HARDWOODS DISTRIBUTION INCOME FUND

QUARTERLY REPORT

For the period July 1, 2004 to September 30, 2004

And the period March 23, 2004 to September 30, 2004

To Our Unitholders

I am pleased to present the results for the third quarter, covering the three months ended September 30, 2004 and the reporting period from March 23, 2004 to September 30, 2004. The third quarter continued the solid performance of Hardwoods Distribution Income Fund since the completion of its initial public offering ("IPO) on March 23, 2004. Our business continues to benefit from the diversity in our customers, our geographic regions of operation, and our product mix, as well as from the continued commitment and entrepreneurship of our employees.

As the Fund commenced operations in March 2004 there are no comparative figures provided in the consolidated interim financial statements included herein. However, we have tried to enhance the usefulness of this report by making reference in certain circumstances to the results of the predecessor companies, adjusted on a pro forma basis to reflect the new financial structure of the Fund. In this light, we hope you find these references useful.

Operations Review

Results for the quarter continue to be ahead of the level anticipated at the time of our IPO. Sales for the quarter were $97.0 million (this compares to $85.0 million in sales generated by the combined predecessor companies for the corresponding period in 2003). Net earnings for the period amounted to $4.4 million (this compares to $3.4 million generated by the combined predecessor companies on a pro forma basis for the corresponding period in 2003). Hardwoods' earnings before taxes, interest, depreciation and amortization and also before non-controlling interest ("EBITDA") was $8.1 million (this compares to EBITDA of $5.9 million generated by the combined predecessor companies on a pro forma basis for the corresponding period in 2003). Refer to page 4 and 5 for further discussion of the use of EBITDA, which is a non-GAAP measure.

Our increase in earnings and EBITDA for the quarter is largely the result of our sales growing by 14.1%, limiting corresponding growth in our expenses, and the effect of the mark to market gain on foreign currency contracts. Most of our expenses do not vary with moderate increases in sales levels. Sales growth has resulted from a combination of increases to product prices and growth in underlying volumes of product sold. Our sales growth has been achieved despite the continued strength of the Canadian dollar against the United States dollar, where the average rate of exchange for the quarter was 1.3119 compared to 1.3801 for the corresponding period in 2003. Approximately two thirds of our business is conducted in the United States.

Cash Distributions

We paid the following cash distributions for the quarter:

Period	Date of Record	Date of Payment	Distribution per Unit	Amount
July 2004	August 20, 2004	August 31, 2004	$0.09	$1,296,900
August 2004	September 20, 2004	September 30, 2004	$0.09	$1,296,900
September 2004	October 20, 2004	October 29, 2004	$0.09	$1,296,900

In addition, on October 29, 2004, the Fund expects to make a quarterly distribution of $1.3 million to Hardwoods' previous owners pursuant to the terms of the subordination agreement between the Fund and the previous owners who continue to own a 20% interest in the business of the Fund. On an after-tax per unit basis, the distributions to previous owners are equivalent to distributions paid to unitholders for the respective period.

Since inception of the Fund cash distributions paid to unitholders have represented 83% of cash available for distribution to unitholders. The Trustees review the monthly cash distributions regularly. Trustees have approved monthly cash distributions to unitholders for October, November and December 2004 as follows:

Period	**Date of Record**	**Date of Payment**	**Distribution per Unit**	**Amount**
October 2004	November 19, 2004	November 30, 2004	$0.09	$1,296,900
November 2004	December 20, 2004	December 31, 2004	$0.09	$1,296,900
December 2004	January 20, 2005	January 31, 2005	$0.09	$1,296,900

Outlook

We believe our operations for the balance of 2004 will continue to be strong, although we do expect the pace of sales growth we have experienced in the period from March 23, 2004 to September 30, 2004 to moderate. In addition, we expect some normal seasonal slowdown in demand to be reflected in the results for the fourth quarter. Our focus will be to consolidate the improvements in underlying sales volumes we have experienced since the time of our IPO, and to maintain tight discipline on our costs. We expect the Fund's performance to continue to meet our financial and cash distribution targets for the remainder of the year.

Maurice E. Paquette
President & Chief Executive Officer
October 27, 2004

Management's Discussion and Analysis of Financial Condition and Results

This management's discussion and analysis ("MD&A") should be read in conjunction with the unaudited interim consolidated financial statements and accompanying notes ("Interim Financial Statements") of Hardwoods Distribution Income Fund for the three month period ended September 30, 2004 and the period from March 23, 2004 to September 30, 2004. Results are reported in Canadian dollars unless otherwise stated and have been prepared in accordance with Canadian generally accepted accounting principles.

This MD&A for the three month period ended September 30, 2004 and the period from March 23, 2004 to September 30, 2004 represents the first such reporting period for the Fund, and consequently, no comparative information is provided in the consolidated interim financial statements. However, in order to enhance the usefulness of this MD&A, certain financial and operating results of the Fund for the three month period ended September 30, 2004 and the period from March 23, 2004 to September 30, 2004 are compared to the unaudited pro forma results of the predecessor companies for the three and six month periods ended September 30, 2003, respectively. All results of the predecessor companies are prepared on a pro forma basis reflecting the new financial structure of the Fund. Such information is for reference purposes only and is not intended to represent a comprehensive comparison of the consolidated financial results.

Selected Unaudited Consolidated Financial Information

(in thousands of dollars)	**For the three months ended September 30, 2004**	**For the three months ended September 30, 2003 (predecessor companies – pro forma[1])**
Total sales	$ 97,040	$ 85,048
Gross profit	17,905	15,716
Gross margin %	*18.5%*	*18.5%*
Selling and administrative expenses	10,958	9,789
Net earnings for the period	4,351	3,391
Add:		
Income taxes	1,264	500
Interest	473	400
Amortization	609	656
Non-controlling interest	1,404	974
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 8,101	$ 5,921
Deduct:		
Interest	(473)	
Mark to market gain on foreign currency contracts	(1,154)	
Capital expenditures	(531)	
Distributable Cash available to non-controlling interest (2)	(1,189)	
Current income taxes	(739)	
Distributable Cash available to Unitholders	$ 4,015	
Cash distributions to Unitholders	$ 3,891	
Total assets	$ 224,148	
Foreign currency contracts asset	$ 851	
Per Unit information:		
Basic and fully diluted earnings per Unit	$ 0.302	
Distributable Cash available to Unitholders per unit	$ 0.279	
Cash distributions per Unit	$ 0.270	
Average Canadian dollar/ U.S. dollar exchange rate	1.3119	1.3801

(in thousands of dollars)	For the period from March 23, 2004 to September 30, 2004	For the six months ended September 30, 2004 (predecessor companies - pro forma[1])
Total sales	$ 196,165	$ 170,762
Gross profit	36,852	31,954
Gross margin %	*18.8%*	*18.7%*
Selling and administrative expenses	21,541	19,987
Net earnings for the period	9,035	6,770
Add:		
Income taxes	2,311	1,000
Interest	753	800
Amortization	1,227	1,447
Non-controlling interest	2,836	1,944
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 16,162	$ 11,961
Deduct:		
Interest	(753)	
Mark to market gain on foreign currency contracts	(851)	
Capital expenditures	(809)	
Distributable Cash available to non-controlling interest (2)	(2,750)	
Current income taxes	(1,466)	
Distributable Cash available to Unitholders	$ 9,533	
Cash distributions to Unitholders	$ 7,911	
Total assets	$ 224,148	
Foreign currency contracts asset	$ 851	
Per Unit information:		
Basic and fully diluted earnings per Unit	$ 0.627	
Distributable Cash available to Unitholders per unit	$ 0.662	
Cash distributions per Unit	$ 0.549	
Average Canadian dollar/ U.S. dollar exchange rate	1.3343	1.3893

Non-GAAP Measures – EBITDA and Distributable Cash

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization and the non-controlling interest in earnings. Management believes that, in addition to net income or loss, EBITDA is a useful supplemental measure of performance and cash available for distribution prior to debt service, changes in working capital, capital expenditures and income taxes. Specifically, Management believes that EBITDA is the appropriate measure from which to make adjustments to determine the Distributable Cash of the Fund.

EBITDA is not an earnings measure recognized by generally accepted accounting principles in Canada ("GAAP") and does not have a standardized meaning prescribed by GAAP. Investors are cautioned that EBITDA should not replace net income or loss (as determined in accordance with GAAP) as an indicator of our performance, or to cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA may differ from the methods used by other issuers. Therefore, our EBITDA may not be comparable to similar measures presented by other issuers.

---

[1] The results of operations of the predecessor companies have been adjusted on a pro forma basis to reflect the Fund's capital structure and the acquisition of the Hardwoods Group of Companies by the Fund. Significant pro forma adjustments relate to changes in amortization, interest and income tax expenses.

2 The non-controlling interest will be distributed to the previous owners who continue to own a 20% interest in the business of the Fund only to the extent the terms of the subordination agreement between the Fund and the previous owners are satisfied.

Distributable Cash of the Fund is a non-GAAP measure generally used by Canadian open-ended income funds as an indicator of financial performance. We define Distributable Cash as net earnings before depreciation, amortization, future income taxes and unrealized mark to market adjustments on foreign exchange hedge contracts, and after capital expenditures and contributions to any reserves that the Board of Trustees deem to be reasonable and necessary for the operation of the Fund.

Our Distributable Cash may differ from similar computations as reported by other similar entities and, accordingly, may not be comparable to distributable cash as reported by such entities. We believe that our Distributable Cash is a useful supplemental measure that may assist prospective investors in assessing the return on their investment in Units.

Overview of the Fund

The Fund is an unincorporated open-ended limited purpose trust formed under the laws of the Province of Manitoba by a declaration of trust dated January 30, 2004. The Fund completed an initial public offering ("IPO") of 14,410,000 trust Voting Units ("Units") on March 23, 2004. Net proceeds of the IPO of $133.5 million together with drawings on credit facilities totaling $31.6 million were used to acquire an 80% interest in the hardwood lumber and sheet goods distribution business (the "Business") from the previous owners.

The Business is North America's largest distributor of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. The Business operates from 37 distribution facilities organized into nine geographic regions throughout North America. In a highly fragmented but stable industry, the Business matches products supplied from hundreds of mills to over 2,500 manufacturing customers.

The owners of the predecessor companies have retained their 20% interest in the Business in the form of Special Voting Units of the Fund and Class B units of the Fund's operating subsidiaries, which together are exchangeable into Units provided that the Fund achieves certain objectives. Distributions by the operating subsidiaries to the previous owners are subject to subordination arrangements until at least March 31, 2006. As at September 30, 2004, the following units of the Fund were issued and outstanding:

Units	14,410,000
Special Voting Units	3,602,500

Hardwoods Distribution Income Fund units trade on the Toronto Stock Exchange under the symbol HWD.UN.

Results of Operations

Sales

Sales for the three month period ended September 30, 2004 were $97.0 million compared to $85.0 million for the combined predecessor companies during same period in 2003. The 14.1% growth in sales during the quarter reflects growth in the U.S. in U.S. dollars of 17.4% plus growth in Canada in Canadian dollars of 18.7%. The combined 14.1% growth has been achieved despite the effect of a lower rate of exchange between the Canadian and U.S. dollar, which averaged 1.3119 for the three month period ended September 30, 2004 as compared to 1.3801 during the corresponding period in 2003.

Sales for the period from March 23, 2004 to September 30, 2004 were $196.2 million compared to $170.8 million for the combined predecessor companies during the six month period ended September 30, 2003. The 14.9% growth in sales for the period reflects growth in the U.S. in U.S. dollars of 18.7% plus growth in Canada in Canadian dollars of 16.9%. As no new operating locations were added relative to the prior period, this sales increase of 14.9% represents sales growth within the Fund's existing facility network.

Sales growth for the three month period ended September 30, 2004 and for the period from March 23, 2004 to September 30, 2004 is a combination of both increased product pricing and growth in underlying sales volume. Sales growth has generally been achieved across all geographic regions, with the strongest increases occurring in the United States.

Gross Profit

Gross profit for the three month period ended September 30, 2004 was $17.9 million which compared to $15.7 million for the combined predecessor companies during the same period in 2003. This increase of $2.2 million, or 13.9%¸ was due primarily to growth in sales.

For the period March 23, 2004 to September 30, 2004 gross profit was $36.9 million compared to $32.0 million for the combined predecessor companies during the six month period ended September 30, 2003. This represents an increase of 15.3%, which is in line with sales growth achieved during the same period. Gross margins have improved slightly to 18.8% of sales for the period March 23, 2004 to September 30, 2004, compared to 18.7% for the combined predecessor companies during the six month period ended September 30, 2003.

Selling and Administrative Expenses

Selling and administrative expenses for the three month period ended September 30, 2004 increased $1.2 million, or 11.9%, to $11.0 million from $9.8 million in the prior year. For the period March 23, 2004 to September 30, 2004 selling and administrative expenses increased $1.5 million, or 7.8%, to $21.5 million compared to $20.0 million for the combined predecessor companies during the six month period ended September 30, 2003. The increase is due primarily to new costs as a public company and an increase in profit sharing associated with the growth in operating profits. Since the IPO of the Fund on March 23, 2004, selling and administrative expenses as a percent of sales has declined to 11.0% as compared to 11.7% for the combined predecessor companies during the six month period ended September 30, 2003, primarily as a result of the increase in sales.

Other Income

As at September 30, 2004, the mark-to-market valuation of the outstanding foreign currency contracts that were put in place at the time of our IPO was an asset to the Fund of $0.9 million. This mark-to-market valuation resulted in a $1.2 million gain on the foreign currency contracts for the three month period ended September 30, 2004, reflecting a strengthening of the Canadian dollar against the United States dollar denominated foreign currency contracts. For the period March 23, 2004 to September 30, 2004 the mark-to-market valuation of the outstanding foreign currency contracts resulted in a $0.9 million gain. We continue to monitor our hedge policy to ensure we mitigate the impact of foreign exchange fluctuations on Canadian dollar distributions generated by our U.S. operations. Refer to Financial Instruments on page 9 for further discussion of our foreign currency contracts.

Net Earnings and EBITDA

Net earnings and EBITDA were $4.4 million and $8.1 million for the three month period ended September 30, 2004, respectively. These compare to $3.4 million and $5.9 million, respectively, for the combined predecessor companies on a pro forma basis for the three month period ended September 30, 2003.

For the period March 23, 2004 to September 30, 2004 net earnings and EBITDA were $9.0 million and $16.2 million, respectively. These compare to $6.8 million and $12.0 million, respectively, for the combined predecessor companies on a pro forma basis for the six month period ended September 30, 2003.

The increase in net earnings and EBITDA for the three month period ended September 30, 2004 and for the period from March 23, 2004 to September 30, 2004 is attributable primarily to sales growth in 2004 compared to 2003, combined with our continued focus on expenses. In addition, the negative impact on net earnings and EBITDA of a strengthening Canadian dollar against the United States dollar in 2004 compared to 2003 has been offset by mark-to-market gains on foreign currency contracts. Refer to Financial Instruments on page 9 for further discussion of our foreign currency contracts.

Quarterly Financial Information

(in thousands of dollars)	For the three months ended September 30, 2004	For the period from March 23, 2004 to June 30, 2004
Total sales	$ 97,040	$ 99,125
Net earnings	4,351	4,684
Basic and fully diluted earnings per Unit	$ 0.30	$ 0.33

Liquidity

Distributable Cash and Distributions

Our policy is to make stable monthly distributions to our Unitholders based on our estimate of distributable cash for the year. We pay distributions at the end of the month that follows the month when the cash was earned. We have made six consecutive monthly distributions totaling $7.9 million to Unitholders since our initial public offering on March 23, 2004. Distributions for the period March 23, 2004 to April 30, 2004 were $0.1082 per unit, and for the months of May and June were $0.0854 per unit, respectively, consistent with monthly distributions anticipated at the time of our IPO. Distributions were increased by 5.4% to $0.09 per unit for the months of July, August, and September based on successful year-to-date results and a continued positive outlook for the Fund. The Fund made one quarterly cash distribution to Hardwoods' previous owners totaling $1.0 million and is expected to make another $1.3 million quarterly cash distribution to Hardwood's previous owners on October 29, 2004. On an after-tax per unit basis, such cash distributions are equivalent to the respective quarterly distributions to public unitholders pursuant to the terms of a subordination agreement as outlined in the Fund's prospectus dated March 12, 2004. For the period March 23, 2004 to September 30, 2004 the ratio of total cash distributions paid to Unitholders as compared to cash available for distribution to Unitholders was 83%.

The Board of Trustees reviews the monthly distributions regularly, and have approved monthly cash distributions to unitholders for October, November, and December 2004 as follows:

Period	Date of Record	Date of Payment	Distribution per Unit	Amount
October 2004	November 19, 2004	November 30, 2004	$0.09	$1,296,900
November 2004	December 20, 2004	December 31, 2004	$0.09	$1,296,900
December 2004	January 20, 2005	January 31, 2005	$0.09	$1,296,900

Capital Expenditures

Capital expenditures were $531,000 for the three month period ended September 30, 2004 and $809,000 for the period from March 23, 2004 to September 30, 2004. This compares to annual maintenance capital expenditures anticipated at the time of the IPO of $800,000. Our capital expenditures have been higher than expected at the time of our IPO primarily due to earlier replacement of forklifts and leasehold improvements to our head office in Langley, British Columbia.

Revolving Credit Facilities

At the time of the IPO, we established independent credit facilities comprising a three-year operating line in each of Canada and the U.S. In Canada, our operating line comprises a maximum facility of $20.0 million, the balance outstanding of which was $16.5 as at September 30, 2004. In the U.S., our operating line comprises a maximum facility of $34.4 million (US $27.0 million), of which the balance outstanding was $29.3 million (US $23.0 million) as at September 30, 2004.

Our credit facilities have increased from balances at the time of the IPO of $12.0 million and $19.8 million (US $15.0 million) in Canada and the U.S. respectively, due primarily to an increase in net non-cash working capital as a result of the growth in our business and the related post-closing working capital adjustment paid to the previous owners pursuant to the IPO.

We believe that the operating loans in both Canada and the U.S. are sufficient to meet our working capital requirements.

Contractual Obligations

The table below sets forth other contractual obligations of the Fund as at September 30, 2004 due in the years indicated, which relate to various premises operating leases:

Total	2004	2005	2006	2007	2008	2009 and thereafter
$25,391	1,579	5,298	4,588	4,429	4,124	5,373

Off-Balance Sheet Arrangements

The Fund has no off balance sheet arrangements with the exception of the foreign currency contracts discussed below in Financial Instruments.

Critical Accounting Estimates

We believe the accounting policies that are critical to our business relate to our use of estimates regarding the collectibility of accounts receivable and valuation of inventories and to the translation of our financial statements into Canadian dollars for reporting purposes, given that approximately two-thirds of our business occurs in the United States with the balance in Canada. In addition, another area requiring judgment includes the allocation of the purchase price in respect our business acquired at the time of our IPO, specifically the allocation between goodwill and other intangible assets, and the amortization period of the intangible assets, which we have determined to be 15 years using the straight-line method.

The preparation of financial statements in accordance with GAAP requires our management to make assumptions and estimates that can have a material impact on our results of operations as reported on a periodic basis. Due to the nature of our business and the credit terms we provide to our customers both in Canada and the United States, estimates and judgments are inherent in the ongoing assessment of the recoverability of accounts receivable. In addition, assessments and judgments are inherent in the determination of the net realizable value of inventories. Inventory is valued at the lower of cost and net realizable value. While our management applies judgment based on assumptions believed to be reasonable in the circumstances, actual results can vary from these assumptions. It is possible that materially different results would be reported using different assumptions.

Our financial statements are prepared in Canadian dollars. Our United States operations are considered to be a self-sustaining foreign operation as the currency of primary economic environment for its business is the US dollar, and, accordingly, the assets and liabilities are translated into Canadian dollars at the period end exchange rates. Revenue and expenses of our United States operations are translated at rates of exchange prevailing during the period. Resulting foreign currency adjustments are included in Unitholders' equity cumulative translation account.

All significant accounting policies have been included in note 2 to the financial statements.

Related Party Transactions

During the three month period ended September 30, 2004 sales of $327,000 were made to affiliates of the previous owners, and the Fund incurred purchases of $484,000 from affiliates of the previous owners. For the period from March 23, 2004 to September 30, 2004 sales of $776,000 were made to affiliates of the previous owners, and the Fund incurred purchases of $737,000 from affiliates of the previous owners. These sales and purchases took place at prevailing market prices. During the three month period ended September 30, 2004 and the period from March 23, 2004 to September 30, 2004 the Fund made cash distributions to Hardwoods' previous owners of $1.0 million pursuant to the terms of a subordination agreement as outlined in the Fund's prospectus dated March 12, 2004, and has recorded a distribution payable to the previous owners of $1.3 million to be paid on October 29, 2004.

Financial Instruments

The Fund uses currency derivatives to manage its exposure to fluctuations in exchange rates between the Canadian dollar and the United States dollar. The foreign currency contracts are recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of operations. At September 30, 2004, the Fund had thirty monthly foreign currency contracts to exchange US$675,000 into approximately $903,000, reflecting an exchange rate of Cdn$1.3385 to US$1.00, each month until April 2007. At September 30, 2004, the fair value of the remaining thirty monthly contracts results in an asset of $851,000, which has been recorded in the accounts of the Fund.

Risks and Uncertainties

The risks and uncertainties described below are not the only risks and uncertainties we face. The risks mentioned are the principal risks relating to the operations of the Business. There are other risks that relate to the structure of the Fund. Additional risks and certainties not currently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks actually occur, our business, results of operations and financial condition, and the amount of cash available for distribution to our unitholders could suffer.

Exchange rate fluctuations may occur between the Canadian dollar and the United States dollar.

We conduct business in both Canada and the United States. Most of the hardwood lumber we distribute in Canada is purchased from suppliers in the United States. Although we report our financial results in Canadian dollars, approximately two-thirds of our sales are generated in the United States. While the changes in the costs of hardwood lumber purchased by us in the United States as a result of the appreciation of the Canadian dollar against the US dollar are usually absorbed by the market, changes in the currency exchange rates of the Canadian dollar against the US dollar will affect the results presented in our financial statements and cause our earnings to fluctuate. Increases in the value of the Canadian dollar against the US dollar will reduce the amount of cash available to us for distribution to our Unitholders.

We have entered into a three-year hedging arrangement to mitigate the potential impact of foreign exchange on Canadian dollar distributions to be made by us through March 2007 and expect to continue an active hedging program in the future. This hedging arrangement is based on substantially all of the amount in U.S. dollars that would have been available for distribution from our U.S operations had we been in existence for the whole of 2003. Accordingly, we will be exposed to exchange rate fluctuations to the extent that the actual amounts of such distributions in the future vary from the amount covered by the hedging arrangement. This could affect the amounts of cash we have available to our Unitholders in Canadian dollars. For example, there is a risk that, if the actual amount of U.S. dollars distributed to us that are derived from our U.S. operations is less than the amount covered by the hedging arrangement and the rate of exchange of the Canadian dollar against the U.S. dollar increases over the rate of exchange for which we have contracted in the hedging arrangement, we may incur a cost to extinguish our liability to acquire Canadian dollars that we have contracted to acquire under the hedging arrangement.

We depend on key personnel, the loss of any of which could harm our business.

Our future performance and development will depend to a significant extent on the efforts and abilities of our executive officers. The loss of the services of one or more of these individuals or other senior managers could harm our business. We maintain key man insurance on the lives of our President and each of our Vice Presidents. Our success will depend largely on our continuing ability to attract, develop and retain skilled employees in all areas of our business.

Decreases in the supply of, demand for, or market values of hardwood lumber or sheet goods could harm our business.

Erosion in the supply of, demand for, or market values of hardwood could reduce our revenues and impact our financial condition and results of operations. Most of the factors that affect the supply of, and demand for, hardwood lumber and sheet goods are beyond our control. However, there has been low fluctuation in the supply of and demand for hardwood lumber and sheet goods historically, and market values for hardwood lumber and sheet goods have exhibited low volatility or variation. In addition, while competing products for hardwood lumber and sheet goods have not reduced demand for hardwood lumber or sheet goods or resulted in the substitution of competing products for hardwood lumber and sheet goods, there can be no assurance that these competing products will not reduce demand for our products in the future.

We may incur losses related to credit provided to our customers.

We generally offer credit to our customers for hardwood lumber and sheet goods purchased by them from us in amounts that they might not be able to obtain from traditional lenders. We obtain security interests in the assets of a number of our customers and personal guarantees from the owners of these customers. However, from time to time a customer is unable to pay for goods purchased from us. Although the bad debt experience of the combined predecessor companies has averaged approximately 0.6% of sales over the past ten years, if our historic bad debt experience increases, we could incur a loss of income, and the cash available for distribution to our Unitholders could be reduced.

We may not be able to sustain our levels of sales or EBITDA.

As a distributor, our income depends upon our ability to generate sales to customers and to sustain our levels of EBITDA. Our EBITDA levels are dependent upon our ability to continue to focus on sales of higher grades of hardwood and to continue to provide products and service to our customers that make us the supplier of choice to our customers. If our costs of goods or operating costs increase, or other distributors of hardwood compete more favourably with us, we may not be able to sustain our levels of sales or EBITDA. In this case, amounts of cash available for distribution to our Unitholders could be reduced.

We may be unable to sustain and manage our growth.

A principal component of our strategy is to continue our growth, both by increasing earnings from operations in existing markets and by expanding into new geographic markets. We may not be successful in growing our business or in managing this growth. Our growth depends on our ability to accomplish a number of things, including:

- Identifying and developing new geographic markets;
- Identifying and establishing, on favorable terms, suitable new branches and possibly identifying and acquiring distributors of hardwood that are suitable acquisition candidates;
- Successfully integrating new distribution and any acquired businesses with our existing operations;
- Establishing and maintaining favorable relationships with customers in new markets and market segments, and maintaining these relationships in existing markets; and
- Successfully managing expansion and obtaining required financing.

Any growth we achieve may require additional employees and increase the scope of both our operating and financial systems and the geographic area of our operations. This will increase our operating complexity and the level of responsibility of existing and new management personnel. We may be unable to attract and retain qualified management and employees, and our existing operating and financial systems and controls may not be adequate to support any growth. Our ability to improve our systems and controls may be limited by increased costs, technological challenges, or lack of qualified employees. Our past results and growth may not be indicative of our prospects or our ability to penetrate new markets, many of which may have different competitive conditions and demographic characteristics than our current markets.

Competition in our markets may lead to reduced revenues and profitability.

The hardwood distribution industry is highly fragmented. We compete directly with a significant number of hardwood distributors for suppliers and customers. Our direct competitors are primarily local and regional businesses. Most of our competitors lack our size, geographic diversification and financial strength. New competitors may enter the hardwoods distribution market in the future. Additionally, existing or future competitors may succeed in entering and establishing successful operations in new geographic markets prior to our entry into those markets. If existing or future competitors seek to gain or retain market share by reducing margins on goods sold, we may also be required to reduce our margins, which may reduce our revenue and harm our operating results and financial condition.

We may become subject to more stringent regulations.

Our business is now subject to very few laws and regulations. There are laws that regulate our credit practices, transporting products, importing and exporting products and employment. Such laws, regulations and related rules and policies are administered by various federal, state, provincial, regional and local agencies and other governmental authorities. New laws governing our business could be enacted and changes to any existing laws could have a significant impact on our business. Failure by us to comply with applicable laws and regulations may subject us to civil or regulatory proceedings, which may have a material adverse effect on our financial condition and results of operations.

Importation of products manufactured with hardwood lumber or sheet goods may increase, and replace products manufactured in North America.

Products manufactured with hardwood lumber or sheet goods are often imported into North America from countries with low labour costs. These products commonly include cabinets and furniture that are mass-produced. Any increase in the importation of products constructed using hardwood lumber and sheet goods could increase competition for manufacturers of similar products in North America. This has occurred in certain segments of the furniture manufacturing industry. Although we do not typically focus our sales efforts upon manufacturers who compete with these imported products, a reduction in the production of cabinets or furniture in North America could reduce our sales and opportunities for growth and adversely affect our business, financial condition and results of operations.

We are dependent upon the financial condition and results of operations of our business.

The Fund is an unincorporated open-ended, limited purpose trust, which is entirely dependent on our operations through the Trust's limited partnership interest in Hardwoods LP and indirect limited partnership interest in Hardwoods USLP. Cash distributions to Unitholders are dependent on, among other things, the ability of the Trust to pay interest on the Trust Notes and to make cash distributions in respect of the Trust Units, which in turn, is dependent on the financial condition and results of operations of our business. Our ability to make cash distributions or other payments or advances is subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities.

Our cash distributions are not guaranteed and will fluctuate with our business performance.

Although the Fund intends to distribute the interest received in respect of the Trust Notes and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by our business or ultimately distributed to the Fund. Our ability to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of our business, and will be subject to various factors including our financial performance, our obligations under applicable credit facilities, fluctuations in our working capital, the sustainability of our margins and our capital expenditure requirements.

Outlook

We believe our operations for the balance of 2004 will continue to be strong, although we do expect the pace of sales growth we have experienced in the period from March 23, 2004 to September 30, 2004 to moderate. In addition, we expect some normal seasonal slowdown in demand to be reflected in our results for the fourth quarter. The sales growth we have experienced since our IPO has been driven by increased volumes and product price increases. In 2005, we expect our sales to return to our historical rate of growth, which has closely paralleled the pace of the overall economy. Our sales growth results has traditionally mirrored general inflation rates as measured by the consumer price index in the United States.

Our focus remains on profitably growing our business while maintaining focus on managing our selling and administrative costs and improving inventory turns and collection of accounts receivable. We continue our efforts to increase sales of our offshore products to our customers, and anticipate continuing to increase our supply of imported products from outside North America. We intend to increase our market presence in the Midwest of the United States and California early in 2005 through branch expansion or new branch openings. Given the fragmented nature of the industry, acquisition opportunities that may broaden and strengthen our market position will also be considered.

In summary, we expect the Fund's performance to continue to be positive and to meet our financial and cash distribution targets for the remainder of the year.

Forward-looking Statements

This MD&A may contain forward-looking statements, which reflect our expectations regarding the future growth, results of operations, performance and business prospects, and opportunities of the Fund. Forward-looking statements contain such words as "anticipate", "believe", "continue", "could", "expects", "intend", "may", "plans" or similar expressions suggesting future conditions or events. Such forward-looking statements reflect our current beliefs and are based on information currently available to us. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from results discussed in the forward-looking statements, including the effects, as well as changes in: national and local business conditions; political or economic instability in local markets; competition; consumer preferences, spending patterns and demographic trends; legislation and governmental regulation. Although the forward-looking statements contained in this MD&A are based on what we believe to be reasonable assumptions, we cannot assure readers that actual results will be consistent with these forward-looking statements.

Additional Information

Additional information relating to the Fund, including all public filings, are available on SEDAR (www.sedar.com) and our website (www.hardwoods-inc.com).

HARDWOODS DISTRIBUTION INCOME FUND

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheet
(Unaudited)
(Expressed in thousands of Canadian dollars)

	September 30, 2004	March 23, 2004
Assets		
Current assets:		
Cash and cash equivalents	$ 1,191	$ -
Accounts receivable	53,297	51,624
Inventory	46,957	38,609
Prepaid expenses	901	255
	102,346	90,488
Property, plant and equipment (note 3)	5,022	5,094
Deferred financing costs (net of accumulated amortization of $34)	165	204
Other intangible assets (net of accumulated amortization of $499)	14,056	15,000
Future income taxes	-	267
Foreign currency contracts (note 4)	851	-
Goodwill	101,708	104,580
	$ 224,148	$ 215,633
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 5)	$ 45,788	$ 31,887
Accounts payable and accrued liabilities	11,619	16,830
Distributions payable to Unitholders	1,297	-
Distributions payable to non-controlling interests	1,252	-
	59,956	48,717
Future income taxes	590	-
Non-controlling interest (note 6)	33,009	33,462
Unitholders' equity:		
Fund Units (note 7)	133,454	133,454
Retained earnings	1,124	-
Cumulative foreign currency translation account	(3,985)	-
	130,593	133,454
	$ 224,148	$ 215,633

See accompanying notes to consolidated financial statements.

Approved on behalf of the Trustees:

(Signed) LAWRENCE I. BELL, Trustee

(Signed) TERRY M. HOLLAND, Trustee

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statements of Operations and Retained Earnings
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended September 30, 2004	Period from March 23, 2004 to September 30, 2004
Sales	$ 97,040	$ 196,165
Cost of sales	79,135	159,313
Gross Profit	17,905	36,852
Expenses (income):		
Selling and administrative	10,958	21,541
Amortization:		
Plant and equipment	346	694
Deferred financing costs	17	34
Other intangible assets	246	499
Interest	473	753
Mark-to-market gain on foreign currency contracts (note 4)	(1,154)	(851)
	10,886	22,670
Earnings before non-controlling interest and income taxes	7,019	14,182
Non-controlling interest (note 6)	1,404	2,836
Earnings before income taxes	5,615	11,346
Income taxes	1,264	2,311
Net earnings for the period	4,351	9,035
Retained earnings, beginning of period	664	-
Distributions to Unitholders	(3,891)	(7,911)
Retained earnings, end of period	$ 1,124	$ 1,124
Basic and diluted earnings per Unit	$ 0.30	$ 0.63
Weighted average number of Units outstanding	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

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

	Three months ended September 30, 2004	Period from March 23, 2004 to September 30, 2004
Cash flows provided by (used in) operating activities:		
Net earnings for the period	$ 4,351	$ 9,035
Items not involving cash:		
Amortization	609	1,227
Gain on sale of property, plant and equipment	(3)	(21)
Mark-to-market gain on foreign currency contracts	(1,154)	(851)
Non-controlling interest	1,404	2,836
Future income taxes	525	845
	5,732	13,071
Changes in non-cash operating working capital (note 8)	(5,986)	(18,705)
Net cash used in operating activities	(254)	(5,634)
Cash flows provided by (used in) investing activities:		
Business acquisition (note 1)	-	(165,137)
Additions to property, plant and equipment	(531)	(809)
Proceeds on disposal of property, plant and equipment	18	48
Net cash used in investing activities	(513)	(165,898)
Cash flows provided by (used in) financing activities:		
Net proceeds from the issuance of Units	-	133,454
Increase in bank indebtedness	3,859	47,181
Increase in deferred financing fees	-	(204)
Distributions paid to Unitholders	(3,825)	(6,614)
Distributions paid to non controlling interest	(1,010)	(1,010)
Net cash provided by (used in) financing activities	(976)	172,807
Increase (decrease) in cash	(1,743)	1,275
Decrease in cash due to foreign currency fluctuations	(71)	(84)
Cash, beginning of period	3,005	-
Cash, end of period	$ 1,191	$ 1,191
Supplementary information (cash amounts):		
Interest paid	$ 473	$ 753
Income taxes paid	369	733

See accompanying notes to consolidated financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

1. Nature of operations and business acquisition:

Hardwoods Distribution Income Fund (the "Fund") is an unincorporated, open ended, limited purpose trust established under the laws of the Province of British Columbia on January 30, 2004 by a Declaration of Trust. The Fund commenced operations on March 23, 2004 when it completed an initial public offering (the "Offering") of Units and acquired (the "Acquisition") an 80% interest in a hardwood lumber and sheet goods distribution business in North America (the "Business") from affiliates of Sauder Industries Limited ("SIL"). The Fund holds, indirectly, 80% of the outstanding limited partnership units of Hardwoods Specialty Products LP ("Hardwoods LP") and Hardwoods Specialty Products US LP ("Hardwoods USLP"), limited partnerships established under the laws of the Province of Manitoba and the state of Delaware, respectively.

On March 23, 2004, the Fund issued 14,410,000 Units at $10 per Unit pursuant to the Offering. Net proceeds from the Offering were $133,454,000, after deducting expenses of the Offering of $10,646,000.

Also on March 23, 2004, the Fund used the net proceeds from the Offering, together with funds from two new credit facilities (note 5), to acquire an 80% interest in Hardwoods LP and Hardwoods USLP for total consideration of $165.1 million. The acquisition of the Funds interest in Hardwoods LP and Hardwoods USLP was completed through a series of transactions and has been accounted for using the purchase method.

The fair value of the net assets acquired are as follows:

Net working capital	$	73,658
Property, plant and equipment		5,094
Goodwill		104,580
Other intangible assets		15,000
Future income taxes		267
Non-controlling interests		(33,462)
Consideration, being cash from the Offering and new credit facilities	$	165,137

The results of operations of Hardwoods LP and Hardwoods USLP have been included in the Fund's consolidated financial statements from March 23, 2004, being the date of acquisition.

2. Significant accounting policies:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements and may not include all disclosures required by generally accepted accounting principles for annual financial statements.

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Funds 80% owned subsidiaries Hardwoods LP and Hardwoods USLP and other wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

2. Significant accounting policies (continued):

(b) Cash and cash equivalents:

The Fund considers deposits in banks, certificates of deposits and short-term investments with original maturities of three months or less as cash and cash equivalents.

(c) Accounts receivable:

Accounts receivable includes trade accounts receivable net of allowances for doubtful accounts plus housing loans related to the relocation of employees.

(d) Inventory:

Inventory is valued at the lower of cost and net realizable value.

(e) Property, plant and equipment:

Property, plant and equipment are stated at cost. Amortization is provided at straight-line rates sufficient to amortize the cost of the assets over their estimated useful lives as follows:

Assets	Estimated useful life
Buildings	20 years
Machinery and equipment	5 to 10 years
Automobiles	3 years
Mobile equipment	7 to 10 years
Leasehold improvements	Over the term of the lease

(f) Deferred financing costs:

Financing costs incurred to obtain credit facilities are deferred and amortized on a straight-line basis over the term of the related debt.

(g) Other intangible assets:

Other intangible assets represent customer relationships acquired in a business combination and are recorded at cost less accumulated amortization. Amortization is provided for on a straight-line basis over 15 years. Management reviews the carrying value of other intangible assets for impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. An impairment loss is recorded when it is determined that the carrying amount of these assets is not recoverable and exceeds their fair value.

(h) Goodwill:

Goodwill is recorded at cost and is not amortized. Management reviews the carrying value of goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that the asset may be impaired. Any excess of carrying value over fair value will be charged to income in the period in which the impairment is determined.

2. Significant accounting policies (continued):

(i) Income taxes:

Incorporated subsidiaries of the Fund use the asset and liability method of accounting for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the substantive enactment date. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

Income tax obligations relating to distributions of the Fund are the obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of the Fund itself.

(j) Revenue recognition:

Revenue from the sale of hardwood lumber and sheet goods is recognized at the time of delivery, which is when title and the risks and rewards of ownership transfers to the customer.

(k) Translation of foreign currencies:

The accounts of the Fund’s foreign self-sustaining operation are translated into Canadian dollars using the current rate method. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date and revenue and expense are translated at average exchange rates for the period. Gains or losses arising from the translation of the financial statements of the self-sustaining foreign operation are deferred in the cumulative foreign currency translation account in the Unitholders’ equity.

Foreign monetary assets and liabilities of the Canadian operations and integrated foreign operations have been translated into Canadian dollars using the rate of exchange in effect at the balance sheet date and foreign non-monetary balances are translated at their historical exchange rates. Revenue and expenses denominated in foreign currencies are translated at the average exchange rates for the period. Exchange gains or losses arising from translation of these foreign monetary balances are reflected in earnings.

(l) Foreign currency contracts:

The Fund uses currency derivatives to manage its exposure to fluctuations in exchange rates. The foreign currency contracts are recognized in the balance sheet and measured at fair value, with changes in fair value recognized currently in income.

(Tabular amounts expressed in thousands of Canadian dollars)

2. Significant accounting policies (continued):

(m) Earnings per Unit:

Basic earnings per Unit is calculated by dividing net earnings by the weighted average number of Units outstanding during the reporting period which commenced March 23, 2004. Diluted earnings per Unit is calculated by application of the if-converted method for convertible securities. As the conversion of convertible securities would not have a dilutive effect on earnings per Unit, diluted and basic earnings per Unit are the same amount.

(n) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Areas requiring significant management estimates include the valuation of goodwill, other intangible assets, allowance for doubtful accounts, future income taxes and amounts of accrued liabilities. Actual amounts may differ from the estimates applied in the preparation of these financial statements.

3. Property, plant and equipment:

September 30, 2004	Cost	Accumulated amortization	Net book value
Buildings	$ 521	$ 24	$ 497
Machinery and equipment	1,234	231	1,003
Automobiles	12	7	5
Mobile equipment	2,479	314	2,165
Leasehold improvements	632	96	536
	4,878	672	4,206
Land	816	-	816
	$ 5,694	$ 672	$ 5,022

4. Foreign currency contracts:

In order to manage the Funds exposure to exchange rate fluctuations on United States dollar denominated distributable cash, a subsidiary of the Fund has entered into foreign currency contracts to exchange US$675,000 each month for approximately CDN$903,000, for thirty-six consecutive months from April 2004 to April 2007. The remaining 30 monthly foreign currency contracts at September 30, 2004 are recognized in the balance sheet and measured at fair value, which at September 30, 2004 represented an asset of $851,000.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Bank indebtedness:

Hardwoods LP	$	16,458
Hardwoods USLP (US$23,000)		29,330
	$	45,788

Bank indebtedness consists of advances under operating lines of credit available to Hardwoods LP and Hardwoods USLP. Hardwoods LP has a revolving credit facility of up to an aggregate amount of $20.0 million and Hardwoods USLP has a revolving credit facility of up to an aggregate amount of $34.4 million (US$27.0 million) (less the net exposure under the foreign currency contracts facility as described in note 4, as determined by the lender from time to time).

The Hardwoods LP credit facility is secured by a first security interest in all of the present and after acquired property of Hardwoods LP and its operating subsidiaries, and by the Hardwoods LP Units held indirectly by the Fund and by an affiliate of SIL, respectively. The Hardwoods USLP credit facility, and the foreign currency hedging arrangements, are secured by a first security interest in all of the present and after acquired property of Hardwoods USLP and by the Hardwoods USLP Units held indirectly by the Fund and by an affiliate of SIL, respectively.

Each facility is a demand loan with a revolving three-year term expiring on March 23, 2007. The credit facilities are repayable without any prepayment penalties and bear interest at a floating rate based on the Canadian dollar or US dollar 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. The rates vary with the ratio of total debt for borrowed money, capital leases and letters of credit (the “funded debt”) (as adjusted for certain items) to EBITDA. Commitment fees and standby charges are payable.

The average annual interest rates payable for the period from March 23, 2004 to September 30, 2004 were 4.9% and 3.3% for the Hardwoods LP and Hardwoods USLP credit facilities, respectively.

6. Non-controlling interest:

Retained interest in Hardwoods LP and Hardwoods USLP	$	33,462
Interest in post-acquisition earnings		2,836
Distributions paid to non-controlling interests		(1,010)
Distributions payable to non-controlling interests		(1,252)
Foreign translation adjustment on exchange of non-controlling equityholders interest in Hardwoods USLP		(1,027)
	$	33,009

6. Non-controlling interest (continued):

The previous owners of the Business (note 1) have retained a 20% interest in Hardwoods LP and Hardwoods USLP through ownership of Class B Hardwoods LP units ("Class B LP Units") and Class B Hardwoods USLP units ("Class B USLP Units"), respectively. The Fund owns an 80% interest in Hardwoods LP and Hardwoods USLP through ownership of Class A Hardwoods LP units ("Class A LP Units") and Class A Hardwoods USLP units ("Class A USLP Units"), respectively.

The Class A LP Units and Class B LP Units and the Class A USLP Units and Class B USLP Units, respectively, have economic and voting rights that are equivalent in all material respects except distributions on the Class B LP Units and Class B USLP Units are subject to the subordination arrangements described below until the date (the "Subordination End Date") on which:

- the consolidated Adjusted EBITDA, as defined in the Subordination Agreement dated March 23, 2004, of the Fund for the 12 month period ending on the last day of the month immediately preceding such date is at least $21.3 million; and
- cash distributions of at least $29.54 million ($2.05 per Unit) have been paid on the Units and a combined amount of cash advances or distributions of at least $7.385 million has been paid on the Class B LP Units and Class B USLP Units ($2.05 per combined Class B LP and Class B USLP Units) (as adjusted for issuances, redemptions and repurchases of Units, LP Units and USLP Units subsequently and by converting the cash distributions or advances by Hardwoods USLP on the USLP Units at the rate of exchange used by the Fund to convert funds received by it in US dollars into Canadian dollars) for the 24 month period ending on the last day of the month immediately preceding such date.

Distributions are to be made monthly on the Class A LP Units and Class A USLP Units equal to $0.0854 per Unit to the extent cash is available to make cash distributions. Generally, distributions on the Class B LP Units and Class B USLP Units will be subordinated and will be made quarterly in a combined amount for one Class B LP Unit and one Class B USLP Unit equal, on a pro rated basis, to the combined amount distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter, only after the distributions have been made on the Class A LP Units and Class A USLP Units and to the extent cash is available to make such distributions.

After the Subordination End Date, the holders of the Class B LP Units and Class B USLP Units will be entitled to effectively exchange all or a portion of their Class B LP Units and Class B USLP Units for up to 3,602,500 Units of the Fund, representing 20% of the issued and outstanding Units of the Fund on a fully diluted basis. In the event the Fund enters into an agreement in respect of an acquisition or a take-over bid of the Fund, the holders of the Class B LP Units and Class B USLP Units will be entitled to exchange such units for Units of the Fund.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Fund Units:

An unlimited number of Units and Special Voting Units may be created and issued pursuant to the Declaration of Trust. Each Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. The Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund or in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Unit, or Special Voting Unit, entitles the holder thereof to one vote at all meetings of voting Unitholders.

On March 23, 2004, the Fund issued 14,410,000 Units at a price of $10 per Unit pursuant to the Offering. Net proceeds from the Offering were $133,454,000 after deducting expenses of the Offering of $10,646,000. The holders of the Class B Units of Hardwoods LP and Hardwoods USLP were issued 3,602,500 Special Voting Units of the Fund, the value of which is included in non-controlling interest (note 6). Such Special Voting Units are to be cancelled on the exchange of Class B Units of Hardwoods LP and Hardwoods USLP for Units of the Fund.

8. Changes in non-cash operating working capital:

	Three months ended September 30, 2004	Period from March 23, 2004 to September 30, 2004
Accounts receivable	$ 400	$ (3,401)
Inventory	(4,477)	(9,821)
Prepaid expenses	(568)	(662)
Accounts payable and accrued liabilities	(1,341)	(4,821)
	$ (5,986)	$ (18,705)

9. Commitments:

(a) The Fund's subsidiaries are obligated under various operating leases that require minimum rental payments in each of the next five years as follows:

2004	$ 1,579
2005	5,298
2006	4,588
2007	4,429
2008	4,124
	20,018
Thereafter	5,373
	$ 25,391

(Tabular amounts expressed in thousands of Canadian dollars)

9. Commitments (continued):

(b) At September 30, 2004, the Fund's subsidiaries were committed in the amount of $170,364 (US$133,598) under letters of credit.

10. Segment disclosure:

Information about geographic areas is as follows:

	Three months ended September 30, 2004	Period from March 23, 2004 to September 30, 2004
Revenue from external customers:		
Canada	$ 30,198	$ 60,838
United States (three months ended September 30, 2004-US$51,010; period from March 23, 2004 to September 30, 2004-US$101,422)	66,842	135,327
	$ 97,040	$ 196,165

	September 30, 2004
Property, plant and equipment:	
Canada	$ 1,708
United States	3,314
	$ 5,022
Goodwill	
Canada	$ 42,043
United States	59,665
	$ 101,708

11. Financial instruments:

(a) Fair values of financial instruments:

The carrying value of cash and cash equivalents, trade accounts receivable, other receivables, accounts payable and accrued liabilities and distributions payable approximate their fair value due to the relatively short period to maturity of the instruments. The carrying value of the credit facilities approximate their fair values due to the existence of floating market based interest rates. The foreign currency contracts are carried at market values.

11. Financial instruments (continued):

(b) Credit risk:

The Fund is exposed to credit risk in the event they are unable to collect in full amounts receivable from its customers. The Fund employs established credit approval practices and employs a full-time credit attorney to mitigate the credit risk. It is the Fund's policy to secure credit terms with customers whenever possible by registering security interests in the assets of the customer and by obtaining personal guarantees. No single customer represents a concentration of credit risk to the Fund.

(c) Counterparty risk:

Changes in the exchange rates and interest rates will result in market gains and losses on the foreign currency contracts entered into by the Fund. Furthermore, the Fund may be exposed to losses should the counterparty to its foreign currency contracts fail to fulfill its obligations. The Fund has sought to minimize potential counter party losses by transacting with high credit quality institutions.

12. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP Plan") along with an affiliate of the previous owners in the form of a Multi Employer Plan. The assets of the USLP Plan are held and related investment transactions are executed by the Plan's Trustee, ING National Trust, and, accordingly, are not reflected in these consolidated financial statements. During the three months ended September 30, 2004 Hardwoods USLP contributed and expensed $237,617 (US$173,492) in relation to the USLP Plan. During the period from March 23, 2004 to September 30, 2004, Hardwoods USLP contributed and expensed $407,617 (US$305,492) in relation to the USLP 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, SunLife, and, accordingly, are not reflected in these consolidated financial statements. During the three months ended September 30, 2004 Hardwoods LP contributed and expensed $47,008 in relation to the LP Plan. During the period from March 23, 2004 to September 30, 2004, Hardwoods LP contributed and expensed $92,985 in relation to the LP Plan.

13. Related party transactions:

During the three months ended September 30, 2004, sales of $327,096 were made to affiliates of the previous owners who have a 20% retained interest in the Business, and the Fund made purchases of $484,366 from affiliates of the previous owners. For the period from March 23, 2004 to September 30, 2004, sales of $776,096 were made to affiliates of the previous owners who have a 20% retained interest in the Business, and the Fund made purchases of $737,366 from affiliates of the previous owners. All these sales and purchases took place at prevailing market prices.