Management's Discussion and Analysis

August 7, 2012

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of August 7, 2012. This MD&A covers our unaudited interim condensed consolidated financial statements as at and for the three and six month periods ended June 30, 2012 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in the Company's 2011 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 the Company for the years ended December 31, 2011 and 2010 ("Audited Financial Statements"). Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting." For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

In this MD&A, references to "EBITDA" are to earnings before interest, income taxes, depreciation and amortization, where interest is defined as net finance income or cost as per the consolidated statement of comprehensive income. In addition to profit or loss, we consider EBITDA to be a useful supplemental measure of a company's ability to meet debt service and capital expenditure requirements, and we interpret trends in EBITDA as an indicator of relative operating performance.

EBITDA is not an earnings measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS. Investors are cautioned that EBITDA should not replace profit or loss or cash flows (as determined in accordance with IFRS) as an indicator of our performance. Our method of calculating EBITDA may differ from the methods used by other issuers. Therefore, our EBITDA may not be comparable to similar measures presented by other issuers. For reconciliation between EBITDA and profit or loss as determined in accordance with IFRS, please refer to the discussion of Results of Operations described in section 3.0 of this report.

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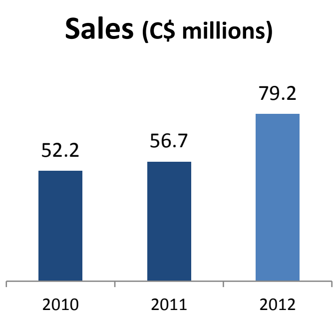
This MD&A includes the following sections:

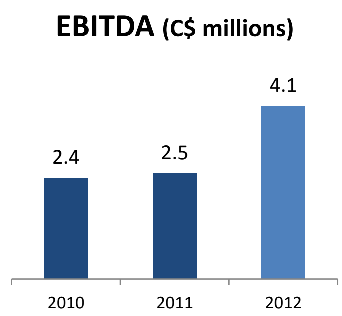
1.0 Executive Summary

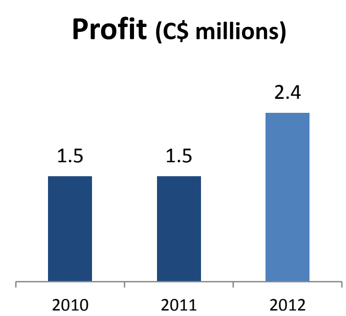
1.1 Overview

Our financial performance continued to strengthen in the second quarter and first half of 2012 as we achieved our best results in over four years. For the three months ended June 30, 2012, we grew revenue by 39.6%, gross profit by 37.8%, EBITDA by 59.9% and profit by 57.3% as compared to the second quarter of 2011. For the six months ended June 30, 2012, revenue increased 39.9%, gross profit was up 40.8%, EBITDA climbed 113.8% and profit increased by 344.7% as compared to the same period in the preceding year.

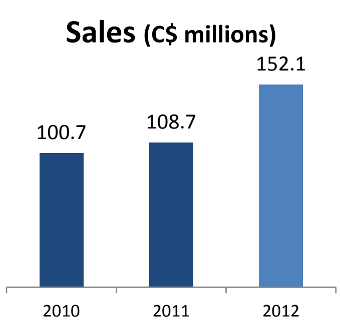
Three Months Ended June 30th:

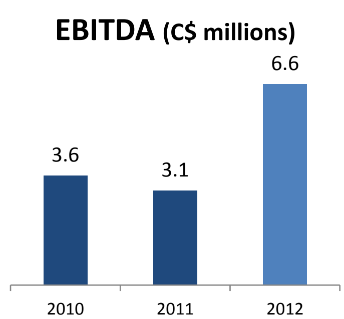


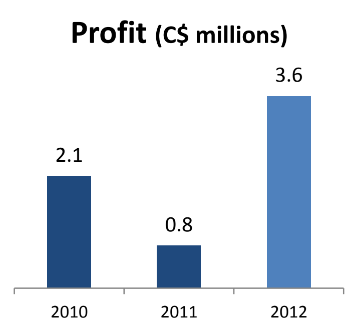




Six Months Ended June 30th:







These gains reflect gradual market improvement, and the successful implementation of our market expansion strategies. Throughout the first half of 2012, we successfully diversified into the commercial construction markets, grew sales of our high-quality line of import products, and increased revenues in major metropolitan market where we previously had no presence or limited representation relative to the size of the market.

The addition of the Frank Paxton Lumber Company business ("Paxton"), acquired in September 2011, played a significant role in our performance improvements. All five of the Paxton branches are performing at or above expectations and we have been successful in continuing to grow this business. We are also achieving solid organic growth from our existing branches by adding experienced sales representatives and implementing our other market strategies. In California, the success of our efforts supports the re-opening of our Sacramento branch which will occur in the third quarter of 2012, bringing our total number of branches in California to three. This is a very positive development in a region which was one of the hardest hit in the US housing market downturn.

On the market front, the seasonally adjusted annual rate of US housing starts were up 23.6% year-over-year to 760,000 at the end of June, according to the US Census Bureau, but remain well below the historical norm of approximately 1.2 million starts. Hardwood lumber prices, which were flat year-over-year, also remain below the 10-year average according to the Hardwood Review. Competition remained intense in all of our markets and put pressure on our ability to achieve product price increases. Given that Hardwoods is performing well at historically low levels of market demand and pricing and high levels of competition, we see significant upside potential should economic conditions make a more pronounced turnaround.

The Canadian residential construction market and the North American non-residential market were generally less affected by the economic downturn, and as such, offer less recovery-related growth potential. However both markets continued to demonstrate stable performance in the second quarter and first half of 2012, compared to the prior year, and we are continuing to achieve growth in both. In the non-residential construction market, we have been successful in opening new commercial customer accounts as we target this market. In Canada, we have achieved growth in Ontario as part of our focus on building our presence in larger markets.

Financially, our balance sheet remains strong. As at June 30, 2012, we had a conservative debt-to-total capital ratio of 26.6% and over $18 million of unused borrowing capacity, which provides the flexibility to continue implementing our strategy, including pursuing attractive acquisition opportunities that provide a strong strategic fit.

1.2 Outlook

We anticipate continued gradual improvement in market conditions through the balance of 2012, with further gains in US housing starts, steady demand in Canadian housing starts and a reasonable level of activity in non-residential construction markets. However competition remains intense and could continue to put pressure on product prices and margins.

We expect that continued performance improvements will be driven primarily by our market expansion strategies. Specifically, we will continue to:

- Strengthen our presence in the commercial and institutional construction markets, including leveraging Paxton's products and capabilities to make a broader range of products available to customers in these sectors.

- Grow our successful import program by seeking out attractive new products and introducing our branded lines of import products to Paxton's base of customers.

- Solidify and further expand our presence in new geographic markets that we entered as a result of the Paxton acquisition, while targeting additional growth in selected existing markets.

We believe the Paxton operations provide significant opportunities for continued near-term growth, and we have begun to invest in new machinery to take advantage of identified market needs and opportunities. The opening of the additional branch in Sacramento, California, as well as additional import product opportunities, is also expected to contribute to growth in the second half of 2012.

Key priorities for the balance of the year will be to continue executing our growth and operating strategies, including seeking out acquisition opportunities that further increase shareholder value.

2.0 Background

2.1 Company Overview

Hardwoods Distribution Inc. is a publicly traded company that holds, indirectly, a 100% ownership interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP (collectively, "Hardwoods" or the "Business"). The Company was formed in order to convert Hardwoods Distribution Income Fund (the "Fund") from an income trust structure to a corporation. The Fund was converted to a corporation by way of a plan of arrangement effective July 1, 2011, and the Fund was wound up into HDI. Hardwoods Distribution Inc. is listed on the Toronto Stock Exchange and trades under the symbol HWD.

2.2 Business and Industry Overview

Serving customers for over 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, 2012 we operated 30 distribution facilities located in 16 states and 5 provinces throughout North America. To maximize inventory management, we utilize 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.

Approximately 40% of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods and other specialty products, including hardwood plywood and non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Our sheet goods and lumber are complementary product lines; both are key products used by our customers in the manufacture of their end-use 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, remanufacturing materials to customer specifications where required, selling in smaller quantities and offering a wider range of product selection than the customer would be able to purchase directly from an individual mill. We also provide an important source of financing for our customers by allowing them to buy material from us on approved credit.

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.

The majority 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, global economic conditions and weaker US housing markets have resulted in supply/demand imbalances and greater variability in product pricing.

The North American economy is currently experiencing a slow recovery after a significant economic downturn in housing and construction, which are key markets for the hardwood 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. We believe that when a sustained economic recovery takes hold, prospects for our industry are attractive.

3.0 Results of Operations

3.1Three Months Ended June 30, 2012 and June 30, 2011

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	For the three months Ended June 30, 2012	For the three months Ended June 30, 2011	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 79,153	$ 56,718	$ 22,435	39.6%
Sales in the US (US$)	*55,686*	*35,450*	*20,236*	57.1%
Sales in Canada	*22,909*	*22,371*	*538*	2.4%
Gross profit	13,894	10,085	3,809	37.8%
Gross profit %	*17.6%*	*17.8%*		
Operating expenses	(10,141)	(7,762)	2,379	30.6%
Profit from operating activities	3,753	2,323	1,430	61.6%
Add: Depreciation and amortization	312	219	93	42.5%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 4,065	$ 2,542	$ 1,523	59.9%
Add (deduct):				
Depreciation and amortization	(312)	(219)	93	42.5%
Net finance income (costs)	135	(47)	182	387.2%
Income tax expense	(1,511)	(765)	746	97.5%
Profit for the period	$ 2,377	$ 1,511	$ 866	57.3%
Basic and fully diluted profit per share/unit	$ 0.15	$ 0.10		
Average Canadian dollar exchange rate for one US dollar	1.010	0.968		

Sales

For the three months ended June 30, 2012, total sales increased to $79.2 million, up 39.6% from $56.7 million during the same period in 2011. This was our highest quarterly sales result in nearly five years. Incremental sales from the Paxton operations contributed $14.4 million, or 64% of the increase, while organic growth from existing operations accounted for $8.0 million, or 36% of the sales increase.

The organic sales growth reflects improved market conditions as well as the success of market expansion strategies introduced in late 2010, as discussed in section 1.0 of this report. A year and a half after launching these strategies our execution is continuing to pay off.

Sales in our US operations were US$55.7 million, an increase of US$20.2 million or 57.1% compared to the same period in the prior year. Approximately US$14.2 million of this growth was provided by the Paxton operations, while the remaining US$6.0 million of the increase reflects organic sales growth of 17.1%. Sales in Canada, a market which has seen more stable ongoing demand for hardwoods throughout the recent economic downturn and is not affected by the Paxton acquisition, increased by a more modest $0.5 million or 2.4% in the second quarter.

Gross Profit

Gross profit for the three months ended June 30, 2012 was $13.9 million, an increase of $3.8 million, or 37.8%, from $10.1 million in the second quarter of 2011. This improvement reflects higher sales for the period, partially offset by a lower gross profit margin. As a percentage of sales, second quarter gross profit was 17.6%, compared to 17.8% in the same period in 2011. The decrease in gross profit margin is predominantly attributed to competitive market conditions, which impacted upon our ability to make price adjustments during the quarter, as well as changes in product mix.

Operating Expenses

Operating expenses were $10.1 million in the second quarter of 2012, compared to $7.8 million during the second quarter of 2011, an increase of $2.4 million. This increase primarily reflects incremental expenses related to the acquired Paxton operations, partially offset by the absence of $0.3 million of corporate conversion costs that were incurred in the second quarter of 2011, but were not repeated in the 2012 period. As a percentage of sales, second quarter 2012 operating expenses were 12.8% of sales, compared to 13.7% in 2011.

EBITDA

For the three months ended June 30, 2012, EBITDA increased to $4.1 million, up $1.5 million from $2.5 million in the second quarter of 2011. The significant year-over-year improvement in EBITDA reflects the $3.8 million increase in gross profit, partially offset by the $2.4 million increase in operating expenses.

Income Tax Expense

An income tax expense of $1.5 million was recorded in the second quarter of 2012, compared to $0.8 million in the same period in the prior year. The increase in income tax expense reflects higher taxable income generated during the three months ended June 30, 2012 compared to the comparable period in 2011.

Profit for the Period

Profit for the three months ended June 30, 2012 increased to $2.4 million, from $1.5 million during the same period in 2011. The $0.9 million improvement reflects the $1.5 million increase in EBITDA and a $0.2 million decrease in net finance cost, partially offset by a $0.1 million increase in depreciation and the $0.7 million increase in income tax expense.

3.2 Six Months Ended June 30, 2012 and June 30, 2011

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	For the six months Ended June 30, 2012	For the six months Ended June 30, 2011	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 152,092	$ 108,748	$ 43,344	39.9%
Sales in the US (US$)	*106,786*	*67,290*	*39,496*	58.7%
Sales in Canada	*44,697*	*43,013*	*1,684*	3.9%
Gross profit	27,004	19,184	7,820	40.8%
Gross profit %	*17.8%*	*17.6%*		
Operating expenses	(20,991)	(16,534)	4,457	27.0%
Profit from operating activities	6,013	2,650	3,363	126.9%
Add: Depreciation and amortization	614	450	164	36.4%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 6,627	$ 3,100	$ 3,527	113.8%
Add (deduct):				
Depreciation and amortization	(614)	(450)	164	36.4%
Net finance income (costs)	(205)	(782)	(577)	-73.8%
Income tax expense	(2,206)	(1,058)	1,148	108.5%
Profit for the period	$ 3,602	$ 810	$ 2,792	344.7%
Basic and fully diluted profit per share/unit	$ 0.22	$ 0.06		
Average Canadian dollar exchange rate for one US dollar	1.006	0.977		

Sales

For the six months ended June 30, 2012 total sales were $152.1 million, compared to $108.7 million in the first half of 2011, an increase of $43.3 million.

Our growth in sales came predominantly from our US operations, where first-half sales activity increased US$39.5 million. Sales from the Paxton business, acquired in September 2011, contributed US$28.3 million of this sales growth. The remaining US$11.2 million of sales growth was generated by organic growth of 16.6% from Hardwoods existing US branch network, reflecting improved market conditions, as well as the benefits of strategy implementation as discussed in section 1.0 of this report.

Sales in Canada increased by a more modest $1.7 million, or 3.9%, in the first half of 2012 compared to the same period in the prior year.

Gross Profit

First-half gross profit increased to $27.0 million, from $19.2 million in the first six months of 2011. The increase in gross profit reflects higher sales, as well as a slightly higher gross profit margin. As a percentage of sales, gross profit was 17.8% in the first half of 2012, compared to 17.6% during the same period in 2011. The addition of the Paxton's in-house remanufacturing capability has added value to our product mix and been a positive influence on average gross profit margin.

Operating Expenses

Operating expenses increased $4.5 million to $21.0 million in the first six months of 2012, from $16.5 million during the same period in 2011. This increase reflects $4.8 million of incremental expenses from the acquired Paxton operations, partially offset by the absence of $0.6 million in costs which were incurred in the first half of 2011 as part of our conversion to a corporation, but which were not repeated in the current-year period. As a percentage of sales, first-half operating expenses were 13.8% of sales, compared to 15.2% in 2011.

EBITDA

For the six months ended June 30, 2011, we increased EBITDA to $6.6 million, from $3.1 million during the same period in 2011. The $3.5 million increase reflects the $7.8 million increase in gross profit, partially offset by the $4.5 million increase in operating expenses.

Net Finance Cost

(in thousands of Canadian dollars)		Six months ended June 30 2012		Six months ended June 30 2011		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(350)	$	(246)	$	104
Amortization of deferred finance cost		-		(98)		(98)
Accretion of finance lease obligation		(41)		(48)		(7)
Change in fair value of non-controlling interest		-		(547)		(547)
Write-off of uncollectible interest on trade receivables		(49)		-		49
Foreign exchange losses		-		(110)		(110)
Total finance expense		(440)		(1,049)		(609)
Finance income:						
Imputed interest on employee loans receivable		7		8		(1)
Interest on trade receivables and customer notes		193		259		(66)
Foreign exchange gain		35		-		35
Total finance income		235		267		(32)
Net finance cost	$	(205)	$	(782)	$	577

Net finance cost was $0.2 million for the six months ended June 30, 2012, compared to $0.8 million during the same period in 2011. As shown in the preceding table, the main factor in the decrease in net finance expense is the $0.6 million change in the fair value of the non-controlling interest liability, which occurred in the first six months of 2011. The non-controlling interest was exchanged for common shares in the Company concurrent with Hardwoods' conversion to a corporation on July 1, 2011. As the non-controlling interest did not exist in the six months ended June 30, 2012, no such fair value adjustment arose in the current-year period.

Income Tax Expense

An income tax expense of $2.2 million was recorded in the first six months of 2012, compared to $1.1 million in the same period in 2011. The increase in income tax expense primarily reflects higher taxable income.

Profit for the Period

Profit for the six months ended June 30, 2012 was $3.6 million, compared to profit of $0.8 million during the same period in 2011. The $2.8 million increase in profit primarily reflects the $3.5 million increase in EBITDA and $0.6 million decrease in net finance expense, partially offset by a $0.2 million increase in depreciation expense and the $1.1 million increase in income tax expense.

4.0 Quarterly Financial Information and Seasonality

(in thousands of dollars)	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010
Total sales	$ 79,153	$ 72,939	$ 63,899	$ 57,372	$ 56,718	$ 52,030	$ 46,392	$ 50,559
Profit (loss)	$ 2,377	$ 1,225	$ (350)	$ 5,605	$ 1,511	$ (701)	$ (980)	$ (147)
Basic profit (loss) per share or unit	$ 0.22	$ 0.08	$ (0.02)	$ 0.37	$ 0.10	$ (0.05)	$ (0.07)	$ (0.01)
Fully diluted profit (loss) per share or unit	$ 0.22	$ 0.07	$ (0.02)	$ 0.36	$ 0.10	$ (0.05)	$ (0.07)	$ (0.01)
EBITDA	$ 4,065	$ 2,562	$ 941	$ 1,928	$ 2,542	$ 558	$ (339)	$ 1,399

The preceding table provides selected quarterly financial information for our eight most recently completed fiscal quarters. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in our opinion, necessary to present a fair statement of the results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of future performance. Historically, the first and fourth quarters have been seasonally slower periods for our business. In addition, net earnings reported in each quarter may be impacted by changes to the foreign exchange rate of the Canadian and US dollar, changes in the carrying value of deferred income tax assets (which occurred in the three months ended September 30, 2011), changes in the fair value of the non-controlling interest liability prior to July 1, 2011, and the impact of the Paxton acquisition on financial results for the third and fourth quarters of 2011 and the first and second quarter of 2012.

5.0 Liquidity and Capital Resources

5.1 Cash Flows from Operating, Investing and Financing Activities

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	Three months ended June 30			Six months ended June 30		
	2012	2011	$ Change	2012	2011	$ Change
Cash provided by (used by) operating activities before changes in non-cash working capital	$ 3,919	$ 2,582	$ 1,337	$ 6,501	$ 5,125	$ 1,376
Changes in non-cash working capital	(7,765)	(5,444)	(2,321)	(13,231)	(7,159)	(6,072)
Net cash used in operating activities	(3,846)	(2,862)	(984)	(6,730)	(2,034)	(4,696)
Net cash provided by (used in) investing activities	(106)	69	(175)	72	122	(50)
Net cash provided by financing activities	3,966	2,634	1,332	6,327	1,898	4,429
Increase (decrease) in cash	14	(159)	173	(331)	(14)	(317)
Cash, beginning of period	47	188	(141)	392	43	349
Cash, end of period	$ 61	$ 29	$ 32	$ 61	$ 29	$ 32

Net cash used in operating activities

Cash used in operating activities was $3.8 million in the second quarter of 2012, compared to $2.9 million in the same period in 2011. Cash provided by operating activities before changes in non-cash working capital increased by $1.3 million, primarily reflecting the $1.5 million increase in second quarter EBITDA. In addition, investment in non-cash working capital was higher by $2.3 million in the second quarter of 2011 compared to the same period in the prior year. An analysis of changes in working capital is provided in section 5.2 of this report.

Cash used in operating activities in the six months ended June 30, 2012 was $6.7 million, compared to $2.0 million in the same period in the prior year. Cash provided by operating activities, before changes in non-cash working capital, increased by $1.4 million, primarily reflecting the $3.5 million increase in EBITDA partially offset by a $1.8 million cash receipt of an income tax refund in the first quarter of 2011 that was not repeated in 2012. Investment made in non-cash working capital increased by $6.1 million in the six months ended June 30, 2012 compared to the prior year period. An analysis of changes in working capital is provided in section 5.2 of this report.

Net cash provided by (used in) investing activities

Net cash from investing activities changed by $0.2 million and $0.1 million, respectively, in the second quarter and first six months of 2012 when compared to the same periods in 2011. Net cash from investing activities comprises cash collections on long-term receivables and proceeds from disposal of property, plant and equipment, less capital expenditures made to acquire additional property, plant and equipment.

Prior to the Paxton acquisition, our capital expenditures were typically low as we leased all of our buildings and contracted out all freight delivery services. Capital expenditures that were made were principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Between 2007 and 2011, capital expenditures were lower than normal, reflecting the closure of 11 branch locations in response to weak economic conditions. These closures freed up additional forklift capacity and reduced our need to purchase replacement forklift equipment. We also decreased many of our discretionary cash outlays for capital items during this period as we emphasized cost reduction and cash conservation. As a result, our total capital expenditures amounted to just $0.1 million in the year ended December 31, 2010, and $0.4 million in 2011. In 2012 we have recommenced a rotational forklift replacement program, which has accounted for the majority of our capital expenditures of $0.2 million in the second quarter of 2012 and $0.3 million in the six months ended June 30, 3012.

We also lease automobiles for the use of outside sales representatives and certain managers. For the year ended December 31, 2011, principle payments on automobile finance lease obligation were $0.7 million (2010 - $0.8 million). In the three months ended June 30, 2012, principle payments on automobile finance lease obligation were $0.2 million (three months ended June 30, 2011 - $0.2 million), and for the six months ended June 30, 2012 were $0.4 million (six months ended June 30, 2011 - $0.3 million).

We believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment.

Our acquisition of Paxton on September 19, 2011 will increase our future maintenance capital expenditure needs. Unlike other Hardwoods Distribution operations, the Paxton business requires ongoing investment in moulders and other light remanufacturing equipment. The Paxton operations also buy trailers and lease tractor units for use in delivery of product to customers, whereas other Hardwoods operations contract out this freight delivery service to third-party carriers. We anticipate that additional annual capital expenditure requirements of approximately $0.5 million will be associated with maintaining the productive capacity of the Paxton business.

Net cash provided by financing activities

Net cash provided by financing activities increased by $1.3 million and $4.4 million, respectively, in the second quarter and the first six months of 2012 when compared to the same periods in 2011. The year-over-year increase in both periods primarily reflects increased bank indebtedness as we supported sales growth with higher working capital investment.

5.2 Working Capital

Our business requires an ongoing investment in working capital, which we consider to be comprised of accounts receivable, inventory, and prepaid expenses, partially offset by provisions and short-term credit provided by suppliers in the form of accounts payable and accrued liabilities. We had working capital of $80.8 million at June 30, 2012, compared to $57.9 million at June 30, 2011. Most of this increase is attributable to the Paxton inventory and accounts receivable we purchased as part of the acquisition, together with our own increased investment in accounts receivable to support sales growth.

Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal 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, 2012 and 2011 is provided below.

(in thousands of Canadian dollars)

Source (use) of funds	**Three months ended June 30, 2012**	**Three months ended June 30, 2011**	**Six months ended June 30, 2012**	**Six months ended June 30, 2011**
Accounts receivable	$ (2,478)	$ (2,769)	$ (9,034)	$ (8,269)
Inventory	(5,755)	(2,510)	(5,905)	(1,702)
Prepaid expenses	(669)	47	(514)	190
Provisions	14	18	5	(52)
Accounts payable and accrued liabilities	1,123	(230)	2,217	2,674
Increase in non-cash operating working capital	$ (7,765)	$ (5,444)	$ (13,231)	$ (7,159)

Continued compliance with financial covenants under our credit facilities is important to ensure that we have adequate financing available to meet our working capital requirements. The terms of our revolving credit facilities are addressed in section 5.3 of this report.

5.3 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)		As at June 30, 2012		As at December 31, 2011
Cash and cash equivalents	$	(61)	$	(392)
Bank indebtedness		27,207		19,794
Net Debt	$	27,146	$	19,402
Shareholders' equity		74,965		71,899
Total Capitalization	$	102,111	$	91,301
Net debt to total capitalization		26.6%		21.3%

We consider our capital to be bank indebtedness (net of cash) and shareholder's equity. As shown above, our net debt balance increased by $7.7 million to $27.1 million at June 30, 2012, from $19.4 million at December 31, 2011. This increase in net debt primarily reflects the use of our bank lines to finance additional investment in working capital to support our higher sales. Overall net debt compared to total capitalization stood at 26.6% as at June 30, 2012, compared to 21.3% at December 31, 2011.

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 our 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 our subsidiaries. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at June 30, 2012 is provided in the following table. At June 30, 2012 the Company had total borrowing capacity available of $21.7 million for future use, and to cover checks issued in excess of funds on deposit which were $3.5 million at June 30, 2012.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	$15 million	$30.5 million (US$30 million)
Credit facility expiry date	August 7, 2016	May 26, 2015
Available to borrow	$ 15.0 million	$ 30.5 million (US$ 30.0 million)
Credit facility borrowings	$ 6.9 million	$ 16.9 million (US$ 16.6 million)
Unused credit facility available	$ 8.1 million	$ 13.6 million (US$ 13.4 million)
Financial covenants:		
	Covenant does not apply when the unused credit facility available exceeds $2.0 million, which it did at June 30, 2012	Covenant does not apply when the unused credit facility available exceeds US$2.5 million, which it did at June 30, 2012

The terms of the agreements with our lenders provide that dividends cannot be made to our shareholders in the event that our subsidiaries are not compliant with their financial covenants. Our operating subsidiaries were compliant with all required credit ratios as at June 30, 2012. Accordingly there were no restrictions on dividends 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 2016 and May 2015, respectively. We do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn on our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and our cash generating capacity going forward. When making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities. We do not target a specific financial leverage amount. We believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy.

5.4 Contractual Obligations

The table below sets forth our contractual obligations as at June 30, 2012. These obligations relate to leases on various premises and automobiles, and become due in the fiscal years indicated.

(in thousands of Canadian dollars) Total	2012	2013	2014	2015	2016	2017 and thereafter
$ 18,102	$ 2,963	$ 5,663	$ 4,789	$ 3,109	$ 1,410	$ 168

5.5 Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

5.6 Financial Instruments

Financial assets include cash and cash equivalents and current and long-term receivables which are measured at amortized cost. Financial liabilities include bank indebtedness, accounts payable and accrued liabilities, income taxes payable and finance lease obligations which are measured at amortized cost. The carrying values of our cash and cash equivalents, accounts receivable, income taxes payable, accounts payable and accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of long-term receivables and finance lease obligations are not expected to differ materially from carrying value given the interest rate being charged. The carrying values of the credit facilities approximate their fair values due to the existence of floating market-based interest rates.

5.7 Share Data

As at August 7, 2012, the date of this MD&A, we had 16,176,087 common shares issued and outstanding. In addition at August 7, 2012 we have outstanding 82,630 performance shares and 279,979 restricted shares under the terms of our long-term incentive plan. The performance and restricted shares can be settled in common shares of the Company issued from treasury, shares purchased by the Company in the market, or in an amount of cash equal to the fair value of our common shares, or any combination of the foregoing. The restricted and performance shares vest over periods of up to three years and we intend to issue common shares from treasury to settle these obligations as they vest.

5.8 Dividends

In the second quarter of 2012, we declared a quarterly dividend of $0.03 per share, which was paid on July 31, 2012 to shareholders of record as at July 20, 2012. On August 7, 2012 we declared a quarterly dividend of $0.03 per share, payable on October 31, 2012 to shareholders of record as at October 19, 2012. The Board regularly assesses the Company's dividend strategy, giving due consideration to anticipated cash needs for additional working capital to support growing the business, appropriate debt levels, acquisition opportunities which may be available, expected market conditions and demand for our products, and other factors.

6.0 Related Party Transactions

Two of our Company directors are senior officers of Sauder Industries Limited ("SIL"). For the three months ended June 30, 2012, sales of $0.1 million were made to affiliates of SIL, and purchases of $7,000 were made from affiliates of SIL. For the six months ended June 30, 2012, sales of $0.1 million were made to affiliates of SIL, and purchases of $27,000 were made from affiliates of SIL. These sales and purchases took place at prevailing market prices.

7.0 Critical Accounting Estimates & Adoption of Changes in Accounting Policies

7.1 Critical Accounting Estimates

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

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.

Deferred 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 us. These estimates and assumptions can have a material impact upon the amount of deferred income tax assets and liabilities that we recognize.

7.2 Adoption of New Accounting Standards

We note that the standard-setting bodies that determine IFRS have significant ongoing projects that could impact the IFRS accounting policies that we have selected. The impact of any new IFRS standards or interpretations will be evaluated as they are drafted and published. New standards and interpretations that have been identified but have yet to be adopted are:

IFRS 9 - Financial Instruments

In November 2009, the IASB issued IFRS 9 - *Financial Instruments*, which is the first step in its project to replace IAS 39 - *Financial Instruments: Recognition and Measurement*. IFRS 9 establishes the measurement and classification of financial assets. Under IFRS 9, financial assets are measured either at fair value through earnings or at amortized cost if certain conditions are met. The effective date of this standard is January 1, 2015, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2015. We are currently evaluating the impact of IFRS 9 on our financial statements.

IFRS 10 – Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10 – *Consolidated Financial Statements*. The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. The adoption of IFRS 10 is not expected to have a significant impact on our consolidated financial statements.

IFRS 12 – Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12 – *Disclosure of Interests in Other Entities*. The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. We are currently evaluating the impact of IFRS 12 on our financial statements.

IFRS 13 – Fair Value Measurement

In May 2011, the IASB issued IFRS 13 – *Fair Value Measurement*. The objective of IFRS 13 is to define fair value, set out in a single IFRS framework for measuring fair value, and establish disclosure requirements regarding fair value measurements. The effective date of this standard is January 1, 2013, but early adoption is permitted. We will apply this standard to our financial statements beginning on January 1, 2013. We are currently evaluating the impact of IFRS 13 on our financial statements.

8.0 Risks and Uncertainties

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of in our Annual Information Form dated March 9, 2012, and in our Information Circular dated March 28, 2012. Both documents are available to readers at www.sedar.com.

9.0 Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"). Any systems of DC&P and ICFR, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to information required to be disclosed and financial statement preparation and presentation. There have been no changes in our ICFR during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our ICFR.

10.0 Note Regarding Forward Looking Information

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

The forward-looking information in this MD&A includes, but is not limited to: our belief that gains in Hardwoods sales, EBITDA and profit reflect gradual market improvement and the successful implementation of our market expansion strategies; our estimate that the historical norm for US housing starts is approximately 1.2 million starts per year; our belief that competition remained intense in all of our markets and put pressure on our ability to achieve product price increases in the second quarter of 2012; our belief that given that Hardwoods is performing well at historically low levels of market demand and pricing and high levels of competition, the Company has significant upside potential should economic conditions make a more pronounced turnaround; our belief that the Canadian residential construction market and the North American non-residential market were generally less affected by the economic downturn, and as such, offer less recovery-related growth potential; that we anticipate continued gradual improvement in market conditions through the balance of 2012, with further gains in US housing starts, steady demand in Canadian housing starts and a reasonable level of activity in non-residential construction markets; that we believe competition remains intense and could continue to put pressure on product prices and margins; that we expect that continued performance improvements will be driven primarily by our market expansion strategies; our intention to continue to strengthen our presence in the commercial and institutional construction markets, including leveraging Paxton's products and capabilities to make a broader range of products available to customers in these sectors; to grow our successful import program by seeking out attractive new products and introducing our branded lines of import products to Paxton's base of customers; and to solidify and further expand our presence in new geographic markets that we entered as a result of the Paxton acquisition, while targeting additional growth in selected existing markets; our belief that the Paxton operations provide significant opportunities for continued near-term growth,; that our plans to open an additional branch in Sacramento, California, as well as additional import product opportunities, will contribute to growth in the second half of 2012; that our key priorities for the balance of the year will be to continue executing our growth and operating strategies, including seeking out acquisition opportunities that further increase shareholder value; our belief that we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment; that we anticipate additional annual capital expenditure requirements of approximately $0.5 million associated with maintaining the productive capacity of the Paxton business; that 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 2016 and May 2015, respectively; that we do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity; that when making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities; that we do not target a specific financial leverage amount; that we believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy; and that we intend to issue common shares from treasury to settle obligations under our long term incentive plan as they vest.

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 our Information Circular and in this MD&A.

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