HARDWOODS DISTRIBUTION INCOME FUND

2006

First Quarter Report To Unitholders

About the Fund

Hardwoods Distribution Income Fund (the "Fund") is an unincorporated open-ended limited purpose trust. The Fund was launched on March 23, 2004 with the completion of an initial public offering (IPO) of 14.4 million trust units ("Class A Units) at $10 per unit. Net proceeds of the IPO were used to acquire an 80% interest in a hardwoods lumber and sheet goods distribution business ("Hardwoods" or the "Business") from the previous owners. The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund's operating subsidiaries ("Class B Units"), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives.

Hardwoods Distribution Income Fund units trade on the Toronto Stock Exchange under the symbol HWD.UN. The Fund's performance depends on the performance of the Business.

About the Business

Hardwoods has been providing quality lumber, hardwood plywood and specialty products to customers for over 45 years. People love hardwood and find many different ways to bring it into their lives. We sell hardwood lumber and sheet goods to industrial customers that use it to manufacture a wide variety of wood products. Whether in kitchen cabinets, doors and mouldings, furniture, or custom interior millwork, consumers place a higher value on products crafted from real wood. It's a preference that doesn't change with the whims of fashion. Demand for hardwood has remained remarkably stable decade after decade, in part because hardwood has no real substitute. There's a warmth to the look and touch of hardwood that no other material can match.

Today, we are one of the largest distributors of hardwood lumber and sheet goods in North America. Headquartered in Langley, British Columbia, we operate a network of 38 distribution centers organized into nine regional clusters. With a proven track record of strong financial performance, Hardwoods plays a critical role linking suppliers and customers in a highly fragmented industry. The Business is diversified by geographic markets served, product mix, and customer type. Touching many areas of the economy, demand for hardwoods typically remains balanced through a range of economic conditions.

To Our Unitholders

I am pleased to report to you on our first quarter 2006 results, and provide an update on the progress of the Fund.

Cash Distributions

For the three months ended March 31, 2006, the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of $3.4 million, or $0.189 per unit. Distributions relating to the period were $3.7 million, or $0.256 per unit to our public unitholders (Class A Units). No distributions were declared to our previous owners (Class B Units). This represents an overall payout ratio of 108.7% for the first quarter, and 93.1% since the Fund's inception. As noted in our 2005 Annual Report, the first quarter represents a seasonally slower period for our business. As expected, cash distributions exceeded cash available for distribution during this period, with a catch-up expected to occur during the stronger second and third quarters.

Cash distributions are dependent upon the financial performance achieved by the Fund, and are made monthly at the discretion of the Fund's independently elected Trustees. In January 2006, concerns about the impact of a higher distribution payout ratio led Trustees to exercise the Fund's subordination feature. Distributions to the Class B Units were suspended and annualized distributions to our public unitholders were returned to the level anticipated in our IPO of $1.02 per unit. At the end of the first quarter of 2006, cash distributions to Class B Units remained suspended. This initiative has lowered our payout ratio and provides greater distribution stability for our public unitholders going forward. The Fund's subordination feature stays in place until EBITDA and distributable cash tests established at the time of the IPO have been met.

Operating Results

I am pleased to report that our 2006 year is of to a good start with an increase in sales activity. Before considering the impact of foreign exchange, our sales climbed 14.5% compared to the first quarter of 2005. Most of this growth was generated in the United States, which accounts for approximately two-thirds of our business.

The increase in sales reflects increased underlying sales activity, as well as the benefit of an additional five selling days in the first quarter of 2006 compared to the same period in the prior year. The year-over-year strengthening of the Canadian dollar partially offset these gains, reducing our first quarter sales growth rate to 9.8% when sales are expressed in Canadian dollars for reporting purposes.

Gross profit also increased during the period, but to a lesser degree than sales, reflecting a lower gross profit margin of 17.7% compared to 18.6% in the first quarter of 2005. The decline in gross profit margin reflects efforts by some of our branches to reduce inventory levels via lower selling prices during the period. Although there are still additional inventory reductions to take place at some branches, we anticipate a higher gross profit margin in the second quarter and for the balance of the year.

As described in our 2005 Annual Report, we made significant investments in personnel improvements during 2005 in order to position Hardwoods to attain future sales growth. As expected, these investments contributed to higher selling and administrative costs, which together with a lower gross profit margin, reduced first quarter earnings. EBITDA decreased to $4.6 million from $5.5 million, and net income to $1.9 million from $2.9 million, as compared to the same period in the prior year.

Outlook

Entering the second quarter, economic conditions remain favourable for demand for hardwood products. We anticipate continued modest growth in underlying sales, although a strengthening Canadian dollar could undermine sales growth when expressed in Canadian dollars. Gross profit margin is expected to improve from first quarter levels. We are looking at our cost base closely, and are taking corrective action where necessary to balance expenses with sales activity.

I look forward to updating you on our progress at the end of the second quarter.

Maurice Paquette

Maurice E. Paquette

President and Chief Executive Officer

Management's Discussion and Analysis

May 1, 2006

This management's discussion and analysis ("MD&A") covers our unaudited interim consolidated financial statements as at and for the three months ended March 31, 2006 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in our 2005 Annual Report. The information below should be read in conjunction with the Interim Financial Statements and the audited consolidated financial statements for the year ended December 31, 2005. Dollar amounts are in Canadian dollars unless otherwise stated, and the consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

About the Fund

The Fund is an unincorporated open-ended limited purpose trust formed under the laws of the Province of British Columbia by a declaration of trust dated January 30, 2004. The Fund was launched on March 23, 2004 with the completion of an initial public offering ("IPO") of 14,410,000 trust Voting Units ("Class A Units"). Net IPO proceeds 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 ("Hardwoods" or the "Business") from the previous owners.

The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund's operating subsidiaries ("Class B Units"), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. Distributions by the Fund's operating subsidiaries to the previous owners are subject to subordination arrangements until certain financial tests established at the time of the IPO and described in the Interim Financial Statements are met. As at March 31, 2006, 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. The Fund's performance depends on the performance of the Business.

About our Business and Industry

Hardwoods is one of North America's largest distributors of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. At March 31, 2006 we operated from 38 distribution facilities organized into nine geographic regions throughout North America. In a highly fragmented but stable industry, we match products supplied from hundreds of mills to over 2,500 manufacturing customers.

Our product mix includes higher grades of hardwood lumber, as well as sheet goods, consisting primarily of hardwood plywood, as well as non-structural sheet goods such as medium density fiberboard, particleboard and melamine-coated stock. Our sheet goods are a key complementary product line as they are used by many purchasers of hardwood lumber in the manufacture of their end products.

Approximately 95% of the hardwood lumber distributed in North America is harvested from North American hardwood forests, located principally in the eastern United States. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. Sheet goods are generally produced in North America by large manufacturers using domestic hardwoods and other materials, although imported hardwood plywood volumes have been increasing. Both domestic and imported hardwood lumber and plywood are distributed principally by third parties such as us. Historically, balanced supply and demand conditions have resulted in a stable pricing environment for hardwood lumber and hardwood plywood. Prices have generally kept pace with inflation over the long term.

The hardwood distribution industry is highly fragmented. While there are a number of hardwood distributors that operate from multiple locations, most are small, privately held companies serving discrete local markets.

Non-GAAP Measures – EBITDA and Distributable Cash

References to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustments on foreign currency contracts 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.

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.

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, non-controlling interest, gains or losses on the sale of property, plant and equipment, and mark-to-market adjustments on foreign currency 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 Class A Units.

First Quarter Overview and Outlook

Market demand for hardwood products was stable in the first quarter, and is expected to remain so through the balance of 2006. Hardwoods' diversified customer base manufactures a range of end use products, such as cabinetry, furniture and custom millwork. These products in turn are sold into multiple sectors of the economy, including new home construction, renovation, non-residential construction and institutional markets. As a result of this diversity, no one measure of business activity in the economy determines demand for Hardwoods' products. There are however some key indicators which, taken together, provide insight into what future sales conditions might be for the Business. Housing starts in 2006 are projected to decrease in Canada (by 7.4% according to the Canada Mortgage and Housing Corp) and in the United States (by 6.3% according to the National Association of Homebuilders), but the resulting new home construction activity remains near historically high levels for both countries. The US home renovation market is projected to expand 5.6% in 2006 by the National Association of Homebuilders, and US non-residential construction is expected to grow by 4.7 % according to the American Institute of Architects. These measures suggest conditions favourable to continued steady demand for our products.

In terms of market developments, China continues to increase in importance as an exporter of hardwood plywood products to the North American market. Hardwoods' is actively participating in this important emerging market trend. We have established a dedicated import department to identify and source Chinese-manufactured products that will add value for our customer base. Our import department personnel and other key managers in the Business travel regularly to China to develop our supply line there and to identify new products that will provide incremental sales and profit opportunities for Hardwoods. Our focus remains on selectively partnering with Chinese mills that produce consistent and high-quality products which Hardwoods' is proud to stand behind when sold to our customers. In some cases, products are branded with Hardwoods' name as a sign of our commitment to product quality, such as our Dragon Ply™ and Rely-A-Form™ proprietary products. Most of our Chinese imports are currently in the form of traditional hardwood plywood products, but it is expected that more specialty and partially manufactured component products will be available in the future as the value- added manufacturing capability of Chinese mills continues to evolve. With our 38 branches across North America and an established customer base, we believe Hardwoods represents one of the most attractive distribution options for China based mills that are increasingly looking to access the large North American market.

In our Canadian business, we have observed the competitiveness of some of our customers being put under pressure by the continued strength of the Canadian dollar. To the extent our Canadian customers rely on selling their products into the U.S. market, these customers continue to see their revenues effectively reduced as the Canadian dollar gains strength. We are monitoring the impact of this reduced competitiveness in some our Canadian customers, both in terms of their continued health and credit-worthiness, as well as any changes in demand it may imply for their hardwood purchasing needs.

Financial results for the first quarter were mixed. After a year of investing in personnel improvements in 2005, we achieved a return to sales growth as we had expected. Before considering the impact of foreign exchange, sales increased 14.5% in the first quarter. Although some of this sales growth is attributed to having an additional five sales days in the first quarter of 2006 compared to the same period in 2005, this still represents a strong beginning to the year. The strengthening Canadian dollar partly undermined this growth, reducing sales growth to 9.8% when sales are expressed in Canadian dollars for reporting purposes.

Although sales growth was a positive factor in the first quarter, the benefit of increased sales was not fully reflected in our profitability due to a decline in our gross profit margin. Gross profit margin was 17.7% in the first quarter, compared to 18.6% in the same period in the prior year. Efforts to reduce inventory in some locations in the first quarter of 2006 contributed to the reduction in gross profit margin. We expect our gross profit margin in the second quarter to improve and to be higher for the balance of the year.

Higher sales, but at a lower gross profit margin, were not sufficient to offset our higher selling and administrative expense base in the first quarter of 2006. As a result, our earnings were reduced. First quarter EBITDA was $4.6 million, down 17% from $5.5 million in the same period in 2005. Net income was $1.9 million for the quarter, compared to $2.9 million in the same period in the prior year.

Moving forward, we believe we have the strong foundation in place to grow sales as we head into our seasonally stronger second and third quarters. Raising our gross profit margin back to historic levels will be a focus for us operationally. We are also making adjustments to our cost base where necessary to match expenses to expected sales over the course of the year.

Results of Operations
Three months ended March 31, 2006 and March 31, 2005
Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)

	For the three months Ended March 31, 2006	For the three months Ended March 31, 2005
Total sales	$ 93,380	$ 85,027
Sales in the US (US$)	*55,633*	*47,288*
Sales in Canada	*29,146*	*27,024*
Gross profit	16,509	15,819
Gross margin %	*17.7%*	*18.6%*
Selling and administrative expenses	12,219	10,485
Realized gain on foreign currency contracts	(289)	(174)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 4,579	$ 5,508
Add (deduct):		
Amortization	(522)	(583)
Interest	(704)	(427)
Mark-to-market adjustment on foreign currency contracts	(454)	(273)
Non-controlling interest	(580)	(845)
Income taxes	(451)	(438)
Net earnings for the period	$ 1,868	$ 2,942
Basic and fully diluted earnings per Class A Unit	$ 0.130	$ 0.204
Average Canadian dollar/US dollar exchange rate	1.1546	1.2266

Sales

Sales for the three month period ended March 31, 2006 were $93.4 million, up 9.8% from $85.0 million in the first quarter of 2005. This 9.8% increase in total sales is comprised of two factors: a 14.5% increase in underlying sales activity, partially offset by a 4.7% reduction to sales due to a negative foreign exchange impact.

The foreign exchange impact reflects a strengthening Canadian dollar and the fact that approximately two-thirds of Hardwoods sales are generated in the United States in US dollars. Accordingly, a strengthening Canadian dollar has a negative top line impact when we translate US sales to Canadian dollars for reporting purposes. The average Canadian dollar exchange rate strengthened by 5.9% in the first quarter of 2006 to $1.1546, compared to $1.2266 in the first quarter of the prior year. Had exchange rates remained consistent with 2005 levels, total sales for the first quarter of 2006 would have been $4.0 million higher, at $97.4 million.

The 14.5% increase in underlying sales activity includes the benefit of five additional sales days in the first quarter of 2006, compared to the same quarter in the prior year. To better understand the impact of these additional sales days, results from the US and Canadian businesses are discussed separately below.

Hardwoods sales in the United States, as measured in US dollars, increased 17.6% to $55.6 million, compared to $47.3 million during the same quarter in 2005. After adjusting for the impact of the five additional sales days, it is estimated that the sales pace in the United States, as measured in US dollars, has increased 8.6% from the prior year. Most of our operations in the United States recorded positive sales growth in the first quarter, benefiting from investments made in personnel, new branches and facility enhancements.

Hardwoods sales in Canada as measured in Canadian dollars increased 7.9% to $29.1 million, from $27.0 million during the first quarter of 2005. After adjusting for the impact of the five additional sales days, it is estimated that sales pace in Canada was on par with 2005 levels. Sales growth in Canada did not match that achieved in the United States in part due to the strengthening Canadian dollar. A stronger Canadian dollar reduces the Canadian dollar purchase price that Hardwoods' Canadian business pays to buy hardwood lumber from mills in the United States. When this product is resold to Hardwoods customers, it is also at a lower Canadian dollar equivalent selling price, and accordingly revenues in Canada are effectively reduced.

Gross Profit

Gross profit for the three months ended March 31, 2006 was $16.5 million, an increase of $0.7 million, or 4.4%, from $15.8 million in the first quarter of 2005. The increase in gross profit reflects the 9.8% increase in sales, partially offset by a lower gross profit margin of 17.7%, compared to 18.6% in the first quarter of 2005. Efforts to reduce inventory through lower selling prices at some locations contributed to the reduction in gross profit margin.

Selling and Administrative Expenses

For the three month period ended March 31, 2006, selling and administrative expenses were $12.2 million, up $1.7 million or 16.5% from $10.5 million in the three month period ended March 31, 2005. The impact of increased costs was partially offset by the strengthening value of the Canadian dollar, which reduced our US dollar expenses when translated to Canadian dollars for reporting purposes.

As described in our Annual Report, during the course of 2005 significant investments were made in personnel improvements to support growth. By the end of 2005 we had hired 35 new employees, made salary adjustments within our existing workforce to retain key employees, enhanced our employee training programs, and reorganized our management team to ensure the right people were in the right leadership positions. Some enhancements were also made to our branch distribution network. These investments in personnel and facilities represent the most significant contributing factors to higher selling and administrative expenses. In addition, higher selling and administrative costs in the first quarter of 2006 reflect an estimated $0.5 million in expenses that are not expected to recur in the remainder of 2006 in the areas of employee relocation expenses, benefit costs, and an insurance policy deductible. As a percentage of sales, selling and administrative expenses in the first quarter of 2006 were 13.1% of sales, compared to 12.3% in the comparative period in 2005.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of $0.3 million on foreign currency contracts which matured in the three months ended March 31, 2006, compared to $0.2 million in the comparative period in 2005. The higher gains on realized foreign currency contracts reflects the continued strengthening of the Canadian dollar in the first quarter of 2006 compared to the first quarter of 2005. The terms of our foreign currency contracts and the Fund's use of currency derivatives to mitigate the economic impact of fluctuations between the Canadian and United States dollar is described under Financial Instruments on page 17 of this report.

EBITDA

EBITDA was $4.6 million in the first quarter of 2006, down $0.9 million from $5.5 million in the same period in 2005. The decrease in EBITDA reflects the $1.7 million increase in selling and administrative expenses, partially offset by the $0.7 million improvement in gross profit and a $0.1 million increase in realized gains on foreign currency contracts.

Interest Expense

Interest expense for the three month period ended March 31, 2006 was $0.7 million, up $0.3 million or 65% from $0.4 million in Q1 2005. The increase in interest expense reflects higher average advances under operating lines of credit available to subsidiaries of the Fund, and increases in borrowing rates. Further discussion of our borrowing arrangements can be found under Revolving Credit Facilities on page 16 of this report.

Other Income

The mark-to-market valuation of our outstanding foreign currency contracts resulted in an adjustment of $0.5 million in the first quarter of 2006 compared to $0.3 million in the same period in 2005. As of March 31, 2006, our foreign currency contracts continued to be an asset to the Fund, having a fair value of $2.2 million. We continue to monitor our foreign currency contract policy to mitigate the impact of foreign exchange fluctuations on Canadian dollar distributions generated by our U.S. operations. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 17 of this report.

Net Earnings

Net earnings for the three months ended March 31, 2006 were $1.9 million, compared to $2.9 million in the comparative period in 2005. The $1.0 million decrease in net earnings primarily reflects the $0.9 million decrease in EBITDA, a $0.3 million increase in interest expense, and a $0.2 million increase in mark-to-market adjustment on foreign currency contracts. This was partly offset by a $0.3 million reduction in non controlling interest as a result of lower profits in the quarter, and a $0.1 million reduction in amortization expense.

Quarterly Financial Information

(in thousands of dollars)	For the three months ended March 31, 2006	For the three months ended December 31, 2005	For the three months ended September 30, 2005	For the three months ended June 30, 2005	For the three months ended March 31, 2005	For the three months ended December 31, 2004	For the three months ended September 30, 2004	For the Period March 23, 2004 to June 30, 2004
Total sales	$ 93,380	$ 84,130	$ 94,766	$ 91,852	$ 85,027	$ 93,730	$ 97,040	$ 99,125
Net earnings	$ 1,868	$ 2,370	$ 4,597	$ 3,442	$ 2,942	$ 5,568	$ 4,351	$ 4,684
Basic and fully diluted earnings per Class A Unit	$ 0.130	$ 0.164	$ 0.319	$ 0.239	$ 0.204	$ 0.386	$ 0.302	$ 0.325

The table above provides selected quarterly financial information for the eight completed fiscal quarters from commencement of operations of the Fund to March 31, 2006. 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 indication of future performance. Historically, the first quarter and fourth quarter have been seasonally slower periods for the Business. In addition, net earnings reported in each quarter will be impacted by changes to the foreign exchange rate of the Canadian and US dollar and gains or losses on foreign currency contracts, which are described under Financial Instruments on page 17 of this report.

Liquidity

Distributable Cash and Cash Distributions

Selected Unaudited Consolidated Financial Information (in thousands of dollars except per unit amounts)

		For the three months Ended March 31, 2006		For the three months Ended March 31, 2005
Net cash provided by (used in) operating activities	$	(1,209)	$	1,798
Increase in non-cash operating working capital		4,859		3,154
Cash flow from operations before changes in non-cash operating working capital		3,650		4,952
Capital expenditures		(253)		(229)
Distributable Cash	$	3,397	$	4,723
Distributions relating to the period:				
Class A Units		3,693 (1)		3,891
Class B Units		- (2)		986
	$	3,693	$	4,877
Outstanding units and per unit amounts:				
Class A Units outstanding		14,410,000		14,410,000
Class B Units outstanding		3,602,500		3,602,500
Total Units outstanding	$	18,012,500	$	18,012,500
Distributable Cash per Unit	$	0.189	$	0.262
Distributions relating to the period:				
Class A Units	$	0.256 (1)	$	0.270
Class B Units	$	- (2)	$	0.274
Total Units	$	0.205	$	0.271
Payout ratio (3)		108.7%		103.3%

[1] Includes the cash distribution which relates to March 2006 operations of the Fund. The cash distribution of $0.08542 per Class A Unit related to March 2006 operations of the Fund was declared on April 7, 2006, to be paid on April 28, 2006 to unitholders of record as of April 20, 2006. As this distribution was not declared until after March 31, 2006, it has not been reflected in the unaudited interim financial statements of the Fund for the three months ended March 31, 2006.

[2] On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, partnerships in which the Fund owns an 80% interest, announced that, effective immediately, quarterly distributions were suspended on the subordinated units, represented by the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in the combined business of Hardwoods, which is subordinated to the Fund's ownership interest in the business. Accordingly, no distributions were declared payable relating to the fourth quarter of 2005 or the first quarter of 2006 to the non-controlling interests and no current liability for distributions payable to the non-controlling interests is reflected in the March 31, 2006 balance sheet.

[3] Payout ratio measures the ratio of distributions relating to the period to distributable cash in the period. Comparative distributable cash and payout ratio figures have been restated to conform with presentation adopted in the current period as a result of the suspension of quarterly distributions on the Class B Units.

We pay distributions on Class A Units at the end of the month following the month in which the cash is earned. Distributions may also be made quarterly on Class B Units in an amount equivalent on an after-tax per-unit basis to distributions made on Class A Units, pursuant to the terms of a subordination agreement as outlined in the Fund's Annual Information Form dated March 20, 2006.

Effective for the fourth quarter of 2005, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, partnerships in which the Fund owns an 80% interest, suspended quarterly distributions on the subordinated units, represented by the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in the combined business of Hardwoods, which is subordinated to the Fund's ownership interest in the business. The quarterly distributions suspended and not declared to Class B Units amounted to $1.0 million related to the fourth quarter of 2005, and $1.0 million related to the first quarter of 2006. The subordination feature allows for these suspended distributions to be made up to the Class B Units in the 12 months following the suspension under certain circumstances. In addition, monthly distributions to Class A public unitholders cannot be increased above the IPO level of $0.08542 per unit during any month in which a suspension of distributions remains in effect for Class B Units in a preceding twelve month period. The Fund's subordination feature is designed to stay in place until the EBITDA and distributable cash tests established at the time of the IPO are met. The terms of these EBITDA and distributable cash tests are described in note 5 to the accompanying financial statements of the Fund.

For the three months ended March 31, 2006, the Fund and its subsidiaries generated distributable cash available to Class A and Class B Units of $3.4 million, or $0.189 per unit. Distributions relating to the first quarter were $3.7 million to Class A Units ($0.256 per Class A Unit), and no distributions were declared to Class B Units, resulting in an overall payout ratio of 108.7% for the period. At March 31, 2006, the overall payout ratio since the Fund's inception was 93.1%. The income tax characterization of distributions paid to unitholders in 2005 was approximately 43% fully taxable distributions, 26% dividends, and 31% return of capital.

Capital Expenditures

Capital expenditures were $0.3 million in the first quarter of 2006. As Hardwoods now leases all of its buildings and contracts out all freight delivery services, the Business has minimal capital requirements. Our capital expenditures are principally comprised of replacement of forklifts, furniture and fixtures, leasehold improvements, and computer equipment. We estimate our maintenance capital expenditures will be approximately $1.2 million annually. Additional capital expenditures may be incurred for new branch openings or to support acquisition opportunities that arise.

Revolving Credit Facilities

We have independent credit facilities in each of Canada and the US. In Canada, the term of our three-year operating line extends to March 23, 2007 and comprises a maximum facility of $22.0 million. The balance outstanding on the Canadian operating line as at March 31, 2006 was $14.4 million. In the U.S., the term of our three-year operating line extends to March 31, 2007, comprises a maximum facility of US$35 million, and as at March 31, 2006 had a balance outstanding of $33.7 million (US $28.8 million). We believe that our operating lines in both Canada and the U.S. are sufficient to meet our current working capital requirements.

Contractual Obligations

The table below sets forth other remaining contractual obligations of the Fund as at March 31, 2006, due in the fiscal years indicated, which relate to operating leases on various premises:

(in thousands of Canadian dollars)

Total	2006	2007	2008	2009	2010	2011 & thereafter
$ 25,966	$ 4,574	$ 5,798	$ 5,348	$ 4,500	$ 2,991	$ 2,755

Off-Balance Sheet Arrangements

The Fund has no off balance sheet arrangements. The foreign currency contracts discussed under Financial Instruments on page 17 of this report are marked-to-market at the end of each quarter, with the fair value recorded on the balance sheet.

Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires that we make estimates and assumptions that can have a material impact on our results of operations as reported on a periodic basis. We base our estimates and assumptions on past experience and other factors that are deemed reasonable under the circumstances. Actual results could differ from these estimates. The critical estimates used in preparing our financial statements are:

Accounts Receivable Provision: Due to the nature of our business and the credit terms we provide to our customers, we anticipate that a certain portion of required customer payments will not be made, and we maintain an allowance for these doubtful accounts. The allowance is based on our estimate of the potential of recovering our accounts receivable, and incorporates current and expected collection trends.

Valuation of Inventories: We anticipate that the net realizable value of our inventory could be affected by market shifts or damage to our products. Our inventory is valued at the lower of cost and net realizable value.

Related Party Transactions

Related parties refers to affiliates of the previous owners of the Business who have retained a 20% interest in Hardwoods through ownership of Class B Hardwoods LP units and Class B Hardwoods USLP units, respectively. For the three months ended March 31, 2006, sales of $0.4 million were made to related parties, and the subsidiaries of the Fund purchased $30,000 from related parties. These sales and purchases took place at prevailing market prices. Subsidiaries of the Fund also paid $27,000 in the first quarter to related parties under the terms of an agreement to provide services for management information systems.

Financial Instruments

The Fund uses currency derivatives to assist in managing 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 March 31, 2006, a subsidiary of the Fund had 25 monthly foreign currency contracts to exchange US$675,000 into approximately $878,000, reflecting an exchange rate of Cdn$1.30 to US$1.00, each month until April 2008. The subsidiary of the Fund also had an additional 12 monthly foreign currency contracts to exchange US$675,000 into approximately Canadian $760,000 each month from May 2008 until April 2009, reflecting an exchange rate of $1.1255. Taken together, the fair value of the Fund’s 37 remaining monthly currency contracts covering the period until April 2009 has been reflected in the financial statements and represents an asset of $2.2 million at March 31, 2006.

Based on the Fund’s current monthly distribution of $0.08542 per unit to public unitholders, during the term of the monthly foreign currency contracts the principal value of the monthly foreign currency contracts is sufficient to fully cover the amount of expected US dollar denominated distributable cash which is necessary to be converted to Canadian dollars to pay current distributions to Class A Unitholders.

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

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

	March 31, 2006	December 31, 2005
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 255	$ 2,203
Accounts receivable	51,900	46,166
Income tax receivable	-	86
Inventory	46,146	47,666
Prepaid expenses	1,109	1,222
	99,410	97,343
Long-term receivables	2,399	2,634
Property, plant and equipment	3,479	3,519
Deferred financing costs	62	77
Foreign currency contracts (note 3)	2,198	2,653
Other intangible assets	11,907	12,103
Goodwill	96,573	96,340
	$ 216,028	$ 214,669
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 4)	$ 50,042	$ 46,925
Accounts payable and accrued liabilities	8,001	9,231
Income tax payable	90	-
	58,133	56,156
Deferred gain on sale – leaseback of land and building	785	804
Non-controlling interests (note 5)	32,736	32,047
Future income taxes	1,595	1,364
Unitholders' equity:		
Fund Units	133,454	133,454
Retained earnings	61	1,886
Cumulative foreign currency translation account	(10,736)	(11,042)
	122,779	124,298
	$ 216,028	$ 214,669

Contingencies (note 11)
Subsequent event (note 12)

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 March 31, 2006	Three months ended March 31, 2005
Sales	$ 93,380	$ 85,027
Cost of sales	76,871	69,208
Gross profit	16,509	15,819
Expenses:		
Selling and administrative	12,219	10,485
Amortization:		
Plant and equipment	301	331
Deferred financing costs	15	16
Other intangible assets	227	236
Deferred gain on sale – leaseback of land and building	(21)	-
Interest	704	427
Realized gain on foreign currency contracts	(289)	(174)
Mark-to-market adjustment on foreign currency contracts (note 3)	454	273
	13,610	11,594
Earnings before non-controlling interests and income taxes	2,899	4,225
Non-controlling interests (note 5)	580	845
Earnings before income taxes	2,319	3,380
Income taxes:		
Current	218	122
Future	233	316
	451	438
Net earnings for the period	1,868	2,942
Retained earnings, beginning of period	1,886	2,801
Distributions declared to Unitholders	(3,693)	(3,891)
Retained earnings, end of period	$ 61	$ 1,852
Basic and diluted earnings per Unit	$ 0.13	$ 0.20
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 March 31, 2006	Three months ended March 31, 2005
Cash flows provided by (used in) operating activities:		
Net earnings for the period	$ 1,868	$ 2,942
Items not involving cash:		
Amortization	522	583
Gain on sale of property, plant and equipment	(5)	(4)
Mark-to-market adjustment on foreign currency contracts	454	273
Non-controlling interests	580	845
Future income taxes	231	313
	3,650	4,952
Change in non-cash operating working capital (note 6)	(4,859)	(3,154)
Net cash provided by (used in) operating activities	(1,209)	1,798
Cash flows provided by (used in) investing activities:		
Additions to property, plant and equipment	(253)	(229)
Proceeds on disposal of property, plant and equipment	6	4
Decrease in long-term receivables, net	241	206
Net cash used in investing activities	(6)	(19)
Cash flows provided by (used in) financing activities:		
Increase in bank indebtedness	2,960	3,098
Distributions paid to Unitholders	(3,693)	(3,891)
Distributions paid to non-controlling interests	-	(986)
Net cash used in financing activities	(733)	(1,779)
Decrease in cash	(1,948)	-
Cash, beginning of period	2,203	-
Cash, end of period	$ 255	$ -
Supplementary information (cash amounts):		
Interest paid	$ 704	$ 427
Income taxes paid	45	44

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

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

For the periods ended March 31, 2006 and 2005

1. Nature of operations:

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 of Units and acquired 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.

2. Basis of presentation:

The Fund prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles on a basis consistent with those used and described in the annual consolidated financial statements for the year ended December 31, 2005. The disclosures contained in these consolidated interim financial statements do not include all the requirements of Canadian generally accepted accounting principles for annual financial statements, and accordingly, these consolidated interim financial statements should be read in conjunction with the annual consolidated financial statements for the period ended December 31, 2005. Certain comparative figures have been restated to conform to the current period's financial statement presentation.

3. Foreign currency contracts:

In order to manage the Fund's 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 $878,000 until April 2008, reflecting an exchange rate of $1.30. The subsidiary of the Fund has also entered into additional monthly foreign currency contracts which require the subsidiary to exchange, beginning in May 2008, US$675,000 into approximately $760,000 each month until April 2009, reflecting an exchange rate of $1.1255. Taken together, the fair value of the Fund's 37 remaining monthly foreign currency contracts at March 31, 2006 represented a cumulative net asset of $2,198,000.

4. Bank indebtedness:

	March 31, 2006	December 31, 2005
Checks issued in excess of funds on deposit	$ 1,947	$ 753
Credit facility, Hardwoods LP	14,422	13,201
Credit facility, Hardwoods USLP (March 31, 2006-US$28,830; December 31, 2005-US$28,350)	33,673	32,971
	$ 50,042	$ 46,925

(Tabular amounts expressed in thousands of Canadian dollars)

5. Non-controlling interests:

Balance, January 1, 2006	$ 32,047
Interest in earnings for the period	580
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	109
Balance, end of period	$ 32,736

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 indirect 80% interest in Hardwoods LP and Hardwoods USLP through ownership of all 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 $21,300,000; and
- cash distributions of at least $29,540,000 ($2.05 per Unit) have been paid on the Units and a combined amount of cash advances or distributions of at least $7,385,000 has been paid on the Class B LP Units and Class B USLP Units, being $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.

The Subordinated End Date had not occurred at March 31, 2006.

Distributions are to be made monthly on the Class A LP Units and Class A USLP Units equal to at least $0.0854 per Unit to the extent cash is available to make cash distributions and as determined by the board of directors of the general partners. 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.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Non-controlling interests (continued):

In January 2006, distributions on the Class B LP Units and the Class B USLP Units were suspended in accordance with the terms of the subordination arrangements. The suspended distributions relating to the three months ended December 31, 2005 of $1.0 million and the three months ended March 31, 2006 of $1.0 million may be declared and paid to the Class B LP Units and the Class B USLP Units in the twelve months following the suspension under certain circumstances. Monthly distributions by the Fund cannot exceed $0.08542 per Unit during any month in which suspended distributions exist on Class B LP Units and Class B USLP Units in a preceding twelve month period.

After the Subordination End Date, the holders of the Class B LP Units and Class B USLP Units will generally be entitled to effectively exchange all or a portion of their Class B LP Units and Class B USLP Units together 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.

6. Changes in non-cash operating working capital:

	Three months ended March 31, 2006	Three months ended March 31, 2005
Accounts receivable	$ (5,553)	$ (2,889)
Income taxes receivable/payable	176	76
Inventory	1,652	269
Prepaid expenses	114	235
Accounts payable and accrued liabilities	(1,248)	(845)
	$ (4,859)	$ (3,154)

(Tabular amounts expressed in thousands of Canadian dollars)

7. Segment disclosure:

Information about geographic areas is as follows:

	Three months ended March 31, 2006	Three months ended March 31, 2005
Revenue from external customers:		
Canada	$ 29,146	$ 27,024
United States	64,234	58,003
	$ 93,380	$ 85,027

	March 31, 2006	December 31, 2005
Property, plant and equipment:		
Canada	$ 1,453	$ 1,559
United States	2,026	1,960
	$ 3,479	$ 3,519
Goodwill		
Canada	$ 42,043	$ 42,043
United States	54,530	54,297
	$ 96,573	$ 96,340

8. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP 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 March 31, 2006, Hardwoods USLP contributed and expensed $144,461 (US$125,118) (three months ended March 31, 2005 - $159,204(US$129,793)) 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, Sun Life Financial Trust Inc., and, accordingly, are not reflected in these consolidated financial statements. During the three months ended March 31, 2006, Hardwoods LP contributed and expensed $106,751 (three months ended March 31, 2005 - $107,790) in relation to the LP Plan.

9. Related party transactions:

For the three months ended March 31, 2006, sales of $401,032 (three months ended March 31, 2005 - $860,363) were made to affiliates of SIL, and the Fund made purchases of $29,524 (three months ended March 31, 2005 - $101,582) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the three months ended March 31, 2006, the Fund paid $27,000 (three months ended March 31, 2005 - $33,272) to affiliates of SIL under the terms of an agreement to provide transitional services for management information systems. This cost is included in the selling and administrative expense in the statement of operations.

10. Seasonality:

The Fund is subject to seasonal influences. Historically the first and fourth quarters are seasonally slower periods for construction activity and therefore demand for hardwood products.

11. Contingencies:

The Fund and its subsidiaries are subject to legal proceedings 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 through insurance or otherwise, would be material in relation to the Fund's consolidated financial statements.

12. Subsequent event:

On April 7, 2006 the Fund declared a cash distribution of $0.08542 per Unit to holders of its Units related to the month of March 2006. The Fund's policy is to pay cash distributions at the end of the month that follows the month when the cash was earned. The cash distribution was paid on April 28, 2006 to holders of record at the close of business on April 20, 2006. Although this cash distribution relates to cash generated in March 2006, because this cash distribution was declared and became payable after the end of the March 31 quarter end it is not reflected as a liability or in distributions to Unitholders in the March 31, 2006 consolidated financial statements.

Unitholder Information

Head Office

#306 – 9440 202nd Street
Langley, BC Canada V1M 4A6
Telephone: 604-881-1999
Facsimile: 604-881-1995

Auditors

KPMG LLP
Vancouver, British Columbia

Listings

The Toronto Stock Exchange
Trading under **HWD.UN**

Transfer Agent

Computershare Trust
Company of Canada

Investor Relations

Rob Brown
Chief Financial Officer
Telephone: 604-881-1990
Email: robbrown@hardwoods-inc.com

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