



HARDWOODS DISTRIBUTION
INCOME FUND

2007

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 36 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:

Our 2007 year is off to an excellent start with significant first quarter gains in distributable cash (up 18%), EBITDA (up 18%) and net earnings (up 34%) as compared to the first quarter of 2006.

For the three months ended March 31, 2007, we generated \$4.0 million (\$0.222 per unit) of distributable cash, up 18% from the same period in 2006, and had a payout ratio of 74%. This is an excellent result for the seasonally slower first quarter, and particularly impressive as it was achieved at a low point in the business cycle. As a result of our improved profitability, stable balance sheet, and our expectation of continued performance improvements in 2007, effective in April 2007 we are increasing our monthly distribution to public unitholders by 5%. Our monthly distribution will increase to \$0.0714 per class A unit, or \$0.857 per unit on an annualized basis. We are comfortable that we can maintain this distribution level while continuing to invest in our business and to target an annual payout ratio in the 70% to 80% range.

Our improved results reflect our success with a number of strategies—particularly our initiatives related to margin improvement. Through tighter inventory control, disciplined selling and the continued growth and success of our import program, we were able to increase our first quarter gross margin percentage to 18.4%, up from 17.7% a year earlier. Having completed necessary infrastructure changes in 2006 and with related non-recurring costs behind us, we also lowered our sales and administrative costs by \$0.4 million during the quarter.

On the sales side, our diversification across multiple sectors, customers and geographic regions continued to shield us from the worst effects of the dramatic year-over-year decline in US housing starts. Total sales were down a modest 1.8% from the first quarter of 2006. Sales in the US were flat compared to a year earlier, with strong results in Texas helping to offset a decline in sales in California. Sales in Canada, meanwhile, were down by 7.6%, primarily reflecting the fourth quarter 2006 closure of our branch in Windsor, Ontario.

Moving into the second quarter, our outlook remains cautious but positive. Although US housing starts are not expected to recover in the near term and the Canadian Housing and Mortgage Corporation forecasts a 7.4% decline in Canadian housing starts in 2007, we expect our diversification will continue to support sales at levels similar to those achieved in 2006.

Our import program was a key factor in the first quarter's stable sales and gross profit margin improvement, and we intend to continue expanding imports. We have recently added an additional contract representative in China and completed initial trials on new products that are now ready for market introduction. These initiatives, combined with strict selling discipline, should help us achieve our target margin of 18.5% or better in 2007. Over the longer term, we plan to further expand and diversify our import program with more value-added products and with products sourced from countries other than China.

As we move forward, we are closely watching the Federal government's proposed changes to income trust taxation, which could come into effect for existing funds like ours beginning in 2011. As 70% of our business is based in the US and already taxed under US laws, we believe the impact may be less on our Fund than on income trusts with operations based primarily in Canada. We will continue to monitor this proposal and take appropriate action as required.

At the close of a very encouraging first quarter, I thank our employees for the hard work that went into improving our results, and I thank you, our investors, for your continued confidence in Hardwoods. I look forward to telling you more about our progress as the year unfolds.

A handwritten signature in black ink that reads "Maurice Paquette". The signature is written in a cursive, flowing style.

Maurice E. Paquette

President and Chief Executive Officer

Management's Discussion and Analysis

May 3, 2007

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, 2007 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in our 2006 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, 2006. For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com. 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.

This MD&A includes the following sections:

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This MD&A may contain forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors outside of our control that could cause actual results to differ materially from those expressed in the forward-looking statements. Hardwoods Distribution Income Fund does not assume responsibility for the accuracy or completeness of the

forward-looking statements and does not undertake any obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

References to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustments on foreign currency contracts, goodwill and other intangible assets impairments, 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. For a reconciliation between EBITDA and net income or loss as determined in accordance with GAAP, please refer to the discussion of Results of Operations described in section 3.0 of this report.

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, mark-to-market adjustments on foreign currency contracts, and goodwill and other intangible assets impairments, 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 Distributable Cash is a useful supplemental measure that may assist investors and prospective investors in assessing the return on their investment in Class A Units. For reconciliation between Distributable Cash and net cash provided by operating activities as determined in accordance with GAAP, please refer to the discussion of Distributable Cash and Cash Distributions described in section 4.1 of this report.

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

1.0 Background

1.1 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 totalling \$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 December 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.

1.2 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, 2007 we operated 36 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.

Approximately 55% of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods, consisting primarily of hardwood plywood, and including 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.

Our customer base manufactures a range of end use products, such as cabinetry, furniture and custom millwork. These products in turn are sold into multiple sectors of the economy, including new home construction, renovation, non-residential construction and institutional markets. As a result of this diversity, it is difficult to determine with certainty what proportion of our products ends up in each sector of the economy. We estimate that approximately 40% to 50% of our products end up in new residential construction, in the form of cabinets, mouldings, custom finishing, and home furniture. We believe the balance of our products end up in other sectors of the economy not associated with new residential construction, such as home renovations, finishing millwork for office buildings, restaurant and bar interiors, hotel lobbies, retail point-of-purchase displays, schools, hospitals, custom motor coaches, yacht interiors and other specialty areas.

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.

2.0 Overview and Outlook

Despite weak conditions in the US residential construction market and lower prices for many of our hardwood lumber products, our first quarter sales remained relatively stable, with a modest 1.8% decline in total sales. Sales in the US were flat compared to a year earlier, with strong results in Texas helping to offset a decline in sales in California. Sales in Canada, meanwhile, were down by 7.6%, reflecting the fourth quarter 2006 closure of our branch in Windsor, Ontario. Combined, underlying sales were down 2.8% year-over-year, with the decline partially offset by a 1% positive impact of a lower Canadian dollar. The relative stability in our sales results reflects our diversification across multiple sectors, customers and geographic regions.

Our profitability improved significantly during the period compared to the first quarter of 2006. One of our key achievements was increasing gross profit margin to 18.4%, from 17.7% a year earlier. This was achieved through tighter inventory control and the continued growth and success of our import program. Sales and administrative (“S&A”) expenses were also lower year-over-year, reflecting the absence of non-recurring costs that affected Q1 2006 results. The combination of higher margins and lower costs contributed to a 18% improvement in EBITDA and a 34% improvement in net earnings.

Our strong performance helped us to generate an 18% increase in distributable cash and end the quarter with a payout ratio of 74%. We view this as an excellent result for our seasonally slower first quarter and a significant improvement over our payout ratio of 109% in the first quarter of 2006. Our balance sheet also remained solid with a net debt-to-EBITDA ratio of 1.78 at quarter end, the same as at December 31, 2006. Our improved profitability and stable balance sheet, combined with our expectation of continued performance improvements in 2007, resulted in the decision by Trustees to increase monthly cash distributions by 5% effective in April 2007. We are confident we can make this increase while continuing to invest in our business and to target a prudent annual payout ratio in the 70% to 80% range.

Although US housing starts are not expected to recover in the near term and the Canadian Housing and Mortgage Corporation forecasts a 7.4% decline in Canadian housing starts in 2007, we expect our sales will remain stable through 2007 as a result of product, end-market and geographic diversification. Credit risk among some customers affected by the reduction in demand remains a concern, however, and we are monitoring this situation carefully.

Strategically, we remain focused on achieving our gross profit margin target of 18.5% or better through strict selling discipline and continued expansion of our import program. During the first quarter we added an additional contract representative in China and completed initial trials on new products that are now ready for market introduction. Over the longer term, we intend to include more value-added products in our import mix and to expand sourcing beyond China.

As we move forward, we continue to monitor and assess the impact of the federal government's proposed taxation of income trusts. If passed into law, these changes will begin to affect our Fund in 2011. Overall, we anticipate that the proposed trust tax may have substantially less impact on our Fund than on other trusts that operate principally or exclusively in Canada.

Approximately 70% of our business is conducted in the United States and is already subject to US taxation. We believe that we may be able to re-organize our business structure prior to 2011 such that our US source income will not be exposed to additional taxes associated with the new Canadian trust tax. The remaining 30% of our earnings that are generated in Canada would be subject to tax at a rate of 31.5%. The proposed tax has not yet been finalized and passed into law, and accordingly all assessments are preliminary and are subject to change.

3.0 Results of Operations

Three Months Ended March 31, 2007 and March 31, 2006

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

	For the three months Ended March 31, 2007	For the three months Ended March 31, 2006
Total sales	\$ 91,720	\$ 93,380
<i>Sales in the US (US\$)</i>	55,299	55,633
<i>Sales in Canada</i>	26,926	29,146
Gross profit	16,868	16,509
<i>Gross profit %</i>	18.4%	17.7%
Selling and administrative expenses	11,750	12,219
Realized loss (gain) on foreign currency contracts	(269)	(289)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	\$ 5,387	\$ 4,579
Add (deduct):		
Amortization	(492)	(522)
Interest	(709)	(704)
Mark-to-market adjustment on foreign currency contracts	(169)	(454)
Non-controlling interest	(803)	(580)
Income taxes	(711)	(451)
Net earnings for the period	\$ 2,503	\$ 1,868
Basic and fully diluted earnings per Class A Unit	\$ 0.174	\$ 0.130
Average Canadian dollar/US dollar exchange rate	1.1717	1.1546

Sales

Sales for the three months ended March 31, 2007 were \$91.7 million, down 1.8% from \$93.4 million in the first quarter of 2006. The decrease in total sales reflects a 2.8% decrease in underlying sales activity, partially offset by a 1.0% increase in sales due to a positive foreign exchange impact.

Sales in the United States, as measured in US dollars, were largely unchanged at \$55.3 million, compared to \$55.6 million during the first quarter of 2006. Our California business experienced a significant drop in sales demand in the first quarter, reflecting weaker construction market conditions, particularly from cabinet manufacturing customers. Our Texas business posted strong sales gains, driven primarily by the successful introduction of import products. Demand in our other US geographic regions generally remained steady.

Sales in Canada, as measured in Canadian dollars, decreased 7.6% to \$26.9 million, from \$29.1 million during the first quarter of 2006. The fourth quarter 2006 closure of the Windsor, Ontario branch was a significant factor in the reduced sales.

Gross Profit

Gross profit for the three months ended March 31, 2007 was \$16.9 million, an increase of \$0.4 million, or 2.2%, from the \$16.5 million reported in 2006. The increase in gross profit reflects a return to a more normal gross profit percentage of 18.4% in the first quarter of 2007. This compares to 17.7% in the first quarter of 2006 when several of our branches worked to reduce inventory through lower selling prices. Some quarter-to-quarter variation in our gross profit percentage is considered normal, with 18% to 19% representing a typical range. Over the longer term, gross profits are targeted to achieve 18.5% of sales or higher.

Selling and Administrative Expenses

S&A expenses decreased \$0.4 million to \$11.8 million in the first quarter of 2007, from \$12.2 million during the same period in 2006. The higher S&A expenses in the prior year period reflected approximately \$0.5 million in non-recurring expenses related to employee relocation expenses, benefit costs, and an insurance claim deductible. These costs were not incurred in the first quarter of 2007, resulting in the decrease in S&A expense.

The improvement in S&A expenses was partially offset by bad debt expense of 0.8% of sales, which was higher than our five year historic average of 0.5% of sales. For further discussion of customer credit risk, refer to section 8.0 of this report.

As a percentage of sales, S&A expenses in the first quarter of 2007 were 12.8% of sales, compared to 13.1% in the comparative period in 2006.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of \$0.3 million on foreign currency contracts which matured in the first quarter of 2007, on par with \$0.3 million of realized gains in the same period in 2006. 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 US dollar are described in section 5.0 of this report.

EBITDA

EBITDA increased to \$5.4 million in the first quarter of 2007, up \$0.8 million from \$4.6 million in the first quarter of 2006. The increase in EBITDA primarily reflects a \$0.4 million increase in gross profit combined with the \$0.4 million reduction in S&A expenses.

Mark-To-Market Adjustment on Foreign Currency Contracts

For the three months ended March 31, 2007, the mark-to-market valuation of our outstanding foreign currency contracts created a loss of \$0.2 million, compared to a loss of \$0.5 million in the same period in 2006. Further discussion of our foreign currency contracts can be found under Financial Instruments in section 5.0 of this report.

Net Earnings

Net earnings for the three months ended March 31, 2007 were \$2.5 million, compared to \$1.9 million in the comparative period in 2006. The \$0.6 million increase in net earnings primarily reflects the \$0.8 million increase in EBITDA and the \$0.3 million reduction in mark-to-market adjustment losses on foreign currency contracts, partially offset by a \$0.3 million increase in income taxes and a \$0.2 million increase in non-controlling interest as a result of higher profits in the quarter.

4.0 Liquidity and Capital Resources

4.1 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, <u>2007</u>	For the three months ended March 31, <u>2006</u>
Net cash provided by (used in) operating activities	\$ 874	\$ (2,149)
Increase (decrease) in non-cash operating working capital	<u>3,359</u>	<u>5,799</u>
Cash flow from operations before changes in non-cash operating working capital	4,233	3,650
Capital expenditures	<u>(236)</u>	<u>(253)</u>
Distributable cash	<u>\$ 3,997</u>	<u>\$ 3,397</u>
Distributions relating to the period:		
Class A Units	2,940 ⁽¹⁾	3,693 ⁽²⁾
Class B Units	- ⁽³⁾	- ⁽³⁾
	<u>\$ 2,940</u>	<u>\$ 3,693</u>
Outstanding units and per unit amounts:		
Class A Units outstanding	14,410,000	14,410,000
Class B Units outstanding	<u>3,602,500</u>	<u>3,602,500</u>
Total Units outstanding	<u>18,012,500</u>	<u>18,012,500</u>
Distributable Cash per Total Units	\$ 0.222	\$ 0.189
Distributions relating to the period:		
Class A Units	\$ 0.204 ⁽¹⁾	\$ 0.256 ⁽²⁾
Class B Units	\$ - ⁽³⁾	\$ - ⁽³⁾
Total Units	\$ 0.163	\$ 0.205
Payout ratio ⁽⁴⁾	<u>73.6%</u>	<u>108.7%</u>

¹ Includes the cash distributions of \$0.068 per Class A Unit per month which relate to the operations of the Fund for January, February, and March 2007.

² Includes the cash distributions of \$0.08542 per Class A Unit per month which relate to the operations of the Fund for January, February, and March 2006.

³ 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 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, the first, second, third and fourth quarters of 2006, and the first quarter of 2007 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the March 31, 2007 balance sheet.

⁴ Payout ratio measures the ratio of distributions relating to the period to distributable cash in the period.

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, 2007.

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 the notes to the accompanying Interim Financial Statements.

For the three months ended March 31, 2007, the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of \$4.0 million, or \$0.222 per unit. Distributions relating to the period were \$2.9 million, or \$0.204 per unit, to our public unitholders (Class A Units). In accordance with the terms of a subordination feature in place with the previous owners (Class B Units), no distributions were made to the previous owners related to the three months ended March 31, 2007. These distributions represent an overall payout ratio of 73.6% for the first quarter of 2007, and 72.1% for the most recent twelve month period ended March 31, 2007. The income tax characterization of distributions paid to unitholders in 2006 was 45.03% fully taxable distributions, 26.33% dividends, and 28.64% return of capital.

Cash distributions are dependent upon the financial performance achieved by the Fund, and are made at the discretion of the Fund's independently elected Trustees. At the most recent meeting of the Trustees, a 5% increase in the rate of monthly distributions to Class A Unitholders was approved, bringing monthly distributions to \$0.0714 per unit. This increase will take effect with the April 2007 distribution, to be paid on May 31, 2007 to unitholders of record as at May 18, 2007.

4.2 Capital Expenditures

Our capital expenditures are typically low as we lease all of our buildings and contract out all freight delivery services. During the first quarter of 2007 capital expenditures were \$0.2 million, in line with expectations. On a full-year basis, 2007 maintenance capital requirements are expected to be approximately \$1.0 million principally for replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment.

4.3 Utilization of Distributable Cash

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

	For the three months ended March 31, <u>2007</u>	For the three months ended March 31, <u>2006</u>
Distributable Cash	\$ 3,997	\$ 3,397
Cash Distributions paid in the period	(2,940)	(3,693)
Distributable Cash Retained	\$ 1,057	\$ (296)
Decrease (increase) in non-cash operating working capital	(3,359)	(5,799)
Decrease (increase) in long-term receivables	325	1,181
Proceeds from disposal of property, plant and equipment	11	6
Decrease (Increase) in bank indebtedness, net of cash	\$ (1,966)	\$ (4,908)

Our utilization of distributable cash, and its relation to working capital use and bank line financing in the Business, is summarized above. For the three months ended March 31, 2007, the Fund generated distributable cash of \$4.0 million, paid cash distributions of \$2.9 million, and retained \$1.1 million of distributable cash. Our investment in non-cash operating working capital increased by \$3.4 million in the first quarter, primarily as a result of a \$4.5 million increase in accounts receivable due to increased sales in the first quarter of 2007 compared to the fourth quarter of 2006. The increase in working capital, partially offset by the increase in retained distributable cash, resulted in a \$2.0 million increase in bank indebtedness (net of cash) in the three-months ended March 31, 2007.

We believe that our credit facilities, combined with the retained portion of our distributable cash, are sufficient to meet our current working capital requirements. The terms of our revolving credit facilities are addressed in the following section 4.4 of this report.

4.4 Revolving Credit Facilities

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	As at March 31, 2007	As at December 31, 2006
Cash and cash equivalents	\$ (2,170)	\$ (594)
Debt	42,409	39,152
Net Debt	\$ 40,239	\$ 38,558
Unitholders' Equity	\$ 112,032	\$ 113,310
Total Capitalization	\$ 152,271	\$ 151,868
Net debt to total capitalization	26.4%	25.4%
Previous 12 months EBITDA	\$ 22,629	\$ 21,821
Net debt to previous 12 months EBITDA	1.78	1.77

We have independent credit facilities in Canada and the U.S. In Canada, our three year operating line extends to November 30, 2009 and comprises a maximum facility of \$22.0 million. The balance outstanding on the Canadian operating line as at March 31, 2007 was \$11.5 million. In the US, our three year operating line extends to March 31, 2010 and comprises a maximum facility of US\$35 million. As at March 31, 2007 the US credit facility had a balance outstanding of \$30.0 million (US \$26.0 million). The principal terms of the credit facilities available to Hardwoods LP and Hardwoods US LP are described in more detail in the Fund's Annual Information Form dated March 20, 2007.

Our net debt at March 31, 2007 was \$40.2 million compared to \$38.6 million at December 31, 2006. Overall net debt compared to total capitalization stood at 26.4% as of March 31, 2007, compared to 25.4% at December 31, 2006. The ratio of net debt to EBITDA in the previous 12 months held steady at 1.78 times compared to December 31, 2006. Net debt to EBITDA serves as an indicator of our financial leverage. The maximum ratio of net debt to EBITDA allowed under our Canadian credit facility is 2.75 times at the end of any financial quarter up to and including September 30, 2007, and not more than 2.50 times at the end of any financial quarter ending thereafter. The maximum ratio of net debt to EBITDA allowed under our US credit facility is 2.85 times. Our operating subsidiaries were fully compliant with these ratios as at March 31, 2007.

4.5 Contractual Obligations

The table below sets forth our contractual obligations as at March 31, 2007. These obligations relate to operating leases on various premises and automobiles and become due in the fiscal years indicated:

(in thousands of Canadian dollars)

<u>Total</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012 & thereafter</u>
\$ 22,018	\$ 5,702	\$ 6,360	\$ 4,783	\$ 2,977	\$ 1,001	\$ 1,195

4.6 Off-Balance Sheet Arrangements

The Fund has no off balance sheet arrangements. The foreign currency contracts discussed under Financial Instruments in section 5.0 of this report are marked-to-market at the end of each quarter, with the fair value recorded on the balance sheet.

5.0 Financial Instruments

We use currency contracts to assist in managing our 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, 2007, one of our subsidiaries has 13 monthly foreign currency contracts to exchange US\$675,000 into approximately Canadian \$878,000 each month until April 2008. This reflects an exchange rate of Cdn\$1.3001 to US\$1.00. This same subsidiary 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. This means that foreign currency contracts will provide approximately \$118,000 less per month beginning in May 2008 than they do currently. The fair value of the 13 remaining monthly currency contracts covering the period until April 2007 to April 2008 have been reflected in the financial statements and represent a current asset of \$1.2 million and a long-term asset of \$0.1 million at March 31, 2007. The fair value of the 12 monthly currency contracts covering the period May 2008 to April 2009 has been reflected in the financial statements and represents a long-term liability of \$0.1 million at March 31, 2007.

Based on the new monthly distribution rate of \$0.0714 per unit to public unitholders effective April 2007, the principal value of our current foreign currency contracts (through to April 2009) are sufficient to fully cover the estimated amount of US dollar denominated distributable cash that must be converted to Canadian dollars to pay distributions to Class A Unitholders.

6.0 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-month period ended March 31, 2007, sales of \$0.2 million were made to related parties and the subsidiaries of the Fund purchased \$0.1 million from related parties. These sales and purchases took place at prevailing market prices.

Subsidiaries of the Fund also paid \$27,000 to related parties to provide services for management information systems.

7.0 Critical Accounting Estimates and New Accounting Standards

7.1 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.

Valuation of Other Intangible Assets and Goodwill: Other intangible assets represent customer relationships acquired at the time of our IPO, and are recorded at cost less accumulated amortization. Amortization is provided for on a straight line basis over 15 years. Goodwill is

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

All significant accounting policies have been included in note 2 to the consolidated audited financial statements of the Fund for the year ended December 31, 2006.

7.2 New Accounting Standards

Effective January 1, 2007, we adopted five new Canadian Institute of Chartered Accountants (“CICA”) accounting standards: (a) Handbook section 1530, Comprehensive Income, (b) Handbook Section 3855, Financial Instruments – Recognition and Measurement, (c) Handbook Section 3861 Financial Instruments – Disclosure and Presentation, (d) Handbook section 3865, Hedges, and (e) Handbook Section 1506, Accounting Changes. Consistent with the requirements of the new accounting standards, we have not restated any prior period amounts as a result of adopting the accounting changes, other than to classify unrealized foreign currency translation gain or losses on net investments in self-sustaining foreign operations in accumulated other comprehensive loss within Unitholders Equity. As required under the transition rules opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policies. The main requirements of these new standards and the resulting financial statement impact are described in detail in note 3 to the Interim Financial Statements.

CICA Section 1530 introduces the term Comprehensive Income, which consist of net earnings and other comprehensive income (“OCI”). OCI represents changes in Unitholders’ equity during the period arising from transactions and other events with non-owner sources and in the case of the Fund includes unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations. As a result of adopting this standard, a new Statement of Comprehensive Income now forms part of the Fund’s consolidated financial statements which includes the current period net earnings and OCI. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Unitholders’ Equity in the balance sheet.

On adoption of these new accounting standards, adjustments were also made to the fair value of the Fund’s long-term employee housing loan receivables. These housing loans do not bear a market rate of interest and as such their fair value was determined to be approximately \$365,000

lower than the carrying amount upon adoption at January 1, 2007. The impact of these adjustments, including its impact on non-controlling interest, future income taxes, and deficit are disclosed in the following table (figures in thousands of Canadian dollars):

	As at December 31, 2006	Reclassification to accumulated other comprehensive loss	Adjustment on adoption of new standards	As at January 1, 2007
Long-term receivables	\$ 3,236	\$ -	\$ (365)	\$ 2,871
Non-controlling interests	33,859	-	(71)	(33,788)
Future income taxes	2,653	-	(99)	2,554
Unitholders Equity				
Cumulative translation adjustment	(11,171)	11,171	-	-
Accumulated other comprehensive loss	-	(11,171)	(9)	(11,180)
Deficit	\$ (8,973)	\$ -	\$ (186)	\$ (9,159)

8.0 Risks and Uncertainties

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of in our Annual Information Report dated March 20, 2007, which is available to readers at www.sedar.com. This section 8.0 provides an update to the risk assessment described in our Annual Information Form.

Demand and Credit Risk: Economic measures released in the first quarter of 2007 continued to indicate a slowdown is underway in the US and Canadian housing sectors. We are diversified geographically, by customer and by the wide range of commercial and residential applications for hardwoods. However, significant erosion in levels of activity in any of these areas, including levels of commercial and new home construction or renovation, could have a negative impact on demand for the hardwood products we sell, and could increase the risk of incurring significant levels of bad debt expense should some of our customers prove unable to stay in business during a period of reduced hardwood demand. In an effort to mitigate this risk, where possible we are proactively negotiating repayment plans and enhanced security on customer accounts deemed to be most at risk from a credit perspective.

Trade Risk: As described in section 2.0 of this report, the development and introduction of import products into our sales mix continues to be a key strategic focus. We believe that import products present one of the most attractive opportunities for Hardwoods to grow sales, and to do so at attractive gross profit margins. In the year ended December 31, 2006, our import business

comprised \$30 million of our annual sales, with substantially all of this product originating from China. Two events occurred in the first quarter that could raise the potential of the United States imposing future restrictions on trade with China and therefore represents a risk to our growing import business.

(1) On February 28, 2007 the US Senate Committee on Finance requested that the US International Trade Commission initiate an investigation into the competitive conditions affecting the US hardwood plywood industry. The US International Trade Commission is obliged under the Tariff Act of 1930 to deliver a report within 15 months of being requested to do so. The investigation will seek to analyze, amongst other things, the competitive position of US producers against foreign suppliers (including China) as it relates to illegal logging, labour practices, environmental policies, and government programs. There is a risk that the findings of this report, together with subsequent actions in the US Congress, could lead to trade outcomes that negatively impact upon our existing import business and undermine our efforts to expand and grow our sales by developing additional import products from China.

(2) Effective in the first quarter of 2007 the US Department of Commerce (“DOC”) has reversed its long-standing policy of not applying duties to subsidized goods from non-market economies. The DOC’s historical position had been that it is too difficult to determine subsidy levels in a non-market economy, which China is considered to be under US trade laws. The US Commerce Secretary has indicated that countervailing duties may now be used as a trade remedy tool against China should a US domestic supplier file a complaint with the DOC. The first instance of such a complaint against China related to the fine paper industry and was filed in 2006. The DOC subsequently imposed preliminary duties on fine paper products imported from China in the first quarter of 2007. There is a risk that a similar complaint could be filed relating to hardwood plywood products from China resulting in the introduction of countervailing duties. This could negatively impact upon our growing import business from China.

The probability of future trade barriers being imposed on our import products from China, and the resulting impact on the Fund, cannot be determined at this time. However in an effort to mitigate the potential trade risks identified above, we are now investigating the development of supply sources for quality import products in other countries to complement those we already import from China. We are also focused on including more specialty and value-added products in our imports from China, as we believe these products may be treated more favorably should trade restrictions emerge.

9.0 Internal Control Over Financial Reporting

During the three-months ended March 31, 2007, no changes were made in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

10.0 Quarterly Financial Information

(in thousands of dollars)	For the three months ended March 31, <u>2007</u>	For the three months ended December 31, <u>2006</u>	For the three months ended September 30, <u>2006</u>	For the three months ended June 30, <u>2006</u>	For the three months ended March 31, <u>2006</u>	For the three months ended December 31, <u>2005</u>	For the three months ended September 30, <u>2005</u>	For the three months ended June 30, <u>2005</u>
Total sales	\$ 91,720	\$ 83,120	\$ 90,974	\$ 95,054	\$ 93,380	\$ 84,130	\$ 94,766	\$ 91,852
Net earnings	\$ 2,503	\$ (4,826)	\$ 2,656	\$ 3,939	\$ 1,868	\$ 2,370	\$ 4,597	\$ 3,442
Basic and fully diluted earnings per Class A Unit	\$ 0.174	\$ (0.335)	\$ 0.184	\$ 0.273	\$ 0.130	\$ 0.164	\$ 0.319	\$ 0.239
EBITDA	\$ 5,387	\$ 4,088	\$ 6,727	\$ 6,427	\$ 4,579	\$ 4,706	\$ 6,679	\$ 6,691
Distributable cash	\$ 3,997	\$ 3,714	\$ 4,921	\$ 4,716	\$ 3,397	\$ 3,324	\$ 5,193	\$ 5,473
Total distributions to Class A and Class B Units	\$ 2,940	\$ 2,940	\$ 2,940	\$ 3,693	\$ 3,693	\$ 3,825	\$ 4,971	\$ 4,910
Payout ratio	74%	79%	60%	78%	109%	115%	96%	90%

The table above provides selected quarterly financial information for the eight most recently completed fiscal quarters of the Fund. 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 our business. In addition, net earnings reported in each quarter may be impacted by changes to the foreign exchange rate of the Canadian and US dollar, write-downs in the carrying value of goodwill and other intangible assets (which occurred in the three months ended December 31, 2006), and gains or losses on foreign currency contracts which are described under Financial Instruments in section 5.0 of this report.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

	March 31, 2007	December 31, 2006
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,170	\$ 594
Accounts receivable	47,761	43,767
Income tax recoverable	103	596
Inventory	42,855	44,584
Prepaid expenses	1,012	1,098
Foreign currency contracts (note 4)	1,210	1,129
	95,111	91,768
Long-term receivables	2,687	3,236
Property, plant and equipment	3,149	3,219
Deferred financing costs	29	32
Foreign currency contracts (note 4)	102	385
Other intangible assets	10,592	10,878
Goodwill	88,382	88,886
	\$ 200,052	\$ 198,404

Liabilities and Unitholders' Equity

Current liabilities:		
Bank indebtedness (note 5)	\$ 42,409	\$ 39,152
Accounts payable and accrued liabilities	6,649	7,590
Distribution payable to Unitholders	980	980
	50,038	47,722
Foreign currency contracts (note 4)	107	141
Deferred gain on sale - leaseback of land and building	691	719
Non-controlling interests (note 6)	34,354	33,859
Future income taxes	2,830	2,653
Unitholders' equity:		
Fund Units	133,454	133,454
Deficit	(9,596)	(8,973)
Accumulated other comprehensive loss	(11,826)	(11,171)
	112,032	113,310
Contingencies (note 12)		
	\$ 200,052	\$ 198,404

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 Statement of Earnings and Retained Earnings (Deficit)

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Sales	\$ 91,720	\$ 93,380
Cost of sales	74,852	76,871
Gross profit	16,868	16,509
Expenses:		
Selling and administrative	11,750	12,219
Amortization:		
Plant and equipment	288	301
Deferred financing costs	3	15
Other intangible assets	223	227
Deferred gain on sale - leaseback of land and building	(22)	(21)
Interest	709	704
Foreign currency contracts	(100)	165
	12,851	13,610
Earnings before non-controlling interests and income taxes	4,017	2,899
Non-controlling interests (note 6)	803	580
Earnings before income taxes	3,214	2,319
Income taxes:		
Current	405	218
Future	306	233
	711	451
Net earnings for the period	2,503	1,868
Retained earnings (deficit), beginning of period (note 3)	(9,159)	1,886
Distributions declared to Unitholders	(2,940)	(3,693)
Retained earnings (deficit), end of period	\$ (9,596)	\$ 61
Basic and diluted earnings per Unit	\$ 0.17	\$ 0.13
Weighted average number of Units outstanding	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Comprehensive Income

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Net earnings for the period	\$ 2,503	\$ 1,868
Other comprehensive income:		
Unrealized gains (losses) on translation of self-sustaining foreign operations	(646)	306
Other comprehensive income (loss)	(646)	306
Comprehensive income	\$ 1,857	\$ 2,174

Consolidated Statement of Accumulated Other Comprehensive Loss

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Accumulated other comprehensive loss, beginning of period (note 3)	\$ (11,180)	\$ (11,042)
Other comprehensive income (loss)	(646)	306
Accumulated other comprehensive loss, end of period	\$ (11,826)	\$ (10,736)

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statements of Cash Flows

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended March 31, 2007	Three months ended March 31, 2006
Cash flows provided by (used in) operating activities:		
Net earnings for the period	\$ 2,503	\$ 1,868
Items not involving cash:		
Amortization	492	522
Gain on sale of property, plant and equipment	(10)	(5)
Mark-to-market adjustment on unrealized foreign currency contracts	169	454
Non-controlling interests	803	580
Future income taxes	276	231
	4,233	3,650
Change in non-cash operating working capital (note 7)	(3,359)	(5,799)
Net cash provided by (used in) operating activities	874	(2,149)
Cash flows provided by (used in) investing activities:		
Additions to property, plant and equipment	(236)	(253)
Proceeds on disposal of property, plant and equipment	11	6
Decrease in long-term receivables, net	325	1,181
Net cash provided by investing activities	100	934
Cash flows provided by (used in) financing activities:		
Increase in bank indebtedness	3,542	2,960
Distributions paid to Unitholders	(2,940)	(3,693)
Net cash provided by (used in) financing activities	602	(733)
Increase (decrease) in cash	1,576	(1,948)
Cash, beginning of period	594	2,203
Cash, end of period	\$ 2,170	\$ 255
Supplementary information (cash amounts):		
Interest paid	\$ 709	\$ 704
Income taxes paid	6	45

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, 2007 and 2006

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, 2006 except as discussed in note 3. 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, 2006. Certain comparative figures have been restated to conform to the current period's financial statement presentation.

3. Adoption of changes in accounting polices:

Effective January 1, 2007, the Fund adopted five new Canadian Institute of Chartered Accountants ("CICA") accounting standards: (a) Handbook Section 1530, *Comprehensive Income*; (b) Handbook Section 3855, *Financial Instruments – Recognition and Measurement*; (c) Handbook Section 3861 *Financial Instruments – Disclosure and Presentation*; (d) Handbook Section 3865, *Hedges*; and (e) Handbook Section 1506, *Accounting Changes*. The main requirements of these new standards and the resulting financial statement impact are described below.

Consistent with the requirements of the new accounting standards, the Fund has not restated any prior period amounts as a result of adopting the accounting changes, other than to classify unrealized foreign currency translation gain or losses on net investments in self-sustaining foreign operations in accumulated other comprehensive loss within Unitholders' Equity. As required under the transition rules the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policies described below.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

3. Adoption of changes in accounting polices (continued):

The effect of the adoption of these standards is summarized in the following table:

	As at December 31, 2006	Reclassification to accumulated other comprehensive loss	Adjustment on adoption of new standards	As at January 1, 2007
Long-term receivables	\$ 3,236	\$ -	\$ (365)	\$ 2,871
Non-controlling interests	33,859	-	(71)	(33,788)
Future income taxes	2,653	-	(99)	2,554
Unitholders Equity				
Cumulative translation adjustment	(11,171)	11,171	-	-
Accumulated other comprehensive loss	-	(11,171)	(9)	(11,180)
Deficit	\$ (8,973)	\$ -	\$ (186)	\$ (9,159)

(a) Comprehensive Income (Section 1530):

CICA Section 1530 introduces the term Comprehensive Income, which consists of net earnings and other comprehensive income ("OCI"). OCI represents changes in Unitholders' equity during the period arising from transactions and other events with non-owner sources and in the case of the Fund includes unrealized foreign currency translation gains or losses arising from self-sustaining foreign operations. As a result of adopting this standard, a new Statement of Comprehensive Income now forms part of the Fund's consolidated financial statements which includes the current period net earnings and OCI. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income, which is presented as a new category of Unitholders' Equity in the balance sheet.

(b) Financial Instruments – Recognition and Measurement (Section 3855):

CICA Section 3855 sets out criteria for the recognition and measurement of financial instruments for fiscal years beginning on or after October 1, 2006. This standard requires all financial instruments within its scope, including derivatives, to be included on the balance sheet and measured either at fair value or, in certain circumstances when fair value may not be considered most relevant, at cost or amortized cost. Changes in fair value are to be recognized in either the Statements of Earnings or the Statement of Comprehensive Income.

All financial assets and liabilities are recognized when the entity becomes a party to the contract creating the item. As such, any of the Fund's outstanding financial assets and liabilities at the effective date of adoption are recognized and measured in accordance with the new requirements as if these requirements had always been in effect. Any changes to the fair values of assets and liabilities prior to January 1, 2007 are recognized by adjusting opening deficit or opening accumulated other comprehensive income.

All financial instruments are classified into one of the following five categories: held-for-trading, held to maturity, loans and receivables, available for sale financial assets, or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification:

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

3. Adoption of changes in accounting polices (continued):

- Held to maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and losses due to impairment are included in current period net earnings using the effective interest method.
- Available for sale financial assets are measured at fair value, with unrealized gains and losses recorded in other comprehensive income until the asset is realized, at which time they will be recorded in net earnings.
- Held for trading financial instruments are measured at fair value. All gains and losses resulting from changes in their fair value are included in net earnings in the period in which they arise.
- All derivative financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses resulting from changes in their fair value are included in net earnings in the period in which they arise.

Upon adoption of these new standards, the Fund has classified its financial instruments as follows:

- Accounts receivable and long term receivables are classified as loans and receivables, which are initially measured at fair value and subsequently measured at amortized cost. Housing loans provided to employees by the Fund to assist in their relocation to new operating locations were identified to be loans with a non-market rate of interest, requiring an adjustment based on the fair market value of the loans at their inception, adjusted for the accretion of the fair market value discount in the period from inception to the adoption of the new accounting standard. This change in accounting standard resulted in a decrease in the carrying value of employee housing loans receivable of \$365,000, a decrease in non-controlling interests of \$71,000 and future income taxes of \$99,000, and an increase in deficit of \$186,000 on the balance sheet at January 1, 2007.
- The Fund's foreign currency contracts are a derivative financial instrument and as such are classified as held for trading, with all gains and losses included in net earnings in the period in which they arise. This is consistent with the Fund's historic accounting treatment of the foreign currency contracts and thus there was no change in accounting on adoption.

(c) Financial Instruments – Disclosure and Presentation (*Section 3861*):

CICA Section 3861 sets out standards which address the presentation of financial instruments and non-financial derivatives, and identifies the related information that should be disclosed. These standards also revise the requirements for entities to provide accounting policy disclosures, including disclosure of the criteria for designating as held-for-trading those financial assets or liabilities that are not required to be classified as held-for-trading; whether categories of normal purchases and sales of financial assets are accounted for at trade date or settlement date; the accounting policy for transaction costs on financial assets and financial liabilities classified as other than held-for-trading; and provide several new requirements for disclosure about fair value.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

3. Adoption of changes in accounting polices (continued):

(d) Hedging (*Section 3865*):

CICA Section 3865 specifies the circumstances under which hedge accounting is permissible and how hedge accounting may be performed. The Fund currently does not hold any financial instruments designated for hedge accounting.

(e) Accounting Changes (*Section 1506*):

CICA Section 1506 revised the standards on changes in accounting policy, estimates or errors to require a change in accounting policy to be applied retrospectively (unless doing so is impracticable), changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. The impact of this new standard cannot be determined until such time as the Fund makes a change in accounting policy, other than the changes resulting from the implementation of the new CICA Handbook standards discussed in this note.

(f) Cash Flow Statements (*Section 1540*):

Amendments to CICA 1540, *Cash Flow Statements*, require entities to disclose total cash distributions on financial instruments classified as equity in accordance with a contractual agreement and the extent to which total cash distributions are non-discretionary. This disclosure requirement is effective for interim and annual financial statements for fiscal periods ending on or after March 31, 2007. The Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the three month period ended March 31, 2007 \$2.9 million (2006 - \$3.7 million) in discretionary cash distributions were paid to Unitholders.

4. Foreign currency contracts:

In order to manage the Fund's exposure to exchange rate fluctuations on United States dollar denominated distributable cash, at March 31, 2007 a subsidiary of the Fund had 13 monthly 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 also had an additional 12 monthly foreign currency contracts to exchange US\$675,000 into approximately \$760,000 each month from May 2008 until April 2009, reflecting an exchange rate of \$1.1255. The fair value of the Fund's 13 remaining monthly foreign currency contracts covering the period April 2007 to April 2008 represent a current asset of \$1,210,000 and a long term asset of \$102,000 at March 31, 2007. The fair value of the Fund's 12 monthly currency contracts covering the period May 2008 to April 2009 represent a long term liability of \$107,000 at March 31, 2007. The fair values were determined based on valuations obtained from the counter-party.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

5. Bank indebtedness:

	March 31, 2007	December 31, 2006
Checks issued in excess of funds on deposit	\$ 904	\$ 797
Credit facility, Hardwoods LP	11,532	10,788
Credit facility, Hardwoods USLP (March 31, 2007 - US\$25,960; December 31, 2006 - US\$23,655)	29,973	27,567
	\$ 42,409	\$ 39,152

6. Non-controlling interests:

Balance, January 1, 2007 (note 3)	\$ 33,788
Interest in earnings for the period	803
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	(237)
Balance, end of period	\$ 34,354

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, 2007.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

6. Non-controlling interests (continued):

Prior to the Subordination End Date, advances and distributions on the LP Units and the USLP Units will be made in the following order of priority:

- At the end of each month, cash advances or distributions will be made to the holders of Class A LP Units and Class A USLP Units in a combined amount that is sufficient to provide available cash to the Fund to enable the Fund to make cash distributions upon the Units for such month at least equal to \$0.08542 per Unit or, if there is insufficient available cash to make distributions or advances in such amount, such lesser amount as is available as determined by the board of directors of the general partners;
- At the end of each fiscal quarter of Hardwoods LP and Hardwoods USLP, including the fiscal quarter ending on the fiscal year end, available cash of Hardwoods LP and Hardwoods USLP will be advanced or distributed in the following order of priority:
 - First, in payment of the monthly cash advance or distribution to the holders of Class A LP Units and Class A USLP Units as described above, for the month then ended;
 - Second, to the holders of Class A LP Units and Class A USLP Units, to the extent that the combined monthly cash advances or distributions in respect of the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on Class A LP Units and Class A USLP Units were not made or were made in amounts less than a combined amount at least equal to \$1.025 per Unit, the amount of any such deficiency. As of March 31, 2007, the amount of such deficiency was \$2.3 million;
 - Third, to the holders of Class B LP Units and Class B USLP Units 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 advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter or, if there is insufficient available cash to make advances or distributions in such amount, such lesser amount as is available;
 - Fourth, to the holders of Class B LP Units and Class B USLP Units, to the extent only that combined advances or distributions in respect of any fiscal quarter(s) during the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on one Class B LP Unit and one Class B USLP Unit were not made, or were made in amounts less, on a pro-rated basis, that the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such 12 month period, the amount of such deficiency. As of March 31, 2008, the amount of such deficiency was \$3.1 million;
 - Fifth, to the extent of any excess, to the holders of the Class A LP Units and Class B LP Units and Class A USLP Units and Class B USLP Units, respectively, so that the combined advances or distributions on one Class A LP Unit and one Class A USLP Unit are the same as the combined advances or distribution on one Class B LP Unit and one Class B USLP Unit in respect of the 12 month period then ended (and not, for greater certainty, any previous 12 month period).

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

6. Non-controlling interests (continued):

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.

7. Changes in non-cash operating working capital:

	Three months ended March 31, 2007	Three months ended March 31, 2006
Accounts receivable	\$ (4,490)	\$ (6,493)
Income taxes recoverable/payable	493	176
Inventory	1,455	1,652
Prepaid expenses	81	114
Accounts payable and accrued liabilities	(898)	(1,248)
	<u>\$ (3,359)</u>	<u>\$ (5,799)</u>

8. Segment disclosure:

Information about geographic areas is as follows:

	Three months ended March 31, 2007	Three months ended March 31, 2006
Revenue from external customers:		
Canada	\$ 26,926	\$ 29,146
United States	64,794	64,234
	<u>\$ 91,720</u>	<u>\$ 93,380</u>

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

8. Segment disclosure (continued):

	March 31, 2007	December 31, 2006
Property, plant and equipment:		
Canada	\$ 1,233	\$ 1,156
United States	1,916	2,063
	<hr/>	<hr/>
	\$ 3,149	\$ 3,219
Goodwill		
Canada	\$ 34,477	\$ 34,477
United States	53,905	54,409
	<hr/>	<hr/>
	\$ 88,382	\$ 88,886

9. 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, 2007, Hardwoods USLP contributed and expensed \$158,454 (US\$135,234) (three months ended March 31, 2006 - \$144,461 (US\$125,118)) 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, 2007, Hardwoods LP contributed and expensed \$90,875 (three months ended March 31, 2006 - \$106,751) in relation to the LP Plan.

10. Related party transactions:

For the three months ended March 31, 2007, sales of \$222,105 (three months ended March 31, 2006 - \$401,032) were made to affiliates of SIL, and the Fund made purchases of \$122,979 (three months ended March 31, 2006 - \$29,524) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the three months ended March 31, 2007, the Fund paid \$27,000 (three months ended March 31, 2006 - \$27,000) 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 earnings.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended March 31, 2007 and 2006

11. 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.

12. 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.

Unitholder Information

Trustees

Lawrence I. Bell
Chair, British Columbia Hydro
& Power Authority

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

Lawrence I. Bell
Chair, British Columbia Hydro
& Power Authority

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Vice Chair, Sauder Industries

Richard N. McKerracher
President, Sauder Industries

Officers

Maurice E. Paquette
President & Chief Executive Officer

Robert J. Brown
Vice President & Chief Financial
Officer

Daniel A. Besen
Vice President, California Region

Garry W. Warner
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Listings

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Trading under **HWD.UN**

Transfer Agent

Computershare Trust
Company of Canada