tax rate differentials and other restructuring		1,116		962
Non-deductible expenses		(547)		350
Prior year tax true-ups		127		300
Change in unrecognized deferred tax assets		46		(1,081)
Other		(96)		(154)
Income tax expense	\$	(9,520)	\$	(10,634)

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, 2019		December 31, 2018		January 1, 2018	
Deferred tax assets:						
Accounts receivable	\$	1,208	\$	1,115	\$	1,014
Accounts payable and provisions		466		764		532
Inventory		2,433		2,672		1,867
Finance lease obligations, net		6,055		4,722		4,049
Goodwill and intangibles		—		1,047		3,088
Tax loss carry forwards and future interest deductions		516		115		252
Share and debt issuance costs		270		518		746
Other		(67)		91		104
		10,881		11,044		11,652
Deferred tax liabilities:						
Prepaid expenses		(777)		(72)		(80)
Property, plant and equipment		(5,643)		(4,128)		(2,662)
		(6,420)		(4,200)		(2,742)
Deferred tax asset	\$	4,461	\$	6,844	\$	8,910

Deferred tax assets and liabilities are measured at the substantively enacted rates expected to apply at the time such temporary differences are forecast to reverse. At December 31, 2019, the Company and its subsidiaries have operating loss carry forwards for income tax purposes of approximately \$1.6 million in Canada that may be utilized to offset future taxable income (December 31, 2018 - \$0.4 million). These losses, if not utilized, will expire in 2040. The Company's US subsidiaries have no operating loss carry forwards.

At December 31, 2019, the Company and its Canadian subsidiaries have capital losses of approximately \$23.0 million (December 31, 2018 - \$24.7 million, January 1, 2018 - \$25.0 million), and suspended capital losses of approximately \$44.7 million (December 31, 2018 - \$44.7 million, January 1, 2018 - \$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 \$9.0 million (December 31, 2018 - \$12.7 million, January 1, 2018 - \$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.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

15. Finance income and expense:

	Note	2019	Restated (Note 3) 2018
Finance expense:			
Interest on bank indebtedness	11	\$ (4,721)	\$ (4,106)
Accretion of finance lease obligation		(4,700)	(4,825)
Foreign exchange loss		(364)	—
Total finance expense		(9,784)	(8,931)
Finance income:			
Interest on trade receivables, customer notes, and employee loans	7	626	513
Foreign exchange gain		—	439
Total finance income		626	952
Net finance expense		\$ (9,158)	\$ (7,979)

16. Segment reporting:

Information about geographic areas is as follows:

	2019	2018
Revenue from external customers:		
Canada	\$ 138,100	\$ 140,903
United States	1,033,821	993,364
	\$ 1,171,921	\$ 1,134,267

	December 31, 2019	Restated (Note 3) December 31, 2018	January 1, 2018 ⁽¹⁾
Non-current assets ⁽¹⁾ :			
Canada	\$ 10,816	\$ 9,609	\$ 10,981
United States	204,818	180,937	158,764
	\$ 215,634	\$ 190,546	\$ 169,745

⁽¹⁾ Excludes financial instruments and deferred income taxes.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

17. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are summarized below.

	2019	2018
Wages, salaries and benefits	\$ 120,746	\$ 112,419
Pensions - defined contribution plans	1,519	1,399
LTIP share based compensation	2,249	2,096
	\$ 124,514	\$ 115,914

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

	2019	2018
Cost of sales	\$ 26,260	\$ 24,571
Selling and distribution	71,235	66,054
Administration	27,019	25,289
	\$ 124,514	\$ 115,914

(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, 2019, Hardwoods USLP, Rugby Holdings LLC and Paxton Hardwoods LLC contributed and expensed \$1.2 million (US \$0.9 million) (2018 - \$1.0 million (US \$0.8 million)) in relation to these Plans. There is no requirement for an employer contribution to the plan maintained by HMI Hardwood LLC and accordingly HMI Hardwoods LLC did not make any contributions to this plan.

Hardwoods LP does not maintain a pension plan. Hardwoods LP does, however, administer a group registered retirement savings plan ("LP Plan") that has a matching component whereby Hardwoods LP makes contributions to the LP Plan which match contributions made by employees up to a certain level. The assets of the LP Plan are held and related investment transactions are executed by LP Plan's Trustee who is a third party, and, accordingly, are not reflected in these consolidated financial statements. During the year ended December 31, 2019, Hardwoods LP contributed and expensed \$0.4 million (2018 - \$0.4 million) in relation to the LP plan.

HARDWOODS DISTRIBUTION INC.

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

Years ended December 31 2019 and 2018

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:

	2019	2018
Short-term employee benefits:		
Salaries and benefits including bonuses	\$ 3,583	\$ 3,732
Automobile benefit	40	40
LTIP Share compensation	1,603	1,595
Total remuneration	\$ 5,226	\$ 5,367

(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, 2019 or December 31, 2018.

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, 2019.

Corporate Information

Directors

Robert J. Brown
Director

Peter M. Bull
President, Blenheim Realty Ltd.

Michelle Lewis
Principal, CapStreet Group

Jim Macaulay
Chief Financial Officer, Marvin Companies

E. Lawrence Sauder
Chair, Interfor Corporation

William Sauder
President, Emax Investments Ltd.

Rob Taylor
President, Sonepar North America

Graham Wilson
President, Grawil Consultants Inc.

Officers

Robert J. Brown
President & Chief Executive Officer

Lance R. Blanco
Senior Vice President, Corporate Development

Faiz H. Karmally
Vice President and Chief Financial Officer

Jason West
Vice President, Canada

Dan A. Besen
Vice President, United States

Dan Figgins
Vice President, Imports

John Griffin
Vice President, Paxton

Dave Hughes
Senior Vice President, Acquisitions

Drew Dickinson
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Listings

The Toronto Stock Exchange
Trades under **HDI**

Transfer Agent

Computershare Trust

HDI
HARDWOODS DISTRIBUTION INC.