Management's Discussion and Analysis

November 5, 2012

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of November 5, 2012. This MD&A covers our unaudited interim condensed consolidated financial statements as at and for the three and nine month periods ended September 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.

Contents

This MD&A includes the following sections:

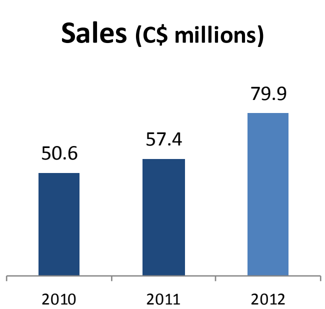
1.0 Executive Summary

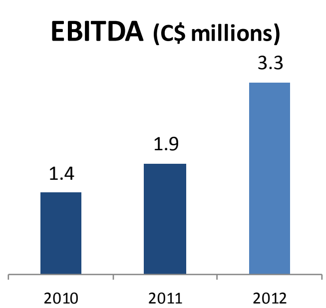
1.1 Overview

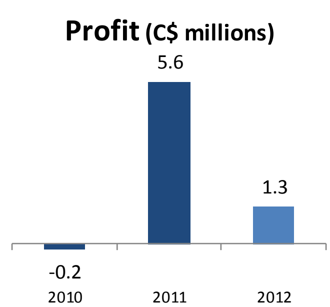
With market conditions improving and our business strategies helping us capitalize on increased demand, we achieved strong operating results in the third quarter and first nine months of 2012. For the three months ended September 30, 2012, sales increased 39.2%, gross profit was up 38.8% and EBITDA climbed 71.8% compared to the third quarter of 2011. Year-to-date results were also significantly stronger, with revenue increasing 39.6%, gross profit up 40.1% and EBITDA climbing 97.7% compared to the first nine months of 2011.

Profit, while benefitting from the improved EBITDA results, did not increase on a year-over-year basis. This primarily reflects higher-than-normal income tax recoveries in the 2011 periods relating to our conversion to a corporation and our acquisition of the Paxton operations. These recoveries were not present in the 2012 results. The year-over-year change in profit also reflects the impact of non-cash foreign exchange losses incurred in 2012, arising from the impact of changes in the Canadian/US dollar exchange rate on translation of intercompany debt for reporting purposes.

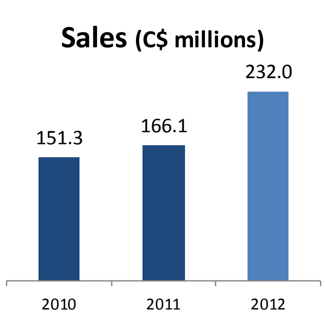
Three Months Ended September 30th:

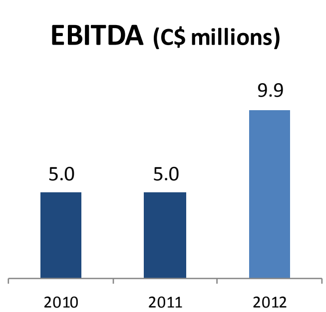


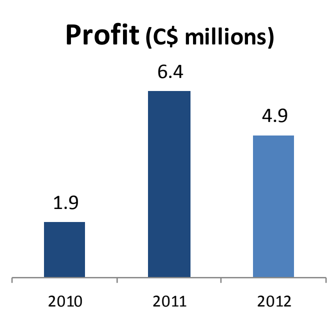




Nine Months Ended September 30th:







The continued strengthening of our operating results reflects improvements in US market conditions, and more specifically our ability to tap this growing demand. According to the US Census Bureau, the US residential housing market strengthened significantly in 2012, with the seasonally adjusted annual rate of housing starts climbing to 872,000 in September 2012, the highest level achieved in four years. Demand from the US recreational vehicle (RV) manufacturing sector was also strong and commercial construction demand remained solid. Hardwood lumber prices were generally stable through both the third quarter and first nine months of the year.

Hardwoods began preparing for a recovery in the US residential construction market over a year ago with the addition of new sales personnel, continued expansion of our product lines, and the September 2011 acquisition of the Frank Paxton Lumber Company ("Paxton"), which expanded our presence in five US markets. The timeliness of these strategies has enabled us to fully capitalize on the market improvements. Our US operations, as measured in US dollars, achieved third quarter organic sales growth of 22.5%, supplemented by acquisition-related growth of 31.9%. Improving demand and the success of our market expansion strategies also enabled us to re-open our Sacramento branch during the third quarter, bringing our total number of branches in California to three.

The Canadian residential construction market was generally less affected by the economic downturn, and as such, the Canadian market is not experiencing the demand gains that we are seeing in the US. However our strategies have continued to help us build sales in all of our Canadian markets, and particularly in Alberta, BC and Ontario. As a result of our efforts, our Canadian operations achieved organic growth of 8.4% during the third quarter.

While we are encouraged by the recovery taking place in the US residential construction market, we note that competition remains intense in all of our markets and continues to constrain product prices and margins. The addition of Paxton's value-added products helped to sustain our gross profit margins at 17.6% in the third quarter and 17.7% for the first nine months, in line with a year ago.

As expected, our operating expenses were higher year-over-year due to the addition of the Paxton operations. However as a percentage of sales, our operating expenses continue to decline, reflecting the efficiencies of larger scale and continued cost discipline.

Financially, we continued to maintain a strong balance sheet. As at September 30, 2012, we had a conservative debt-to-total capital ratio of 27.8% and over $16 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

Forecasters predict that US housing starts will continue to benefit from stabilizing house prices, low mortgage rates and near record low home inventories over the next year, and are predicting rates of growth for 2013 similar to those experienced in 2012. Given that hardwood products are typically applied at the final stages of house construction (typically 9 to 12 months after house construction starts), we expect to see higher demand for our products continuing well into 2014. The outlook for the US repair and remodeling market is also positive with growth of 5% or better forecast for 2013 by Harvard's Joint Center for Housing Studies. Indicators for commercial construction are for continued steady growth of 2% to 5% in 2013.

The positive outlook for the US market is tempered by fragility in the broader US economy and ongoing concerns related to high unemployment, high levels of US government debt and the risk of macroeconomic shock from Europe's debt crisis. In addition, on September 27, 2012, an antidumping and countervailing duty case was initiated in the US against imported hardwood plywood panels produced in China. If trade duties were levied against Chinese hardwood plywood, this would impact our business in the United States. These impacts may include material changes to the selling prices, margins, and/or product supply availability of both imported and domestically manufactured hardwood plywood. We are closely monitoring proceedings in the trade dispute and investigating a range of alternative supply solutions for our customers should it become necessary. However, the resulting impact on markets and therefore on Hardwoods business cannot be determined at this time. It is estimated that sales of hardwood plywood imported from China for resale to the Company's customers located in the United States comprised approximately 14.6% of Hardwoods total revenues in the third quarter of 2012 and 13.5% in the first nine months of 2012.

The outlook for the Canadian market is also cautious with housing starts expected to decline slightly in 2013 according to the Canada Mortgage and Housing Corporation. Modest growth is expected to continue in the renovation and commercial construction markets in the range of 3% to 4% annually.

Given the mixed market influences, we will continue to focus on capturing available market related growth and to rely on our strategies to drive ongoing performance improvements. Specifically, we will continue to:

- Strengthen our presence in the commercial and institutional construction markets.
- Leverage our ability to source high-quality products from international markets.
- Solidify and further expand our presence in selected geographic markets where we see opportunities for growth.

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 September 30, 2012 we operated 31 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 one third 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 caused prices for hardwood lumber products to remain below the 10-year average.

The North American residential construction market, which is a key market for the hardwood products we distribute, is now experiencing a recovery after a significant economic downturn. However, current levels of housing and construction activity remain low relative to both historical norms and expected longer-term population and housing trends. Accordingly we believe that as the economic recovery strengthens, prospects for our industry are attractive.

3.0 Results of Operations

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

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	For the three months Ended September 30, 2012	For the three months Ended September 30, 2011	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 79,862	$ 57,372	$ 22,490	39.2%
Sales in the US (US$)	*57,421*	*37,187*	*20,234*	54.4%
Sales in Canada	*22,672*	*20,908*	*1,764*	8.4%
Gross profit	14,048	10,121	3,927	38.8%
Gross profit %	*17.6%*	*17.6%*		
Operating expenses	(11,047)	(8,412)	2,635	31.3%
Profit from operating activities	3,001	1,709	1,292	75.6%
Add: Depreciation and amortization	312	219	93	42.5%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 3,313	$ 1,928	$ 1,385	71.8%
Add (deduct):				
Depreciation and amortization	(312)	(219)	93	42.5%
Net finance (costs) income	(574)	725	1,299	179.2%
Income tax (expense) recovery	(1,163)	3,171	4,334	136.7%
Profit for the period	$ 1,264	$ 5,605	$ (4,341)	-77.4%
Basic and fully diluted profit per share/unit	$ 0.08	$ 0.35	0.350	
Average Canadian dollar exchange rate for one US dollar	0.995	0.981		

Sales

For the three months ended September 30, 2012, total sales increased to $79.9 million, up 39.2% from $57.4 million during the same period in 2011. This was our highest quarterly sales result in five years.

Sales in our US operations were US$57.4 million, an increase of US$20.2 million or 54.4% compared to the same period in the prior year. Approximately US$12.3 million of this growth was provided by the Paxton operations, which were acquired on September 19, 2011. The remaining US$7.9 million increase reflects organic sales growth of 22.5% from existing US operations. Our California operations continued to grow sales with a resurgence of regional demand leading to the re-opening of the Sacramento branch. We also capitalized on strong RV manufacturing activity in the Lake States region and continued strong demand in Texas. As discussed in section 1.0 of the report, strong organic sales growth from our US operations has been driven not only by growing demand, but also reflects the continued success of our corporate strategies to expand sales.

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 steady $1.8 million or 8.4% in the third quarter. Our Canadian branch locations cover from BC through to Ontario, and all regions reported sales growth in the three months ended September 30, 2012, compared to the same period in the prior year.

Gross Profit

Gross profit for the three months ended September 30, 2012 was $14.0 million, an increase of $3.9 million, or 38.8%, from $10.1 million in the third quarter of 2011. This improvement reflects higher sales for the period. As a percentage of sales, third quarter gross profit was 17.6%, unchanged from the same period in 2011.

Operating Expenses

Third quarter operating expenses were $11.0 million, compared to $8.4 million during the same period in 2011, an increase of $2.6 million. This increase primarily reflects incremental expenses related to the acquired Paxton operations. As a percentage of sales, third quarter 2012 operating expenses were 13.8% of sales, down from 14.7% in 2011, reflecting economies of scale related to our larger size and continued cost management throughout our operations. In addition expenses of $0.1 million relating to our acquisition of Paxton in the third quarter of 2011 were not repeated in the current year period.

EBITDA

For the three months ended September 30, 2012, EBITDA increased to $3.3 million, up $1.4 million from $1.9 million in the third quarter of 2011. The significant year-over-year improvement in EBITDA reflects the $3.9 million increase in gross profit, partially offset by the $2.6 million increase in operating expenses.

Net Finance Income (Cost)

(in thousands of Canadian dollars)		Three months ended 30-Sep 2012		Three months ended 30-Sep 2011		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(219)	$	(113)	$	106
Amortization of deferred finance cost		-		(27)		(27)
Accretion of finance lease obligation		(20)		(22)		(2)
Change in fair value of non-controlling interest		-				-
Write-off of uncollectible interest on trade receivables		3		-		(3)
Foreign exchange losses		(447)		-		447
Total finance expense		(683)		(162)		521
Finance income:						
Imputed interest on employee loans receivable		3		4		(1)
Interest on trade receivables and customer notes		106		141		(35)
Foreign exchange gain		-		742		(742)
Total finance income		109		887		(778)
Net finance income (cost)	$	(574)	$	725	$	1,299

Net finance cost was $0.6 million for the three months ended September 30, 2012, compared to net finance income of $0.7 million during the same period in 2011. As shown in the preceding table, the main factor in the increase in net finance expense was the $1.2 million change in foreign exchange gains/losses between the periods. The change in foreign exchange gains/losses primarily relates to the impact of changes in the Canadian/US dollar exchange rate on translation for reporting purposes of intercompany debt held by or with subsidiaries of the Company. During the three months ended September 30, 2012, a strengthening of the Canadian dollar resulted in a foreign exchange loss of $0.4 million on this intercompany debt. In contrast, the Canadian dollar weakened during the comparative period in 2011, resulting in a foreign exchange gain of $0.7 million.

Income Tax Expense (Recovery)

An income tax expense of $1.2 million was recorded in the three months ended September 30, 2012 based on taxable income generated in the period. This compares to an income tax recovery of $3.2 million during the same period in 2011. The prior-year tax recovery primarily reflects a $3.8 million deferred income tax recovery arising in the third quarter of 2011 as a result of the Paxton acquisition and other restructuring activities at that time.

Profit for the Period

Profit for the three months ended September 30, 2012 decreased to $1.3 million, from $5.6 million during the same period in 2011. The $4.3 million decrease in profit reflects the $4.3 million decrease in income tax recovery, the $1.3 million decrease in net finance income, and a $0.1 million increase in depreciation, partially offset by the $1.4 million increase in EBITDA.

3.2 Nine Months Ended September 30, 2012 and September 30, 2011

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

	For the nine months Ended September 30, 2012	For the nine months Ended September 30, 2011	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 231,954	$ 166,120	$ 65,834	39.6%
Sales in the US (US$)	*164,207*	*104,477*	*59,730*	57.2%
Sales in Canada	*67,369*	*63,921*	*3,448*	5.4%
Gross profit	41,052	29,305	11,747	40.1%
Gross profit %	*17.7%*	*17.6%*		
Operating expenses	(32,038)	(24,946)	7,092	28.4%
Profit from operating activities	9,014	4,359	4,655	106.8%
Add: Depreciation and amortization	926	669	257	38.4%
Earnings before interest, taxes, depreciation and amortization and non-controlling interest (“EBITDA”)	$ 9,940	$ 5,028	$ 4,912	97.7%
Add (deduct):				
Depreciation and amortization	(926)	(669)	257	38.4%
Net finance costs	(779)	(57)	722	1266.7%
Income tax (expense) recovery	(3,369)	2,113	5,482	259.4%
Profit for the period	$ 4,866	$ 6,415	$ (1,549)	-24.1%
Basic profit per share/unit	$ 0.30	$ 0.43		
Fully diluted profit per share/unit	0.30	0.42		
Average Canadian dollar exchange rate for one US dollar	1.002	0.978		

Sales

For the nine months ended September 30, 2012 total sales climbed to $232.0 million, from $166.1 million in the first nine months of 2011, an increase of $65.8 million.

This growth came predominantly from our US operations, where sales activity increased by US$59.7 million. Revenue from the Paxton business, acquired in September 2011, contributed US$40.6 million of the sales growth, with the remaining US$19.1 million generated by organic growth from our existing US branch network. The 18.3% organic growth in sales from our US operations reflects 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 $3.4 million, or 5.4%, in the first nine months of 2012, compared to the same period last year.

Gross Profit

Year-to-date gross profit increased to $41.0 million, from $29.3 million in the first nine 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 17.7% in the first nine months of 2012, compared to 17.6% during the same period in 2011.

Operating Expenses

Operating expenses increased $7.1 million to $32.0 million in the first nine months of 2012, from $24.9 million during the same period in 2011. This increase primarily reflects $7.2 million of incremental expenses from the acquired Paxton operations. As a percentage of sales, operating expenses in the first nine months of 2012 were 13.8% of sales, compared to 15.0% in 2011. Expenses in the 2011 period included $0.7 million in costs related to the acquisition of Paxton and costs associated with our conversion to a corporation which were not repeated in the 2012 period.

EBITDA

For the nine months ended September 30, 2012, we increased EBITDA to $9.9 million, from $5.0 million during the same period in 2011. The $4.9 million increase reflects the $11.7 million increase in gross profit, partially offset by the $6.8 million increase in operating expenses before depreciation and amortization expense.

Net Finance Cost

(in thousands of Canadian dollars)		Nine months ended 30-Sep 2012		Nine months ended 30-Sep 2011		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(569)	$	(359)	$	210
Amortization of deferred finance cost		-		(125)		(125)
Accretion of finance lease obligation		(61)		(70)		(9)
Change in fair value of non-controlling interest		-		(546)		(546)
Write-off of uncollectible interest on trade receivables		(46)		-		46
Foreign exchange losses		(412)		-		412
Total finance expense		(1,088)		(1,100)		(12)
Finance income:						
Imputed interest on employee loans receivable		10		12		(2)
Interest on trade receivables and customer notes		299		400		(101)
Reversal of write off of uncollectible interest on trade receivables						
Foreign exchange gain		-		631		(631)
Total finance income		309		1043		(734)
Net finance cost	$	(779)	$	(57)	$	(722)

Net finance cost was $0.8 million for the nine months ended September 30, 2012, compared to $0.1 million during the same period in 2011 as shown in the table above. The main factors in the increase in net finance expense were changes in foreign exchange gains/losses, partly offset by change in the fair value of non-controlling interest.

We reported foreign exchange losses of $0.4 million in the first nine months of 2012, compared to foreign exchange gains of $0.6 million in the comparable period in 2011. The net increase in foreign exchange losses primarily relates to the impact of changes in the Canadian/US dollar exchange rate on translation for reporting purposes of intercompany debt held by or with subsidiaries of the Company.

The change in the fair value of the non-controlling interest liability in the first nine months of 2011 was a loss of $0.6 million. 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 nine months ended September 30, 2012, no such fair value adjustment arose in the current-year period.

Income Tax Recovery (Expense)

An income tax expense of $3.4 million was recorded in the first nine months of 2012 based on taxable income generated during the period. In the comparative 2011 period, an income tax recovery of $2.1 million was recorded. This was primarily due to the recognition of a deferred income tax recovery arising from the Paxton acquisition and other restructuring activities in the third quarter of 2011 as previously described in section 3.1 of this report.

Profit for the Period

Profit for the nine months ended September 30, 2012 was $4.9 million, compared to profit of $6.4 million during the same period in 2011. The $1.5 million decrease in profit primarily reflects the $5.5 million increase in income tax expense, the $0.7 increase in net finance costs and the $0.2 million increase in depreciation expense, partially offset by the $4.9 million increase in EBITDA.

4.0 Quarterly Financial Information and Seasonality

(in thousands of dollars)	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010
Total sales	$ 79,862	$ 79,153	$ 72,939	$ 63,899	$ 57,372	$ 56,718	$ 52,030	$ 46,392
Profit (loss)	$ 1,264	$ 2,377	$ 1,225	$ (350)	$ 5,605	$ 1,511	$ (701)	$ (980)
Basic profit (loss) per share or unit	$ 0.08	$ 0.22	$ 0.08	$ (0.02)	$ 0.37	$ 0.10	$ (0.05)	$ (0.07)
Fully diluted profit (loss) per share or unit	$ 0.08	$ 0.22	$ 0.07	$ (0.02)	$ 0.36	$ 0.10	$ (0.05)	$ (0.07)
EBITDA	$ 3,313	$ 4,065	$ 2,562	$ 941	$ 1,928	$ 2,542	$ 558	$ (339)

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, as well as the first, second and third quarters 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 September 30			Nine months ended September 30		
	2012	2011	$ Change	2012	2011	$ Change
Cash provided by (used by) operating activities before changes in non-cash working capital	$ 2,278	$ 1,997	$ 281	$ 8,779	$ 7,122	$ 1,657
Changes in non-cash working capital	(3,886)	(1,100)	(2,786)	(17,117)	(8,259)	(8,858)
Net cash provided by (used in) operating activities	(1,608)	897	(2,505)	(8,338)	(1,137)	(7,201)
Net cash provided by (used in) investing activities	(18)	(13,684)	13,666	54	(13,562)	13,616
Net cash provided by financing activities	1,630	13,084	(11,454)	7,957	14,982	(7,025)
Increase (decrease) in cash	4	297	(293)	(327)	283	(610)
Cash, beginning of period	61	29	32	392	43	349
Cash, end of period	$ 65	$ 326	$ (261)	$ 65	$ 326	$ (261)

Net cash used in operating activities

Cash used in operating activities was $1.6 million in the third quarter of 2012, compared to cash provided by operating activities of $0.9 million during the same period in 2011. Cash provided by operating activities before changes in non-cash working capital increased by $0.3 million, primarily reflecting the $1.4 million increase in third quarter EBITDA, partially offset by a $1.0 million increase in income taxes paid. In addition, investment in non-cash working capital was higher by $2.8 million in the third quarter of 2012 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 during the nine months ended September 30, 2012 was $8.3 million, compared to $1.1 million for the same period in 2011. Cash provided by operating activities, before changes in non-cash working capital, increased by $1.7 million, primarily reflecting the $4.9 million increase in EBITDA, partially offset by the $2.9 million change in income taxes paid/received. Investment made in non-cash working capital increased by $8.9 million in the nine months ended September 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 used in investing activities decreased by $13.7 million and $13.6 million, respectively, in the third quarter and first nine months of 2012 when compared to the same periods in 2011. The change in investing activity reflects the impact of the $13.7 million business acquisition of Paxton on third quarter 2011 results. Net cash from investing activities also 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.

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.

Our acquisition of Paxton on September 19, 2011 increased 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.

In 2012 we have recommenced a rotational forklift replacement program in all our operations and also made some capital investments in our Paxton operations, which together accounted for the majority of the $0.4 million of capital expenditures recorded in the third quarter of 2012 and the $0.8 million recorded in the nine months ended September 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 September 30, 2012, principle payments on automobile finance lease obligation were $0.2 million (three months ended September 30, 2011 - $0.2 million), and for the nine months ended September 30, 2012 were $0.6 million (nine months ended September 30, 2011 - $0.5 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.

Net cash provided by financing activities

Net cash provided by financing activities decreased by $11.4 million and $7.0 million, respectively, in the third quarter and the first nine months of 2012 when compared to the same periods in 2011. The year-over-year decrease in both periods primarily reflects that additional bank indebtedness incurred in the 2011 periods to finance the purchase of Paxton, was not incurred in the 2012 periods. The decrease was partially offset by increased bank borrowing in the 2012 period to support higher working capital investment associated with our sales growth.

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. As at September 30, 2012, we had working capital of $82.5 million, compared to $72.0 million at September 30, 2011. Most of this increase is attributable to our increased investment in accounts receivable and inventory 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 nine months ended September 30, 2012 and 2011 is provided below.

(in thousands of Canadian dollars) Source (use) of funds	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Accounts receivable	$ (407)	$ 1,737	$ (9,441)	$ (6,532)
Inventory	$ (4,018)	(4,377)	(9,923)	(6,079)
Prepaid expenses	$ 218	(244)	(296)	(54)
Provisions	$ (9)	(32)	(4)	(84)
Accounts payable and accrued liabilities	$ 330	1,816	2,547	4,490
Increase in non-cash operating working capital	$ (3,886)	$ (1,100)	$ (17,117)	$ (8,259)

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 September 30, 2012		As at December 31, 2011
Cash and cash equivalents	$	(65)	$	(392)
Bank indebtedness		28,830		19,794
Net Debt	$	28,765	$	19,402
Shareholders' equity		74,522		71,899
Total Capitalization	$	103,287	$	91,301
Net debt to total capitalization		27.8%		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 $9.4 million to $28.8 million at September 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 27.8% as at September 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 September 30, 2012 is provided in the following table. At September 30, 2012 the Company had total borrowing capacity of $16.3 million available for future use and to cover checks issued in excess of funds on deposit (amounting to $0.7 million) at September 30, 2012.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	**Canadian Credit Facility**	**US Credit Facility**
Maximum borrowings under credit facility	$15 million	$29.5 million (US$30 million)
Credit facility expiry date	August 7, 2016	May 26, 2015
Available to borrow	$ 15.0 million	$ 29.5 million (US$ 30.0 million)
Credit facility borrowings	$ 8.4 million	$ 19.8 million (US$ 20.1 million)
Unused credit facility available	$ 6.6 million	$ 9.7 million (US$ 9.9 million)
Financial covenants:		
	Covenant does not apply when the unused credit facility available exceeds $2.0 million, which it did at September 30, 2012	Covenant does not apply when the unused credit facility available exceeds US$2.5 million, which it did at September 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 September 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 strategy.

5.4 Contractual Obligations

The table below sets forth our contractual obligations as at September 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
$ 17,226	$ 1,506	$ 5,775	$ 4,973	$ 3,165	$ 1,496	$ 311

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 November 5, 2012, the date of this MD&A, we had 16,176,087 common shares issued and outstanding. In addition, at November 5, 2012 we had 82,630 performance shares and 279,979 restricted shares outstanding 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 third quarter of 2012, we declared a quarterly dividend of $0.03 per share, which was paid on October 31, 2012 to shareholders of record as at October 19, 2012. On November 5, 2012 we declared a quarterly dividend of $0.03 per share, payable on January 31, 2013 to shareholders of record as at January 18, 2013. 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 September 30, 2012, sales of $39,000 were made to affiliates of SIL, and purchases of $3,000 were made from affiliates of SIL. For the nine months ended September 30, 2012, sales of $0.1 million were made to affiliates of SIL, and purchases of $29,000 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.

On September 27, 2012 an unfair trade petition was filed in the United States with respect to imported hardwood plywood from China. The action was filed by the Coalition for Fair Trade of Hardwood Plywood (CFTHP), an association of U.S. manufacturers of hardwood and decorative plywood. The petition, filed with the U.S. Department of Commerce and the U.S. International Trade Commission, alleges that imports of Chinese manufactured hardwood plywood are sold in the United States at prices below cost, and are subsidized by the Government of China. The petition claims that U.S. manufacturers of hardwood and decorative plywood have suffered material competitive injury and that the industry continues to be threatened by further injury from Chinese imports. The filing requests that the U.S. Government investigate, and seeks antidumping and countervailing duty in excess of 300 percent to be applied against the value of imported hardwood plywood originating from China. In announcing the filing, the CFTHP indicated it expects a preliminary ruling to be implemented by Spring 2013 and a final ruling by late Fall 2013.

Hardwoods sells hardwood plywood, lumber and related sheet goods and specialty wood products to customers in North America. Our strategy includes selling both imported and domestically produced hardwood plywood to satisfy demand from Hardwoods customers. The majority of the imported hardwood plywood which is sold by Hardwoods is sourced from China. If trade duties were levied against Chinese hardwood plywood, this would impact our business in the United States. These impacts may include material changes to the selling prices, margins, and/or product supply availability of both imported and domestically manufactured hardwood plywood. We are currently analyzing the trade petition filing, however, the resulting impact on markets, and therefore on our business, cannot be determined at this time. It is estimated that sales of hardwood plywood imported from China for resale to the Company's customers located in the United States comprised approximately 14.6% of Hardwoods total revenues in the third quarter of 2012 and 13.5% in the first nine months of 2012.

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 September 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 perspective that forecasters predict that US housing starts will continue to benefit from stabilizing house prices, low mortgage rates and near record low home inventories over the next year, and are predicting rates of growth for 2013 similar to those experienced in 2012; our perspective that given that hardwood products are typically applied at the final stages of house construction (typically 9 to 12 months after house construction starts), we expect to see higher demand for our products continuing well into 2014; our view that the outlook for the US repair and remodeling market is also positive with growth of 5% or better forecast for 2013 by Harvard's Joint Center for Housing Studies; our evaluation that indicators for commercial construction are for continued steady growth of 2% to 5% in 2013; our opinion that the positive outlook for the US market is tempered by fragility in the broader US economy and ongoing concerns related to high unemployment, high levels of US government debt and the risk of macro shock from Europe's debt crisis; our caution that in addition, on September 27, 2012, an antidumping and countervailing duty case was initiated in the US against imported hardwood plywood panels produced in China, that if trade duties were levied against Chinese hardwood plywood, this would impact upon our business in the United States, that these impacts may include material changes to the selling prices, margins, and/or product supply availability of both imported and domestically manufactured hardwood plywood., that we are closely monitoring proceedings in the trade dispute and investigating a range of alternative supply solutions for our customers should it become necessary, that the resulting impact on markets and therefore on Hardwoods business cannot be determined at this time and that we estimate that sales of hardwood plywood imported from China for resale to the Company's customers located in the United States comprised approximately 14.6% of Hardwoods total revenues in the third quarter of 2012 and 13.5% in the first nine months of 2012; our perspective that the outlook for the Canadian market is also cautious with housing starts expected to decline slightly in 2013 according to the Canada Mortgage and Housing Corporation; our view that modest growth is expected to continue in the Canadian renovation and commercial construction markets in the range of 3% to 4% annually; that given the mixed market influences, we intend to continue to focus on capturing available market related growth and to rely on our strategies to drive ongoing performance improvements; specifically, we will continue to: strengthen our presence in the commercial and institutional construction markets, leverage our ability to source high-quality products from international markets, and Solidify and further expand our presence in selected geographic markets where we see opportunities for growth; our view that 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 opinion that the North American residential construction market, which is a key market for the hardwood products we distribute, is now experiencing a recovery after a significant economic downturn, that current levels of housing and construction activity remain low relative to both historical norms and expected longer-term population and housing trends, and accordingly that we believe that as the economic recovery strengthens, prospects for our industry are attractive; 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 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; 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 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.