HARDWOODS DISTRIBUTION INCOME FUND

2010

Second Quarter

Report To Unitholders

About the Fund

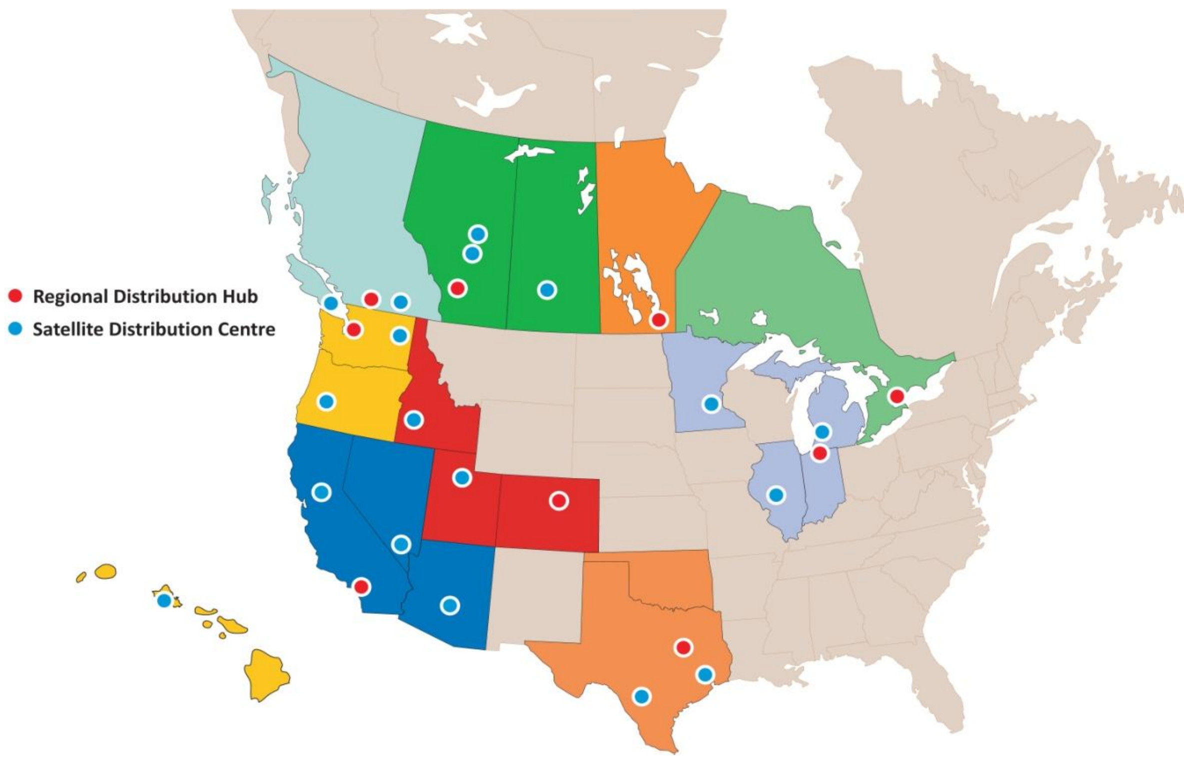
Hardwoods Distribution Income Fund (the "Fund") is an unincorporated open-ended limited purpose trust. The Fund was launched on March 23, 2004 with the completion of an initial public offering (IPO) of 14.4 million trust units ("Class A Units"). Net proceeds of the IPO were used to acquire an 80% interest 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 in business for almost 50 years. We sell quality lumber, hardwood plywood and specialty products to cabinet makers, custom millworkers, furniture makers and other industrial customers that manufacture products made from hardwood. Demand for products made from hardwood comes from multiple sectors of the North American economy, including new home construction, renovation, non-residential construction and institutional markets. There is warmth to the look and touch of hardwoods that no other material can match, and people place a high value on products crafted from real wood. Hardwood products are a part of our daily lives in the homes we live in (cabinets, mouldings, custom finishing, and home furniture) and places we visit (furniture, cabinetry, and finishing millwork for office buildings, restaurant and bar interiors, hotel lobbies, retail point-of-purchase displays, schools, hospitals, custom motor coaches, yacht interiors and other specialty areas).

Our role in the industry is to provide the critical link between mills that manufacture large volumes of hardwood lumber and sheet goods, and industrial customers that require smaller quantities of many different hardwood products for their own manufacturing processes. We provide a means for hundreds of hardwood mills to get their product to thousands of small to mid-sized industrial manufacturers. We add value to our suppliers by buying their product in volume and paying them promptly, effectively acting as their third party sales force. We add value for our customers by providing them with the materials they need on a just-in-time basis, in smaller quantities and offering a wider range of product selection than the customer would be able to purchase directly from an individual mill. We are also important to our customers by allowing them to buy material from us on approved credit, which is an important source of financing for customers in our industry.

We are one of the largest distributors of hardwood lumber and sheet goods in North America. We are larger than most of our suppliers, customers, and direct competitors. 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.



As shown in the map above, we operate 27 distribution centres organized into nine regions, providing geographic coverage in 14 states and 5 provinces across the US and Canada. To maximize inventory management, we operate utilizing a hub-and-spoke distribution system. Our major hub distribution centres hold the bulk of our inventory, and make regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

The North American economy is currently experiencing a sluggish recovery after a significant downturn in housing and construction, which are key markets for the hardwoods products that we distribute. However current levels of housing and construction activity in North America are low relative to expected longer term population and housing trends, and we believe that when a sustained economic recovery takes hold prospects for our industry are attractive.

To Our Unitholders

This is my first report to you as President and CEO of Hardwoods Distribution Income Fund and I want to begin by acknowledging my predecessor, Maurice Paquette. Maurice retired as the Fund's President and CEO on July 5, 2010, following 36 years with Hardwoods and its predecessor companies. In his final years with Hardwoods, Maurice was tasked with steering the Fund safely through one of one of the worst downturns in the history of the hardwoods industry. He did that job extremely well and the results we are reporting today provide clear evidence of his success.

I am pleased to report that during the three-month period ended June 30, 2010, we capitalized on improved market conditions for hardwood products and tightly managed all aspects of our business to achieve stronger financial results. Our sales, EBITDA, net earnings and distributable cash results all improved significantly compared to the same period last year.

The increase in our sales was aided by higher prices for hardwood lumber, which accounts for close to half of our sales. Average lumber prices were up 24% compared to a year ago as mill closures and curtailments caused supply to fall below demand levels. Product demand also improved in some markets and we generated solid gains with our sales strategies. Throughout the first half of 2010 we have remained proactive in promoting differentiated and higher-margin products such as our lines of Greenbelt and import products, and we have had good success with sales force programs designed to win new customer accounts.

These efforts, together with the higher prices for hardwood lumber, contributed to a 5.5% increase in total sales during the quarter compared to the second quarter of last year, including a 14.0% increase in underlying sales before the impact of foreign exchange. We were also successful in increasing our gross margin percentage to 17.9% from 17.5% in the second quarter last year.

While strengthening the top-line of our business, we also maintained our focus on tight control of costs and careful management of bad debt. These efforts helped us reduce S&A expense by $1.9 million in the second quarter and by $3.1 million in the first six months of 2010, compared to the same periods last year. Together with our higher sales and margins, this resulted in improved EBITDA and our second consecutive quarter of positive Distributable Cash. We have now generated $3.0 million of Distributable Cash since the start of 2010.

While we are encouraged by this progress, we remain cautious in our outlook and believe that a full-scale economic recovery is still some way off. The US market in particular continues to face challenges from a weak housing market, a large inventory of foreclosed homes and continuing weakness on the jobs front. Canada also presents potential challenges as the Harmonized Sales Tax is introduced and adds to the cost of buying houses in Ontario and British Columbia.

With the expectation of continuing market challenges, tight management of our business will remain a priority for us through the balance of 2010 with careful management of cash and expenses, a close eye on bad debt management, and continued efforts to protect and build our market share.

Longer term, we recognize that current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends, and we believe that when a sustained economic recovery takes hold, prospects for our industry are attractive. Accordingly, we will continue to pursue strategies that strengthen our product and service offering and ensure we can participate fully in the eventual recovery.

Lance R. Blanco

President and Chief Executive Officer

Management's Discussion and Analysis

August 4, 2010

This management's discussion and analysis ("MD&A") covers our unaudited interim consolidated financial statements as at and for the three and six month periods ended June 30, 2010 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in our 2009 Annual Report. The information below should be read in conjunction with the Interim Financial Statements, and the audited consolidated financial statements and accompanying notes of Hardwoods Distribution Income Fund (the "Fund") for the years ended December 31, 2009 and 2008. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

This MD&A includes the following sections:

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

The forward-looking information in this MD&A includes, but is not limited to: our belief that when a sustained economic recovery takes hold prospects for our industry are attractive; our belief that given the intense competition currently affecting our industry, a gross margin in the high 17% range is the sustainable level that can be achieved through this part of the business cycle; that our outlook remains cautious, particularly in light of the continued fragility of the US residential construction market; our anticipation of a continuation of very challenging market conditions through the balance of 2010; our intent to remain focused in the coming months on tight control of costs, inventories and working capital, and minimizing customer credit risk; our intent to remain proactive on the marketing front with continued efforts to expand our market share, and make further investment in strategic products such as our import and Greenbelt lines of products; our intent to keep S&A expense closely in line with market opportunities; that our Trustees will look for indications of a sustainable and predictable return of the Fund’s cash generation capability, and will consider any needs to invest in working capital to support sales growth, before any decision is taken to reinstate distributions to unitholders; that annual maintenance capital requirements are expected to average approximately $1.0 million per year, but may be higher or lower in a particular year, based on the needs of the business; our belief that we have made sufficient investment to sustain productive capacity of the business as it relates to our needs for property, plant and equipment; our belief that the productive capacity of our business in terms of our human capital relative to available market demand, as measured by sales, has been largely sustained; our expectation that the adoption of IFRS will not have a material impact on the Fund’s reported cash flows; our belief that bad debt risk will remain elevated through 2010; our belief that making a leadership change at the CEO level represents an uncertainty facing the business in 2010; and, our planned debt management strategy.

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: there are no material exchange rate fluctuations between the Canadian and US dollar that affect our performance; the general state of the economy does not worsen; we do not lose any key personnel; there are no decreases in the supply of, demand for, or market values of hardwood lumber or sheet goods that harm our business; we do not incur material losses related to credit provided to our customers; our products are not subjected to negative trade outcomes; we are able to sustain our level of sales and EBITDA margins; we are able to grow our business long term and to manage our growth; there is no new competition in our markets that leads to reduced revenues and profitability; we do not become subject to more stringent regulations; importation of products manufactured with hardwood lumber or sheet goods does not increase and replace products manufactured in North America; our management information systems upon which we are dependent are not impaired; our insurance is sufficient to cover losses that may occur as a result of our operations; and, the financial condition and results of operations of our business upon which we are dependent is not impaired.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from historical results or results anticipated by the forward-looking information. The factors which could cause results to differ from current expectations include, but are not limited to: exchange rate fluctuations between the Canadian and US dollar could affect our performance; our results are dependent upon the general state of the economy; we depend on key personnel, the loss of which could harm our business; decreases in the supply of, demand for, or market values of hardwood lumber or sheet goods could harm our business; we may incur losses related to credit provided to our customers; our products may be subject to negative trade outcomes; we may not be able to sustain our level of sales or EBITDA margins; we may be unable to grow our business long term to manage any growth; competition in our markets may lead to reduced revenues and profitability; we may become subject to more stringent regulations; importation of products manufactured with hardwood lumber or sheet goods may increase, and replace products manufactured in North America; we are dependent upon our management information systems; our insurance may be insufficient to cover losses that may occur as a result of our operations; we are dependent upon the financial condition and results of operations of our business; our credit facilities affect our liquidity, contain restrictions on our ability to borrow funds, and impose restrictions on distributions that can be made by our operating limited partnerships; our future growth may be restricted by the payout of substantially all of our operating cash flow; and, other risks described in our Annual Information Form and this MD&A.

All forward-looking information in this MD&A is qualified in its entirety by this cautionary statement and, except as may be required by law, we undertake no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

In this MD&A, references to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, unrealized foreign currency gains and losses, goodwill and other intangible assets impairments, and the non-controlling interest in earnings. 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.

References to "Distributable Cash" are to net cash provided by operating activities, before changes in non-cash operating working capital, less capital expenditures and contributions to any reserves that the Boards of Directors of our operating entities determine to be reasonable and necessary for the operation of the businesses owned by these entities.

We believe that, in addition to net income or loss, our EBITDA and our Distributable Cash are each a useful supplemental measure of operating performance that may assist investors in assessing their investment in Class A Units. Neither EBITDA nor Distributable Cash are earnings measures recognized by GAAP and they do 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, nor should Distributable Cash replace cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA and Distributable Cash may differ from the methods used by other issuers. Therefore, our EBITDA and Distributable Cash 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. For a 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.

We believe that this MD&A has been prepared in all material respects in accordance with recommendations issued by the Canadian Institute of Chartered Accountants (the "CICA") with respect to "Standardized Distributable Cash in Income Trusts and Other Flow Through Entities" and National Policy 41-201 of the Canadian Securities Administrators "Income Trusts and Other Indirect Offerings" (collectively, the "Interpretive Guidance"). The Interpretive Guidance provides guidance on standardized preparation and disclosure of distributable cash for income trusts ("Standardized Distributable Cash"). The CICA calculation of Standardized Distributable Cash, which is also a non-GAAP measure, is defined, for the purposes of the Fund, as the periodic cash provided by operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital, less total capital expenditures. For a summary of our Standardized Distributable Cash, please refer to section 4.2 of this report. For a reconciliation between Standardized Distributable Cash and our Distributable Cash, please see section 4.2.

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 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 Audited Financial Statements are met. As at June 30, 2010, 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

Serving customers for almost 50 years, 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 June 30, 2010 we operated 27 distribution facilities organized into nine geographic regions covering 14 states and 5 provinces throughout North America. To maximize inventory management, we operate utilizing a hub and spoke distribution system, with major hub distribution centres holding the bulk of our inventory and making regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

Approximately half 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 role in the industry is to provide the critical link between mills that manufacture large volumes of hardwood lumber and sheet goods, and industrial customers that require smaller quantities of many different hardwood products for their own manufacturing processes. We provide a means for hundreds of hardwood mills to get their product to thousands of small to mid-sized industrial manufacturers. We add value to our suppliers by buying their product in volume and paying them promptly, effectively acting as their third party sales force. We add value for our customers by providing them with the materials they need on a just-in-time basis, in smaller quantities and offering a wider range of product selection than the customer would be able to purchase directly from an individual mill. We are also important to our customers because we allow them to buy material from us on approved credit, which is an important source of financing for customers in our industry.

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 at least 50% of our products are used 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, and is milled by hundreds of small mills. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. 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. More recently, the global economic crisis has resulted in supply/demand imbalances and greater variability in product pricing.

The North American economy is currently experiencing a sluggish recovery after a significant economic downturn in housing and construction, which are key markets for the hardwoods products that we distribute. However current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends, and we believe that when a sustained economic recovery takes hold, prospects for our industry are attractive.

2.0 Overview and Outlook

Our financial results strengthened in the second quarter on a combination of higher product prices, demand increases in some regional markets, and tight control of expenses.

Our improved results benefitted from higher prices for hardwood lumber, which accounts for close to half of our sales. According to the Hardwood Review, average prices for hardwood lumber increased by 24% compared to a year ago as supply began to lag demand. Throughout the downturn, hardwood producers have been steadily cutting back on logging and production and have now reached a point where wood shortages are occurring.

On the demand side, the US housing market improved through the first quarter and part of the second, fuelled by the positive impact of the US homebuyers tax credit until its subsequent expiry at the end of April. Demand from the recreational vehicle manufacturing segment was also stronger. In Canada, the residential construction market continued to strengthen throughout the first half with the seasonally adjusted annual rate of housing starts climbing to 189,000 in June, from 112,000 a year earlier. We were able to capitalize on this momentum by increasing import sales into the Canadian market and expanding our sales territories in some provinces.

The stronger market conditions helped to support a 5.5% increase in total sales for the second quarter (compared to the same period last year), which included a 14.0% increase in underlying sales, partially offset by the negative impact of a stronger Canadian dollar on the translation of

US dollar sales. Our sales gains included a 15.4% increase in US sales and an 11.5% increase in Canadian sales, compared to the same periods last year.

Second quarter gross profit margin also improved to 17.9%, from 17.5% last year, while profit margin for the first six months increased slightly to 17.8% from 17.7% in the first half of 2009. Traditionally we target a gross margin range of 18% to 19%, however given the intense competition currently affecting our industry, we believe a gross margin in the high 17% range is the sustainable level that can be achieved through this part of the business cycle.

An important contributor to our improved results was continued reduction of sales and administrative (S&A) expense. During the second quarter and first half of 2010, S&A expenses were down $1.9 million and $3.1 million respectively, reflecting a reduction in bad debt resulting from a slow down in the number of customer failures, lower premises expenses as we reduced our footprint and negotiated more favourable leases, and savings flowing from facilities rationalization that we implemented last year.

The reduced expenses, combined with the improvement in our sales and gross margin, contributed to stronger EBITDA and Distributable Cash results in both the second quarter and first half of 2010; we have now generated a total of $3.0 million in Distributable Cash this year. We also ended the second quarter in a strong financial position. As at June 30, 2010, we had just $11.5 million of bank indebtedness (net of cash) financing $58.4 million of net working capital assets, and $19.5 million of unused credit facility available to us.

While we are encouraged by our performance in the second quarter and first half, our outlook remains cautious, particularly in light of the continued fragility of the US residential construction market. Since expiry of the US government homebuyer's tax credit at the end of April, housing starts in the US have started to decline again. Housing prices also remain low and the large inventory of foreclosed homes is putting added pressure on house values. As reported by the Economist, an estimated 25% of homeowners in the US have mortgages that exceed the value of their home, suggesting that conditions in the US housing market could worsen. In addition, sustained housing recoveries have historically been dependent upon job growth, and current US job creation figures remain low.

The Canadian market is faring better, with housing starts increasing compared to last year. However, the introduction of the Harmonized Sales Tax (HST) in Ontario and British Columbia is making home buying more expensive in those provinces and could have a negative impact on

Canadian construction activity. Overall, we anticipate a continuation of very challenging market conditions through the balance of 2010.

With this expectation, our focus in the coming months will remain on tight control of costs, inventories and working capital. Minimizing customer credit risk will also remain a priority as we work to contain bad debt expense resulting from customer business failures.

We will also remain proactive on the marketing front with continued efforts to expand our market share, and further investment in strategic products such as our import and Greenbelt lines of products. While this strategy could add to our cost base as we compensate employees for results, overall we expect to keep S&A expense closely in line with market opportunities. Our goal through the balance of 2010 will be to protect our business, our balance sheet and strong market position. Decisions about reinstating cash distributions will be evaluated, but given the risk of continued market weakness, we do not anticipate a change in direction until our Trustees see signs of a more sustainable market recovery and a more predictable level of cash generation performance.

3.0 Results of Operations

3.1 Three Months Ended June 30, 2010 and June 30, 2009

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

		For the three months Ended June 30, 2010		For the three months Ended June 30, 2009
Total sales	$	52,206	$	49,489
Sales in the US (US$)		*30,353*		*26,303*
Sales in Canada		*20,978*		*18,806*
Gross profit		9,323		8,643
Gross profit %		*17.9%*		*17.5%*
Selling and administrative expenses		(6,949)		(8,835)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")		2,374	$	(192)
Add (deduct):				
Amortization		(161)		(240)
Interest		(186)		(116)
Non-cash foreign currency gains (losses)		101		(666)
Non-controlling interest		(426)		891
Income tax expense		(880)		(168)
Net earnings (loss) for the period	$	822	$	(491)
Basic and fully diluted earnings per Class A Unit	$	0.057	$	(0.034)
Average Canadian dollar exchange rate for one US dollar		1.0283		1.1669

Sales

For the three months ended June 30, 2010, total sales were $52.2 million, up 5.5% compared to $49.5 million during the same period in 2009. The increase in total sales reflects a 14.0% increase in underlying sales activity, partially offset by an 8.5% decrease due to the negative effect of a stronger Canadian dollar.

Our second quarter sales results varied by geographic area, reflecting local demand conditions, with six of our regions posting year-over-year sales growth and three regions experiencing sales declines. Second quarter sales at our US operations (as measured in US dollars) were up by 15.4%. Factors contributing to the US sales increase include stronger average prices for hardwood lumber compared to a year ago, the impact on housing markets of temporary stimulus programs implemented by the US government (which expired at the end of April), and improved demand for hardwoods from the recreational vehicle customer segment. In Canada, second quarter home construction activity was significantly stronger than a year ago, contributing to an increase in sales of 11.5%. Economic conditions influencing our sales are discussed further in section 2.0 of this MD&A.

Gross Profit

Gross profit for the three months ended June 30, 2010 was $9.3 million, an increase of $0.7 million from the $8.6 million reported in the same period in 2009. The improvement in gross profit reflects the higher sales, as well as an increase in gross profit as a percentage of sales to 17.9% in the second quarter of 2010, compared to 17.5% in the same period in 2009. Our target range for gross profit percentage is traditionally 18% to 19%, with some quarter-to-quarter variation. In the current market environment, competition for business is significant and has resulted in margins trending below our target range through this part of the business cycle.

Selling and Administrative (S&A) Expenses

S&A expenses decreased 21.3% to $6.9 million in the second quarter of 2010, from $8.8 million during the same period in 2009. The $1.9 million decrease primarily reflects a $0.9 million reduction in bad debt expense (bad debts were 0.5% of sales in the second quarter of 2010, more in line with historical experience for the business), a $0.7 million reduction in other expenses (rental income earned from subletting excess warehouse space, and restructuring costs related to facilities closures in the prior year were not repeated in the current period), a $0.2 million reduction in premises expense (reduced rental rates and a reduction in square footage on facility lease renewals), and a $0.6 million positive foreign exchange impact of a stronger Canadian dollar on the conversion of S&A expenses at our US operations. These S&A expense savings were partly offset by a $0.5 million increase in our people expense, primarily reflecting higher sales incentive costs and higher benefit costs under our US employee medical plan. As a percentage of sales, second quarter 2010 S&A expenses were 13.3% of sales, compared to 17.9% in 2009.

EBITDA

For the three months ended June 30, 2010, we recorded EBITDA of $2.4 million, compared to an EBITDA loss of $0.2 million during the same period in 2009. The $2.6 million increase in EBITDA reflects the $1.9 million reduction in S&A expenses, and the $0.7 million increase in gross profit.

Non-Cash Foreign Currency Gains and Losses

For the three months ended June 30, 2010, non-cash foreign currency gains totaled $0.1 million. This gain was related to the foreign currency translation of US dollar-denominated balances held by the Fund and its Canadian subsidiaries. In the comparative three-month period ended June 30, 2009, a non-cash loss of $0.7 million was recorded, primarily related to the translation of US dollar-denominated intercompany debt advanced by the Fund to a wholly-owned US subsidiary at that time.

Non-controlling Interest

The non-controlling interest's ("NCI") share of pre-tax earnings was $0.4 million in the second quarter of 2010. In contrast, the value of the NCI was reduced by $0.9 million in the comparable period in 2009, reflecting the Class B Unit's interest in pre-tax loss in the period, less an adjustment to NCI to reflect the value of subordinated distributions that could no longer be recovered by the Class B Units under the terms of the Fund's subordination feature. The Fund's subordination feature is further described in section 4.0 of this report and in the Interim Financial Statements.

Income Tax

An income tax expense of $0.9 million was recorded in the second quarter of 2010, compared to $0.2 million in the same period in 2009. The $0.9 million income tax expense primarily reflects the use of tax assets to reduce taxable income generated during the period.

Net Earnings (Loss)

Net earnings for the three months ended June 30, 2010 were $0.8 million, compared to a net loss of $0.5 million in 2009. The $1.3 million increase to net earnings primarily reflects the $2.6 million increase in EBITDA and the $0.8 million increase in non-cash foreign currency gains, partially offset by the $1.3 million decrease in recovery from the NCI and the $0.7 million increase in income tax expense.

3.2 Six Months Ended June 30, 2010 and June 30, 2009

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

	For the six months Ended June 30, 2010	For the six months Ended June 30, 2009
Total sales	$ 100,704	$ 102,911
Sales in the US (US$)	*58,056*	*52,806*
Sales in Canada	*40,663*	*39,243*
Gross profit	17,952	18,259
Gross profit %	*17.8%*	*17.7%*
Selling and administrative expenses	(14,409)	(17,535)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	3,543	$ 724
Add (deduct):		
Amortization	(343)	(465)
Interest	(331)	(268)
Non-cash foreign currency gains (losses)	44	(334)
Non-controlling interest	(583)	1,365
Income tax recovery (expense)	(1,094)	354
Net earnings for the period	$ 1,236	$ 1,376
Basic and fully diluted loss per Class A Unit	$ 0.086	$ 0.095
Average Canadian dollar exchange rate for one US dollar	1.034	1.206

Sales

For the six months ended June 30, 2010, total sales were $100.7 million, down from $102.9 million in the first half of 2009. The 2.1% decrease in total sales reflects a 9.6% decrease in sales due to the negative impact of a stronger Canadian dollar, partially offset by a 7.5% increase in underlying sales activity. Had exchange rates remained consistent with 2009 levels, total sales in the first half of 2010 would have been $10.0 million higher, at $110.7 million. The improvement in underlying sales reflects some modest recovery in hardwood products demand and pricing following several years of challenging business conditions. First-half sales activity at our US operations, as measured in US dollars, increased 9.9% year-over-year, and sales in Canada were up by 3.6%. Our outlook with respect to economic conditions that will impact our sales for the balance of 2010 is discussed further in section 2.0.

Gross Profit

First-half gross profit was $18.0 million, down from $18.3 million in the first six months of 2009. The reduction in gross profit reflects lower sales. As a percentage of sales, gross profit was 17.8% in the first half of 2010, slightly higher than the 17.7% achieved during the same period in 2009.

Selling and Administrative Expenses

S&A expenses decreased $3.1 million to $14.4 million in the first six months of 2010, from $17.5 million during the same period in 2009. $1.5 million of the S&A reduction is attributable to the positive impact of the stronger Canadian dollar on the conversion of S&A expenses at our US operations. The remaining $1.6 million in savings includes lower bad debt expense ($1.0 million), lower premises expense ($0.4 million), and lower other expenses, including a $0.3 million one-time expense recovery related to proceeds from a lawsuit settlement. As a percentage of sales, first-half S&A expenses were 14.3% of sales, compared to 17.0% in 2009.

EBITDA

First-half EBITDA was $3.5 million, up from $0.7 million in the same period in 2009. The $2.8 million increase in EBITDA reflects the $3.1 million decrease in S&A expenses, partially offset by the $0.3 million reduction in gross profit.

Non-Cash Foreign Currency Gains and Losses

For the six months ended June 30, 2010, non-cash foreign currency gains were $44,000. This arose primarily due to the foreign currency translation of US dollar-denominated balances held by the Fund and its Canadian subsidiaries. In the comparative six-month period ended June 30, 2009, a non-cash loss of $0.3 million arose due to the translation of US dollar-denominated intercompany debt advanced by the Fund to a wholly-owned US subsidiary at that time.

Non-controlling Interest (NCI)

NCI's interest in pre-tax earnings in the first half of 2010 was $0.6 million. In the comparable period in 2009, NCI was reduced by $1.4 million, representing the Class B Unit's interest in pre-tax loss in the period, less an adjustment to NCI to reflect the value of subordinated distributions that were not made to the Class B Units and that can no longer be recovered by the Class B Units under the terms of the Fund's subordination feature. The Fund's subordination feature is further described in section 4.0 of this report and in the Interim Financial Statements.

Income taxes

Income tax in the six months ended June 30, 2010 was $1.1 million, compared to income tax recovery of $0.4 million in the same period in 2009. The increase in income tax expense primarily reflects the higher taxable income earned in the six months ended June 30, 2010 compared to the comparable period in 2009.

Net Earnings

Net earnings for the six months ended June 30, 2010 were $1.2 million, compared to $1.4 million in the first half of 2009. The $0.2 million decrease in net earnings primarily reflects the $2.0 million decrease in recovery from NCI and the $1.5 million increase in income tax expense, partially offset by the $2.8 million increase in EBITDA and the $0.4 million increase in non-cash foreign currency gains.

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)

	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Net cash provided by (used in) operating activities	$ (3,443)	$ 1,498	$ (7,228)	$ 6,912
Increase (decrease) in non-cash operating working capital	5,511	(2,022)	10,274	(6,726)
Cash flow from operations before changes in non-cash operating working capital	2,068	(524)	3,046	186
Capital expenditures	(13)	(45)	(29)	(50)
Distributable Cash	$ 2,055	$ (569)	$ 3,017	$ 136
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	-	-	-	-
Total Units	$ -	$ -	$ -	$ -
Outstanding units and per unit amounts:		-		
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,500	18,012,500	18,012,500	18,012,500
Distributable Cash per Total Units	$ 0.114	$ (0.032)	$ 0.167	$ 0.008
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	$ -	$ -	$ -	$ -
Total Units	$ -	$ -	$ -	$ -
Payout ratio (2)	0.0%	0.0%	0.0%	0.0%

	March 23, 2004 to June 30, 2010
Cumulative since inception:	
Distributable Cash	78,495
Distributions relating to the period	66,754
Payout ratio (2)	85.0%

[1] On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on 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 Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the June 30, 2010 balance sheet.
[2] Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

When distributions are declared by the Trustees of the Fund, they are paid 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. Except as outlined in the terms of the subordination agreement with the Class B Units, there are no limitations on distributions from the subsidiaries of the Fund arising from the existence of a minority interest in a subsidiary of the Fund. Further description of the subordination arrangement is included in the notes to the accompanying Interim Financial Statements.

The Fund's subordination feature is designed to stay in place until the EBITDA and certain Distributable Cash tests are met. The terms of these tests are described in the notes to the accompanying Interim Financial Statements.

In the three months ended June 30, 2010, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of $2.1 million, or $0.114 per unit. For the six months ended June 30, 2010, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of $3.0 million, or $0.167 per unit. No distributions were made relating to the three or six-month periods ended June 30, 2010.

On November 3, 2008, the Trustees of the Fund suspended monthly cash distributions until such time as market conditions and the Fund's financial performance have stabilized. Although the Fund has generated $3.0 million in Distributable Cash in the first six months of 2010, cumulative Distributable Cash since the start of the market downturn has been much weaker at just $1.1 million since distributions were suspended seven fiscal quarters ago. Given the considerable uncertainty that continues to exist regarding the timing and sustainability of the recovery in the North American economy, the Trustees will look for indications of a sustainable and predictable return of the Fund's cash generation capability, as well as consider the need to invest in additional working capital in order to support sales growth, before any decision is taken to reinstate distributions to unitholders. Since its initial public offering on March 23, 2004, the Fund has paid $66.8 million in distributions, representing 85.0% of Distributable Cash generated since its' inception.

4.2 Standardized Distributable Cash and Cash Distributions

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

	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Net cash provided by (used in) operating activities	$ (3,443)	$ 1,498	$ (7,228)	$ 6,912
Capital expenditures	(13)	(45)	(29)	(50)
Standardized Distributable Cash	$ (3,456)	$ 1,453	$ (7,257)	$ 6,862
Distributions relating to the period:				
Class A Units	$ -	$ -	$ -	$ -
Class B Units (1)	-	-	-	-
Total Units	$ -	$ -	$ -	$ -
Outstanding units and per unit amounts:				
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,500	18,012,500	18,012,500	18,012,500
Standardized Distributable Cash per Total Units	$ (0.192)	$ 0.081	$ (0.403)	$ 0.381
Distributions per Total Units	$ -	$ -	$ -	$ -
Standardized payout ratio (2)	0.0%	0.0%	0.0%	0.0%

	March 23, 2004 to June 30, 2010
Cumulative since inception:	
Standardized Distributable Cash	86,055 (3)
Distributions relating to the period	66,754
Standardized Payout ratio (2)	77.6%

[1] On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on 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 Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the June 30, 2010 balance sheet.
[2] Payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.
[3] Calculation of cumulative Standardized Distributable Cash since inception excludes a $10.3 million increase in non-cash operating working capital, which relates to a final working capital adjustment payment made to the former owners to complete the initial purchase of the Business.

In addition to our Distributable Cash, the Interpretive Guidance also recommends disclosure of Standardized Distributable Cash. This is provided in the table above. We believe that the calculation of Standardized Distributable Cash distorts the Fund's quarter-to-quarter distributable cash and payout ratios, as our non-cash operating working capital fluctuates significantly as a result of the seasonality of our business and significant changes in market demand for our products. The board of directors of our operating entities looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. As a result, we believe that our historical measure of Distributable Cash, which excludes the impact of changes in non-cash working capital, is a better measure for determining our operating performance.

The table below reconciles Standardized Distributable Cash to our Distributable Cash.

Selected Unaudited Consolidated Financial Information
(in thousands of dollars)

	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Standardized Distributable Cash	$ (3,456)	$ 1,453	$ (7,257)	$ 6,862
Increase (decrease) in non-cash operating working capital	5,511	(2,022)	10,274	(6,726)
Distributable Cash	$ 2,055	$ (569)	$ 3,017	$ 136

4.3 Working Capital

Our business requires an ongoing investment in working capital, comprised of accounts receivable, income taxes recoverable, inventory, and prepaid expenses, partly offset by short-term credit provided by suppliers in the form of accounts payable and accrued liabilities. Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal or cyclical changes in sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers and payments made to our suppliers. Historically the first and fourth quarters are seasonally slower periods for construction activity and therefore demand for hardwood products decreases. As a result, sales and working capital requirements may be lower in these quarters. A summary of changes in our non-cash operating working capital during the three and six months ended June 30, 2010 and 2009 is provided below.

(in thousands of Canadian dollars)

Source (use) of funds	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Accounts receivable	$ (931)	$ (833)	$ (6,227)	$ (4,743)
Income taxes recoverable	370	184	370	1,915
Inventory	(4,799)	1,788	(5,286)	5,150
Prepaid expenses	(186)	(438)	(11)	(239)
Accounts payable and accrued liabilities	35	1,321	880	4,643
Decrease (increase) in non-cash operating working capital	$ (5,511)	$ 2,022	$ (10,274)	$ 6,726

Continued compliance with financial covenants under our credit facilities is important to ensure that we maintain adequate availability of financing to meet our working capital requirements. The terms of our revolving credit facilities are addressed in section 4.6 of this report.

4.4 Capital Expenditures and Productive Capacity

Our capital expenditures are typically low as we lease all of our buildings and contract out all freight delivery services. Capital expenditures are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Annual maintenance capital requirements are expected to average approximately $1.0 million per year, but may be higher or lower in a particular year, based on the needs of the business. More recently, and consistent with our current focus on cost reduction and cash conservation, we have decreased our discretionary cash outlays for capital items. In 2009 our total capital expenditures amounted to just $0.1 million, and in the first half of 2010 were just $29,000. The closing of nine branch locations in the past two years has freed up additional forklift capacity and reduced our need to purchase replacement forklift equipment. Despite the reduction in capital expenditures, we believe we have made sufficient investment to sustain productive capacity of the business as it relates to our needs for property, plant and equipment.

In addition to maintaining the productive capacity of our property, plant and equipment, we also manage the productive capacity of the business in terms of: (1) available distribution infrastructure; and (2) maintenance of a skilled work force.

Available distribution infrastructure refers to the physical capacity of the distribution network maintained by our business, and may be measured in terms of the number and total square footage of distribution centres in operation. Since the Fund's IPO in March 2004, we have made a number of adjustments to our distribution network, including opening, closing, and relocating some of our distribution facilities. In response to the lengthy market downturn, we have downsized our distribution infrastructure, closing a total of nine branches in 2008 and 2009. We believe these reductions are appropriate to better match our productive capacity to current market demand.

Selected Unaudited Consolidated Financial Information

	June 30, 2010	December 31, 2009	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005
Number of distribution centres in operation	27	27	29	36	36	39
Total square footage of distribution centres	0.9 million s.f.	1.0 million s.f.	1.1 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.

Maintenance of a skilled workforce is also important to managing the productive capacity of our business. Our staffing levels reflect decisions regarding our distribution network and our expectations for sales demand based upon prevalent economic conditions. Trends in our workforce capacity, as measured in terms of number of employees and average annual sales dollars per employee, are summarized below. Although the productive capacity of our human capital is difficult to measure directly, we believe the productive capacity of our business in terms of our human capital relative to available market demand, as measured by sales, has been largely sustained.

Selected Unaudited Consolidated Financial Information

	June 30, 2010	December 31, 2009	December 31, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004
Number of employees	159	159	190	236	252	259	224
Annual sales per employee ($ millions)	1.3 (1)	1.2	1.3	1.4	1.4	1.4	1.7

(1) Six months sales to June 30, 2010 annualized, divided by number of employees

4.5 Utilization of Distributable Cash

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	3 months ended June 30, 2010	3 months ended June 30, 2009	6 months ended June 30, 2010	6 months ended June 30, 2009
Distributable Cash	$ 2,055	$ (569)	$ 3,017	$ 136
Cash Distributions paid in the period	-	-	-	-
Distributable Cash retained (shortfall)	$ 2,055	$ (569)	$ 3,017	$ 136
Decrease (increase) in non-cash operating working capital	(5,511)	2,022	(10,274)	6,726
Decrease (increase) in long-term receivables	270	437	433	623
Decrease (increase) in deferred financing fees	-	(80)	-	(80)
Proceeds from disposal of property, plant and equipment	8	19	23	29
Decrease (increase) in bank indebtedness, net of cash	$ (3,178)	$ 1,829	$ (6,801)	$ 7,434

Our utilization of Distributable Cash and its relation to working capital use and bank line financing are summarized in the preceding table.

For the three months ended June 30, 2010, the Fund generated Distributable Cash of $2.1 million and paid no cash distributions. We increased our investment in non-cash operating working capital by $5.5 million, primarily in the form of additional inventory to support higher sales in the second quarter. We also reduced our investment in long-term receivables by $0.3 million. Combined, these actions increased our bank indebtedness (net of cash) by $3.2 million in the second quarter of 2010.

For the six months ended June 30, 2010 the Fund generated Distributable Cash of $3.0 million and made no cash distributions during the period. We increased our non-cash operating working capital by $10.2 million and decreased our investment in long-term receivables by $0.4 million. Taking these factors together, the Fund increased its bank indebtedness (net of cash) by $6.8 million in the first six months of 2010.

4.6 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	As at June 30, 2010	As at December 31, 2009
Cash and cash equivalents	$ (116)	$ (463)
Bank indebtedness	11,638	4,960
Net Debt	11,522	4,497
Unitholders' Equity	56,702	55,158
Total Capitalization	$ 68,224	$ 59,655
Net debt to total capitalization	16.9%	7.5%

As discussed previously in section 4.5 of this report, we increased our net debt by $6.8 million during the six months ended June 30, 2010. The impact of a weaker Canadian dollar (as at June 30, 2010 compared to December 31, 2009) on the conversion of our US dollar bank line increased our debt by a further $0.2 million. Combined, the Fund's net debt balance increased by $7.0 million to $11.5 million at June 30, 2010, from $4.5 million at December 31, 2009. Overall net debt compared to total capitalization stood at 16.9% as of June 30, 2010, compared to 7.5% at December 31, 2009.

We have independent credit facilities in both Canada and the U.S. These facilities may be drawn down to meet short-term financing requirements such as fluctuations in non-cash working capital, and in the case of the Canadian credit facility to also make capital contributions to the Fund's US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is, from time-to-time, limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at June 30, 2010 is provided in the following table.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	$15 million	$26.6 million (US$25 million)
Credit facility expiry date	August 7, 2012	September 30, 2011
Available to borrow	$12.9 million	$ 18.2 million (US$17.1 million)
Credit facility borrowings	$ 2.3 million	$ 9.3 million (US$8.7 million)
Unused credit facility available	$ 10.6 million	$ 8.9 million (US$8.4 million)
Financial covenants:		
a. (EBITDA - Cash Taxes - Capital Expenditures) / Interest [(1)]		
Covenant minimum	1.1	
Covenant actual	30.2	
b. Minimum Trailing EBITDA covenant		Covenant does not apply when the unused credit facility available exceeds US$4.0 million, which it did as at June 30, 2010

[1] EBITDA and Interest calculated on a trailing twelve month basis in accordance with the terms of the Canadian credit facility.

The principal terms of the credit facilities of Hardwoods LP and Hardwoods US LP are available at www.sedar.com.

The terms of the agreements with our lenders provide that distributions cannot be made to our unitholders in the event that our subsidiaries are not compliant with their financial covenants. As shown in the preceding table, our operating subsidiaries were compliant with all required credit ratios as at June 30, 2010, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Our debt management strategy is to roll and renew, as opposed to repay and retire, our revolving credit facilities in Canada and the US when they expire in August 2012 and September 2011, respectively. We do not intend to restrict future distributions in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn upon our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and the cash generating capacity of the Fund. When making distribution decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate for the Fund given existing and expected market conditions and available business opportunities. Currently our focus is on cash conservation and maximizing liquidity until such time as market conditions and the Fund's financial performance and cash generating performance have stabilized. We do not target a specific financial leverage amount.

4.7 Contractual Obligations

The table below sets forth our contractual obligations as at June 30, 2010. These obligations relate to operating leases on various premises and automobiles, and become due in the fiscal years indicated:

(in thousands of Canadian dollars)

Total	2010	2011	2012	2013	2014	2015 & thereafter
$ 18,424	$ 2,909	$ 5,224	$ 3,825	$ 2,945	$ 2,386	$ 1,135

4.8 Off-Balance Sheet Arrangements

The Fund has no off-balance sheet arrangements.

5.0 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 months ended June 30, 2010, sales of $0.1 million were made to related parties, and the subsidiaries of the Fund purchased $17,000 from related parties. For the six months ended June 30, 2009, sales of $0.3 million were made to related parties, and the subsidiaries of the Fund purchased $44,000 from related parties. These sales and purchases took place at prevailing market prices.

6.0 Critical Accounting Estimates and Adoption of Changes in Accounting Policies

6.1 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.

Future Income Taxes: We are required to make estimates and assumptions regarding future business results, as well as the amount and timing of certain future discretionary tax deductions available to the Fund. These estimates and assumptions can have a material impact upon the amount of future income tax assets and liabilities that we recognize.

6.2 Adoption of New Accounting Standards

On January 1, 2011, International Financial Reporting Standards ("IFRS") will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles ("Canadian GAAP") for public companies. Changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Fund's reported financial position and results of operations. It may also affect certain business functions. We have adopted an IFRS changeover plan. It is expected that our changeover plan will be modified and updated as we proceed through the changeover process. Key elements of our current changeover plan include:

Year	Key Activities
2008	Completed IFRS education and training with our accounting staff. Identified an IFRS project manager. Determined the intended use of outside consultants. Analyzed differences between our current accounting policies and IFRS.
2009	Made preliminary selections of IFRS accounting policies. Identified one-time elective exemptions available on initial IFRS adoption. Identified the information required to deliver the preliminary selections of IFRS accounting policies. Identified system changes (accounting, policies, procedures, information technology) required to get that information. Developed a master conversion plan for changes identified. Automated and tested data collection. Identified and addressed the impact of changes IFRS makes to our business drivers, including debt covenants, incentive plans, and management reporting, budgeting, and other items.
2010	Calculate impacts of IFRS adoption on our financial statements at transition date and collect information on adjustments related to 2010 comparatives. Commence IFRS accounting to provide comparative figures for 2011 IFRS startup date. Prepare IFRS communication plan for stakeholders. Link IFRS to CEO/CFO certification processes and update certification documentation relating to internal controls over financial reporting and disclosure controls.
2011	Commence IFRS reporting.

While the effects of IFRS have not yet been fully determined, the Fund has identified a number of key areas which are likely to be impacted, including:

- the deferred gain on sale-leaseback of land and building on the balance sheet will be transferred proportionately to the non-controlling interest and to Unitholders' deficit at January 1, 2011. The anticipated effect is a decrease to liabilities, decrease to deficit, and increase to non-controlling interest;

- at the IFRS balance sheet transition date, the Fund expects to elect under IFRS 1 *First Time Adoption of International Financial Reporting Standards* to reduce to nil cumulative translation differences that exist related to translation of self sustaining foreign subsidiaries. The anticipated effect is to decrease to nil the balance of accumulated other comprehensive loss, and make a corresponding increase to deficit;

- subsidiaries of the Fund lease vehicles for employee use. Under IFRS is it anticipated such leases will be determined to be capital leases, rather than operating leases as is currently the case. The anticipated effect is to increase property, plant and equipment, and to record a lease obligation liability. Amortization on the property, plant and equipment and finance costs associated with the lease obligation will be recorded in earnings as compared to an operating lease expense.

- under IFRS, it is anticipated that the Fund units will be determined to meet the definition of a liability. The anticipated effect is to reduce unitholders' equity, and increase Fund unit liability.

The Fund is still in process of quantifying the impact of these measurement and classification differences. In addition, financial statement presentation changes and additional disclosure requirements are anticipated under IFRS. The adoption of IFRS is not expected to have a material impact on the Fund's reported cash flows.

7.0 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 Form dated March 29, 2010, which is available to readers at www.sedar.com. Particular risks we see facing the Business in 2010 include:

1. US economic performance: Historically two thirds of our business originates in the US. It is unclear to what degree and how quickly the US economy will recover in 2010. Until such time as sustained and positive economic indicators return to housing and construction markets, demand for hardwood products remains highly uncertain, and our ability to predict our sales and profitability is an elevated business risk.

2. Bad debt expenses: The fallout of over two years of contraction in market demand and pricing for hardwoods products has been that a number of our customers have closed operations, been forced out of business, or no longer qualify for credit and have been cut off from further sales. Our bad debt expense in 2009 was significantly higher than what we have experienced in the past under normal market conditions. To the extent that the economic downturn continues for an extended period or worsens, we could experience further credit losses if additional customers are forced out of business. We believe our bad debt risk will remain elevated through 2010.

3. Leadership change: After 36 years in the industry, our former CEO retired on July 5, 2010 and was succeeded by a newly hired CEO, Lance Blanco. Making a leadership change at the CEO level is done infrequently by Hardwoods, and this transition represents an uncertainty facing the business in the 2010.

8.0 Internal Control Over Financial Reporting

During the three months ended June 30, 2010, 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.

9.0 Quarterly Financial Information

(in thousands of dollars)	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008
Total sales	$ 52,206	$ 48,498	$ 41,577	$ 46,435	$ 49,489	$ 53,422	$ 56,650	$ 62,115
Net earnings	$ 822	$ 414	$ (544)	$ (11,072)	$ (491)	$ 1,867	$ (12,941)	$ 885
Basic and fully diluted earnings (loss) per Class A Unit	$ 0.057	$ 0.029	$ (0.038)	$ (0.768)	$ (0.034)	$ 0.130	$ (0.898)	$ 0.061
EBITDA	$ 2,374	$ 1,169	$ (2,421)	$ 543	$ (192)	$ 916	$ (1,430)	$ 1,344
Distributable Cash	$ 2,055	$ 962	$ (505)	$ 230	$ (569)	$ 705	$ (1,730)	$ 1,000
Total distributions to Class A and Class B Units	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 1,081
Payout ratio	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	108.2%

The table above provides selected quarterly financial information for our eight most recently completed fiscal quarters. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in our opinion, necessary to present a fair statement of the results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of future performance. Historically, the first and fourth quarters have been seasonally slower periods for our business. In addition, net earnings reported in each quarter may be impacted by 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, 2008), and write-downs in the carrying value of future income tax assets (which occurred in the three months ended September 30, 2009).

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

	June 30, 2010	December 31, 2009
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 116	$ 463
Accounts receivable (note 6)	31,839	25,585
Income tax recoverable	1,933	2,286
Inventory (note 5)	29,501	23,901
Prepaid expenses	894	878
	64,283	53,113
Long-term receivables (note 6)	1,783	1,883
Property, plant and equipment	1,031	1,291
Deferred financing costs	307	396
Future income taxes	16,735	17,587
	$ 84,139	$ 74,270
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 7)	$ 11,638	$ 4,960
Accounts payable and accrued liabilities	5,930	4,988
	17,568	9,948
Deferred gain on sale-leaseback of land and building	382	416
Non-controlling interests (note 8)	9,487	8,748
Unitholders' equity:		
Fund units	133,454	133,454
Deficit	(58,962)	(60,198)
Accumulated other comprehensive loss	(17,790)	(18,098)
	56,702	55,158
Contingencies (note 14)		
	$ 84,139	$ 74,270

See accompanying notes to consolidated financial statements.

Approved on behalf of the Trustees:

(Signed) GRAHAM M. WILSON Trustee **(Signed) TERRY M. HOLLAND** Trustee

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Operations and Deficit
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Sales	$ 52,206	$ 49,489	$ 100,704	$ 102,911
Cost of sales	42,883	40,846	82,752	84,652
Gross profit	9,323	8,643	17,952	18,259
Expenses:				
Selling and administrative	6,949	8,835	14,409	17,535
Amortization:				
Plant and equipment	136	207	292	430
Deferred financing costs	44	55	89	79
Deferred gain on sale - leaseback of land and building	(19)	(22)	(38)	(44)
Interest	186	116	331	268
Unrealized foreign currency losses (gains)	(101)	666	(44)	334
	7,195	9,857	15,039	18,602
Earnings (loss) before non-controlling interests and income taxes	2,128	(1,214)	2,913	(343)
Non-controlling interests (note 8)	(426)	891	(583)	1,365
Earnings (loss) before income taxes	1,702	(323)	2,330	1,022
Income tax expense (recovery):				
Current	108	102	134	107
Future	772	66	960	(461)
	880	168	1,094	(354)
Net earnings (loss) for the period	822	(491)	1,236	1,376
Deficit, beginning of period	(59,784)	(48,091)	(60,198)	(49,958)
Distributions declared to Unitholders	-	-	-	-
Deficit, end of period	$ (58,962)	$ (48,582)	$ (58,962)	$ (48,582)
Basic and diluted earnings (loss) per Unit	$ 0.06	$ (0.03)	$ 0.09	$ 0.10
Weighted average number of Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Comprehensive Income (Loss)
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Net earnings (loss) for the period	$ 822	$ (491)	$ 1,236	$ 1,376
Other comprehensive income:				
Unrealized gain (loss) on translation of self-sustaining foreign operations	1,132	(2,275)	308	(1,225)
Other comprehensive income (loss)	1,132	(2,275)	308	(1,225)
Comprehensive income (loss)	$ 1,954	$ (2,766)	$ 1,544	$ 151

Consolidated Statement of Accumulated Other Comprehensive Loss
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Accumulated other comprehensive loss, beginning of period	$ (18,922)	$ (13,674)	$ (18,098)	$ (14,724)
Other comprehensive income (loss)	1,132	(2,275)	308	(1,225)
Accumulated other comprehensive loss, end of period	$ (17,790)	$ (15,949)	$ (17,790)	$ (15,949)

HARDWOODS DISTRIBUTION INCOME FUND

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

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Cash flows provided by (used in) operating activities:				
Net earnings (loss) for the period	$ 822	$ (491)	$ 1,236	$ 1,376
Items not involving cash:				
Amortization	180	262	381	509
Imputed interest income in employee loans	(5)	(98)	(12)	(138)
Deferred gain on sale- leaseback of land and building	(19)	(22)	(38)	(44)
Gain on sale of property, plant and equipment	(7)	(16)	(20)	(25)
Unrealized foreign exchange losses (gains)	(101)	666	(44)	334
Non-controlling interests	426	(891)	583	(1,365)
Future income taxes	772	66	960	(461)
	2,068	(524)	3,046	186
Change in non-cash operating working capital (note 9)	(5,511)	2,022	(10,274)	6,726
Net cash provided by (used in) operating activities	(3,443)	1,498	(7,228)	6,912
Cash flows provided by (used in) investing activities:				
Additions to property, plant and equipment	(13)	(45)	(29)	(50)
Proceeds on disposal of property, plant and equipment	8	20	23	30
Decrease in long-term receivables, net	270	437	433	623
Net cash provided by investing activities	265	412	427	603
Cash flows provided by (used in) financing activities:				
Increase (decrease) in bank indebtedness	3,099	(2,227)	6,454	(7,330)
Increase in deferred bank fees	-	(80)	-	(80)
Net cash provided by (used in) financing activities	3,099	(2,307)	6,454	(7,410)
Increase (decrease) in cash	(79)	(397)	(347)	106
Cash, beginning of period	195	587	463	84
Cash, end of period	$ 116	$ 190	$ 116	$ 190
Supplementary information (cash amounts):				
Interest paid	$ 186	$ 116	$ 331	$ 268
Income taxes paid	7	-	67	-
Income taxes received	295	175	295	1,975
Transfer of accounts receivable to long-term customer notes receivable, net of write offs, being a non-cash transaction	-	958	-	958

See accompanying notes to consolidated financial statements.

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, 2009. 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, 2009. Certain comparative figures have been restated to conform to the current period's financial statement presentation.

3. Adoption of new accounting standards:

The CICA will transition Canadian generally accepted accounting principles ("GAAP") for publicly accountable entities to International Financial Reporting Standards ("IFRS"). The Fund's consolidated financial statements are to be prepared in accordance with IFRS for the fiscal year commencing January 1, 2011. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences on recognition, measurement, and disclosures. While the effects of IFRS have not yet been fully determined, the Fund has identified a number of key areas which are likely to be impacted, including:

- the deferred gain on sale-leaseback of land and building on the balance sheet will be transferred proportionately to the non-controlling interest and to Unitholders' deficit at January 1, 2011. The anticipated effect is a decrease to liabilities, decrease to deficit, and increase to non-controlling interest;
- at the IFRS balance sheet transition date, the Fund expects to elect under IFRS 1 to reduce to nil cumulative translation differences that exist related to translation of self sustaining foreign subsidiaries. The anticipated effect is to decrease to nil the balance of accumulated other comprehensive loss, and make a corresponding increase to deficit;
- subsidiaries of the Fund lease vehicles for employee use. Under IFRS is it anticipated such leases will be determined to be capital leases, rather than operating leases as is currently the case. The anticipated effect is to increase property, plant and equipment, and to record a lease obligation liability. Amortization on the property, plant and equipment and finance costs associated with the lease obligation will be recorded in earnings as compared to an operating lease expense.
- under IFRS, it is anticipated that the Fund units will be determined to meet the definition of a liability. The anticipated effect is to reduce unitholders' equity, and increase Fund unit liability.

(Tabular amounts expressed in thousands of Canadian dollars)

3. Adoption of new accounting standards (continued):

In addition, financial statement presentation changes and additional disclosure requirements are anticipated under IFRS. The adoption of IFRS is not expected to have a material impact on the Fund's reported cash flows.

4. Capital Disclosures:

The Fund's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Fund considers its capital to be bank indebtedness (net of cash) plus Unitholders' equity. The Fund's capitalization is as follows:

	June 30, 2010	December 31, 2009
Cash and cash equivalents	$ (116)	$ (463)
Bank indebtedness	11,638	4,960
Net debt	11,522	4,497
Unitholders' equity	56,702	55,158
Total capitalization	$ 68,224	$ 59,655

The Fund monitors on a monthly basis the ratio of net debt to earnings before interest, income taxes, depreciation and amortization ("EBITDA"). Net debt to EBITDA serves as an indicator of the Fund's financial leverage. The U.S. credit facility is subject to a minimum trailing EBITDA covenant that is only applicable in the event the U.S. subsidiary's unused credit availability falls below US $4.0 million. The Canadian credit facility is subject to a Fixed Charge Coverage Ratio ("FCCR") calculated as (EBITDA – capital expenditures – cash taxes)/(interest expense) which cannot be less than 1.1 for Hardwoods LP.

The terms of the agreements with the Fund's lenders provide that distributions cannot be made to its unitholders in the event that its subsidiaries do not meet the above covenant requirements as well as certain additional credit ratios. The Fund's operating subsidiaries were compliant with all required credit ratios as at June 30, 2010, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Distributions are one of the ways the Fund manages its capital. Distributions of the Fund's available cash are made to the maximum extent possible, subject to reasonable reserves established by the Trustees of the Fund. Distributions are made by the Fund having given consideration to a variety of factors including the outlook for the business, financial leverage, and the ratio of distributions to available cash of the Fund.

There were no changes in the Fund's approach to capital management during the period ended June 30, 2010. On November 3, 2008 the Trustees of the Fund suspended further monthly distributions until such time as market conditions and the Fund's generation of cash has improved.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Inventory:

	June 30, 2010	December 31, 2009
Lumber	$ 11,208	$ 8,224
Sheet Goods	14,501	12,171
Specialty	1,870	2,099
Goods in-transit	1,922	1,407
	$ 29,501	$ 23,901

During the three months ended June 30, 2010 inventory write-downs totaling $0.2 million (six months ended June 30, 2010 - $0.5 million) were recorded to reduce certain inventory items to their net realizable value. (Three months ended June 30, 2009 - $0.4 million, six months ended June 30, 2009 - $0.9 million)

Cost of sales for the three months ended June 30, 2010 were $42.9 million (six months ended June 30, 2010 - $82.8 million), which included $41.3 million (six months ended June 30, 2010 - $79.6 million) of costs associated with inventory. The other $1.6 million (six months ended June 30, 2010 - $3.2 million) related principally to freight and other related selling expenses. (Six months ended June 30, 2009 - $81.4 inventory and $3.3 million other related expenses)

(Tabular amounts expressed in thousands of Canadian dollars)

6. Receivables:

The following is a breakdown of the Fund's current and long-term receivables and represents the Fund's exposure to credit risk related to its financial assets:

Accounts receivable	June 30, 2010	December 31, 2009
Trade accounts receivable - Canada	$ 11,577	$ 9,756
Trade accounts receivable - United States	22,068	16,117
Sundry receivable	187	203
Current portion of long-term receivables	598	919
	34,430	26,995
Less: allowance for doubtful accounts	2,591	1,410
	$ 31,839	$ 25,585

Long-term receivables	June 30, 2010	December 31, 2009
Employee housing loans	$ 413	$ 450
Customer notes	1,484	1,834
Security deposits	484	518
	2,381	2,802
Less: current portion, included in accounts receivable	598	919
	$ 1,783	$ 1,883

The aging of trade receivables was:

	June 30, 2010	December 31, 2009
Current	$ 21,398	$ 14,557
Past due 31-60 days	5,358	5,283
Past due 61-90 days	2,010	2,181
Past due 90+ days	4,879	3,852
	$ 33,645	$ 25,873

The Fund determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectable are written off. The total allowance at June 30, 2010 was $2.6 million (December 31, 2009 - $1.4 million). The amount of the allowance is considered sufficient based on the past experience of the business, the security the Fund has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Bank indebtedness:

	June 30, 2010	December 31, 2009
Checks issued in excess of funds on deposit	$ 945	$ 1,077
Credit facility, Hardwoods LP	1,473	1,945
Credit facility, Hardwoods USLP (June 30, 2010 - US$8,660; December 31, 2009 - US$1,844)	9,220	1,938
	$ 11,638	$ 4,960

Bank indebtedness consists of checks issued in excess of funds on deposit and advances under operating lines of credit available to Hardwoods LP and Hardwoods USLP (the "Credit Facilities").

Each of the Credit Facilities is separate, is not guaranteed by the other partnership, and does not contain cross default provisions to the other Credit Facility. The Credit Facility made available to Hardwoods LP is secured by a first security interest in all of the present and after acquired property of Hardwoods LP and its operating subsidiaries, and by the LP Units held by a subsidiary of the Fund and SIL. The Credit Facility made available to Hardwoods USLP is secured by a first security interest in all of the present and after acquired property of Hardwoods USLP and by the USLP Units held by a subsidiary of the Fund and by SIL.

The Hardwoods LP Credit Facility has a three year term, provides financing up to $15.0 million and has a maturity date of August 7, 2012. The Hardwoods USLP Credit Facility has a three year term, provides financing of up to US$ 25.0 million and has a maturity date of September 30, 2011. Each facility is payable in full at maturity. The Hardwoods LP Credit Facility is a revolving credit facility which Hardwoods LP may terminate subject to prepayment penalties of $225,000 if terminated in the first 12 months of the credit facility term, $150,000 if repaid in the second 12 months of the credit facility term, and $75,000 thereafter if repaid prior to the maturity date of the credit facility. The Hardwoods USLP Credit Facility may be terminated by Hardwoods USLP without prepayment penalties. The Credit Facilities bear interest at a floating rate based on the Canadian or US prime rate (as the case may be), LIBOR or bankers acceptance rates plus, in each case, an applicable margin. Letters of credit are also available under the Credit Facilities on customary terms for facilities of this nature. The Credit Facilities' rates vary with the ratio of EBITDA minus capital expenditures and cash taxes, divided by interest. Commitment fees and standby charges usual for borrowings of this nature were and are payable.

The amount made available under the Credit Facility to Hardwoods LP from time to time is limited to the extent of 85% of the book value of accounts receivable and the lesser of 60% of the book value or 85% of appraised value of inventories with the amount based on inventories not to exceed 60% of the total amount to be available. Certain identified accounts receivable and inventories are excluded from the calculation of the amount available under the Credit Facility. Hardwoods LP is required to maintain a fixed charge coverage ratio (calculated as the ratio of EBITDA less cash taxes less capital expenditures, divided by interest) of not less than 1.1 to 1. At June 30, 2010 the Hardwoods LP credit facility had $10.6 million of additional borrowing capacity.

(Tabular amounts expressed in thousands of Canadian dollars)

7. Bank indebtedness (continued):

The amount to be made available under the Credit Facility to Hardwoods USLP from time to time is limited to the extent of 85% of the book value of certain accounts receivable and 50% of the book value of inventories (with certain accounts receivable and inventory being excluded). Hardwoods USLP is required to maintain a minimum trailing EBITDA covenant until December 31, 2010, and a fixed charge coverage ratio (calculated as EBITDA less cash taxes less capital expenditures, divided by interest plus distributions) of 1.0 to 1 thereafter. These covenants of the Hardwoods USLP Credit Facility do not need to be met however when the unused availability under the credit facility is in excess of US$4.0 million. At June 30, 2010 the Hardwoods USLP credit facility had unused availability of $8.9 million (US$8.4 million).

8. Non-controlling interests:

Balance, January 1, 2010	$ 8,748
Interest in earnings:	
Interest in earnings before taxes	583
	9,331
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	156
Balance, end of period	$ 9,487

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 June 30, 2010.

8. 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 June 30, 2010, the amount of such deficiency was $14.8 million (2009 - $12.6 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; and
  - 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).

(Tabular amounts expressed in thousands of Canadian dollars)

8. 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.

9. Changes in non-cash operating working capital and additional cash flow disclosures:

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Accounts receivable	$ (931)	$ (833)	$ (6,227)	$ (4,743)
Income taxes recoverable/payable	370	184	370	1,915
Inventory	(4,799)	1,788	(5,286)	5,150
Prepaid expenses	(186)	(438)	(11)	(239)
Accounts payable and accrued liabilities	35	1,321	880	4,643
	$ (5,511)	$ 2,022	$ (10,274)	$ 6,726

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. The Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the three and six month periods ended June 30, 2010 and June 30, 2009 no discretionary cash distributions were paid to Unitholders.

(Tabular amounts expressed in thousands of Canadian dollars)

10. Segment disclosure:

Information about geographic areas is as follows:

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Revenue from external customers:				
Canada	$ 20,978	$ 18,806	$ 40,663	$ 39,243
United States	31,228	26,303	60,041	63,668
	$ 52,206	$ 49,489	$ 100,704	$ 102,911

	June 30, 2010	December 31, 2009
Property, plant and equipment:		
Canada	$ 347	$ 450
United States	684	841
	$ 1,031	$ 1,291

11. 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 June 30, 2010, Hardwoods USLP contributed and expensed $52,442 (US$50,999) (three months ended June 30, 2009 - $60,131 (US$51,531)) in relation to the USLP Plan. During the six months ended June 30, 2010, Hardwoods USLP contributed and expensed $112,023 (US$108,319) (six months ended June 30, 2009 - $128,816 (US$106,839)) 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 June 30, 2010, Hardwoods LP contributed and expensed $52,924 (three months ended June 30, 2009 - $41,728) in relation to the LP Plan. During the six months ended June 30, 2010, Hardwoods LP contributed and expensed $117,092 (six months ended June 30, 2009 - $91,581) in relation to the LP Plan.

12. Related party transactions:

For the three months ended June 30, 2010, sales of $138,696 (three months ended June 30, 2009 - $108,553) were made to affiliates of SIL, and the Fund made purchases of $16,854 (three months ended June 30, 2009 - $24,169) from affiliates of SIL. For the six months ended June 30, 2010, sales of $266,558 (six months ended June 30, 2009 - $270,762) were made to affiliates of SIL, and the Fund made purchases of $44,329 (six months ended June 30, 2009 - $32,087) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

13. 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.

14. 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.

15. Unitholders' Rights Plan:

The Fund had a Unitholders' Rights Plan (the "Rights Plan") as described in note 12(b) in the annual consolidated financial statements, until the Annual General Meeting of Unitholders on May 20, 2010. At the Annual General Meeting, the Unitholders voted against renewing the Rights Plan and, as such, at June 20, 2010 the Rights Plan is no longer in place.

Unitholder Information

Officers

Lance R. Blanco
President & Chief Executive Officer

Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California Region

Garry W. Warner
Vice President,Northwestern Region

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