



HARDWOODS DISTRIBUTION
INCOME FUND

2008

Second Quarter Report to Unitholders



About the Fund

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

About the Business

Hardwoods has been providing quality lumber, hardwood plywood and specialty products to customers for over 45 years. Today, we are one of the largest distributors of hardwood lumber and sheet goods in North America, operating a network of 34 distribution centers organized into nine regional clusters.

To Our Unitholders:

Market conditions remained extremely challenging through the second quarter, with US housing starts falling to a 17-year low and the broader North American economy continuing to deteriorate. Demand for hardwood lumber, which traditionally increases in our seasonally stronger second quarter, declined both year-over-year and sequentially compared to the first quarter of 2008 as furniture, cabinet manufacturing, and millwork customers reduced production. Prices for hardwood lumber also declined, adding to the negative sales impact. While coping with these challenges, we also faced gross margin impacts from higher freight costs and increased market competition as distributors lowered prices to shore up declining sales.

Without a doubt, market conditions in the first half of 2008 were as challenging as any we have ever experienced, and we felt the effects. Our top and bottom-line results for both the second quarter and the first half of 2008 were down compared to 2007. Our payout ratio also increased significantly, leading to our decision to reduce cash distributions to a more sustainable level as we work through this market downturn. Effective with the July distribution, monthly cash distributions will be reduced by 67% to \$0.025 per unit, or \$0.30 on an annualized basis. While a difficult decision, we feel it is a necessary one given the impact of lower sales and EBITDA. We believe the revised rate of monthly distributions is sustainable provided that we do not experience a further deterioration of market conditions.

Internally, we have also taken appropriate steps to ensure we maintain a solid footing. During the first half of 2008, we have continued to reduce our sales and administrative expenses with selected branch closures and a reduction in our employee base. We have also tightened our management of working capital with a significant reduction in our inventory levels.

Going forward, we will continue to reduce costs wherever possible, while protecting our core productive capability. Our intention is to maintain a strong presence in our chosen North American markets and to pursue the market share opportunities that a weak economic cycle can provide. To support this strategy, we are maintaining a high level of customer service and continuing to develop our import program with appealing products that offer a competitive advantage over the domestic alternative. For example, our new line of imported Echo Wood™ veneer products has been a bright light for us in 2008, winning new customers and offering attractive margins. We will focus on growing this line as the year progresses.

While we anticipate a continuation of market challenges through the balance of 2008 and likely 2009, we believe we are well positioned to withstand this market downturn. Our business model and distribution network give us a reasonable ability to manage costs. Our balance sheet remains strong. Our people are highly committed to the hardwoods industry and to seeing us successfully through this cycle. While we are aware of the challenges being placed on our unitholders during this downturn, we are fully committed to managing the business with your interests in mind and with a view to rewarding your investment over the full length of the cycle.

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

Maurice E. Paquette

President and Chief Executive Officer

This management's discussion and analysis ("MD&A") covers our unaudited interim consolidated financial statements as at and for the three and six month periods ended June 30, 2008 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in our 2007 Annual Report. The information below should be read in conjunction with the Interim Financial Statements and the audited consolidated financial statements and accompanying notes of Hardwoods Distribution Income Fund for the years ended December 31, 2007 and 2006. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

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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: we believe the revised rate of monthly distributions is sustainable provided that we do not experience a further deterioration of market conditions.; we expect to close another two satellite distribution centres in the third quarter with corresponding personnel reductions; we will continue developing our import program with high-margin products that offer a competitive advantage over the domestic alternative; we anticipate a continuation of challenging conditions over at least the next 12 months, with depressed housing starts and general economic weakness reducing demand for furniture, cabinets, recreational vehicles and other products that utilize hardwood lumber and sheet goods; prices for hardwood lumber are also expected to remain low, despite production curtailments by many lumber mills; our import program, which is a key contributor of higher margin sales, is also expected to feel pressure from reduced North American demand and from higher prices in the Chinese wood market, but imports are expected to remain an important and high-margin segment of our business; we expect that existing foreign currency contracts, currently valued at approximately \$0.7 million, will be realized during the third quarter; our annual maintenance capital requirements are expected to average approximately \$1.0 million per year, but may be higher or lower than this in a particular year based on the needs of the business, and we believe this annual amount is sufficient to maintain the existing productive capacity of the business as it relates to our needs for property, plant and equipment; we anticipate capital expenditures in 2008 will not exceed \$0.6 million; we believe the productive capacity of our business in terms of our human capital has been largely sustained since the Fund’s IPO in March 2004; and, we believe that our credit facilities, combined with the retained portion of our Distributable Cash, are sufficient to meet our current working capital requirements.

The 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 the amount of cash we have available to distribute to our unitholders in Canadian dollars; 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 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; the downturn in the general state of the economy does not worsen and impact upon our results; 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 the amount of cash we have available to distribute to our unitholders in Canadian dollars; 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 or 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; our results are dependent upon the general state of the economy; 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; our credit facilities contain restrictions on our ability to borrow funds and restrictions on distributions that can be made; there are tax risks associated with an investment in our units; our future growth may be restricted by the payout of substantially all of our operating cash flow; and, other risks described in our Annual Information Form and our other continuous disclosure documents.

All forward-looking information in this MD&A is qualified in its entirety by this cautionary statement and, except as may be required by law, we undertake no obligation to revise or update

any forward-looking information as a result of new information, future events or otherwise after the date hereof.

In this MD&A, references to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustments on foreign currency contracts, goodwill and other intangible assets impairments, and the non-controlling interest in earnings. In addition to net income or loss, EBITDA is a useful supplemental measure of performance and cash available for distribution prior to debt service, changes in working capital, capital expenditures and income taxes.

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

We believe that, in addition to net income or loss, our EBITDA and our Distributable Cash are each a useful supplemental measure of operating performance that may assist investors in assessing their investment in Class A Units. Neither EBITDA nor Distributable Cash are earnings measures recognized by GAAP and they do not have a standardized meaning prescribed by GAAP. Investors are cautioned that EBITDA should not replace net income or loss (as determined in accordance with GAAP) as an indicator of our performance, nor should Distributable Cash replace cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA and Distributable Cash may differ from the methods used by other issuers. Therefore, our EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. For reconciliation between EBITDA and net income or loss as determined in accordance with GAAP, please refer to the discussion of Results of Operations described in section 3.0 of this report. For reconciliation between Distributable Cash and net cash provided by operating activities as determined in accordance with GAAP, please refer to the discussion of Distributable Cash and Cash Distributions described in section 4.1 of this report.

We believe that this MD&A has been prepared in all material respects in accordance with recommendations issued in by the Canadian Institute of Chartered Accountants (the “CICA”) with respect to “Standardized Distributable Cash in Income Trusts and Other Flow Through Entities” and National Policy 41-201 of the Canadian Securities Administrators “Income Trusts

and Other Indirect Offerings” (collectively, the “Interpretive Guidance”). The Interpretive Guidance provides guidance on standardized preparation and disclosure of distributable cash for income trusts (“Standardized Distributable Cash”). The CICA calculation of Standardized Distributable Cash, which is also a non-GAAP measure, is defined, for the purposes of the Fund, as the periodic cash provided by operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital, less total capital expenditures. For a summary of our Standardized Distributable Cash, please refer to section 4.2 of this report. For reconciliation between Standardized Distributable Cash and our Distributable Cash, please see section 4.2.

1.0 Background

1.1 About the Fund

The Fund is an unincorporated open-ended limited purpose trust formed under the laws of the Province of British Columbia by a declaration of trust dated January 30, 2004. The Fund was launched on March 23, 2004 with the completion of an initial public offering (“IPO”) of 14,410,000 trust Voting Units (“Class A Units”). Net IPO proceeds of \$133.5 million, together with drawings on credit facilities totalling \$31.6 million, were used to acquire an 80% interest in the hardwood lumber and sheet goods distribution business (“Hardwoods” or the “Business”) from the previous owners.

The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund’s operating subsidiaries (“Class B Units”), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. Distributions by the Fund’s operating subsidiaries to the previous owners are subject to subordination arrangements until certain financial tests established at the time of the IPO and described in the Audited Financial Statements are met. As at March 31, 2008, the following units of the Fund were issued and outstanding:

Units	14,410,000
Special Voting Units	3,602,500

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

1.2 About our Business and Industry

Hardwoods is one of North America's largest distributors of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. At June 30, 2008 we operated 34 distribution facilities organized into nine geographic regions throughout North America. In a highly fragmented but stable industry, we match products supplied from hundreds of mills to over 2,500 manufacturing customers.

Approximately half of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods, consisting primarily of hardwood plywood, and including non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Our sheet goods are a key complementary product line as they are used by many purchasers of hardwood lumber in the manufacture of their end products.

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

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

more recently we have experienced a more pronounced downward trend in hardwood pricing as a result of weaker market conditions.

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

2.0 Overview and Outlook

Market conditions continued to worsen in the second quarter of 2008. Further declines in US residential housing starts, flat remodeling sales and weaker consumer confidence all had a significant impact on our US operations, which represent approximately two-thirds of our business. While the Canadian market performed somewhat better, Canada's economy is also softening and our domestic customers continue to be negatively affected by the strong Canadian dollar and by their own challenges with selling into the US market.

The impact of weaker demand and lower prices for hardwood lumber products was evident in our results. Total sales for the second quarter were down 25.6% compared to the same period in 2007, reflecting a 21.4% decrease in underlying sales activity and a 4.2% negative foreign exchange impact. Our US business was hardest hit with second quarter sales down 23.4%, while Canadian sales were down by 17.2%.

Our results were further affected by higher freight costs and more intense market competition, which put downward pressure on gross margins. While we maintained margins in our target range of 18.5% or better for the first half of 2008, they fell to 18.0% in the second quarter of 2008, compared to 19.0% during the same period in 2007. The lower margins, combined with significantly lower sales, contributed to a 51.3% decline in second-quarter EBITDA. Based on declining sales and profitability, we tested the carrying value of our goodwill and intangible assets at the end of the second quarter and recorded a \$70 million impairment. The impairment writedown is a non-cash item that does not affect Distributable Cash.

As part of our strategic response to the current market conditions, we continue to focus on reducing costs. Over the past 12 months, we have reduced our North American employee base by 9%, closed two distribution centres, eliminated excess trucking capacity and sublet under-utilized warehouse space. We expect to close another two satellite distribution centres in the third quarter with corresponding personnel reductions. While we will continue to look for other

opportunities to reduce costs, our intention is to maintain a strong presence in our chosen North American markets and to pursue opportunities to build market share and support margins. As part of this, we will continue developing our import program with high-margin products that offer a competitive advantage over the domestic alternative.

Maintaining a strong balance sheet is particularly important in a market downturn and we have taken decisive steps to ensure ours remains sound. During the second quarter, we reduced our inventory levels to \$30.1 million, from \$39.3 million a year ago, maintaining our inventory turnover at a relatively constant 7.0 times annually. With both sales and EBITDA under significant pressure and our distribution payout ratio for both the second quarter and first half well over 100%, we have also announced a reduction to our cash distributions. Monthly cash distributions will be reduced by 67% to \$0.025 per unit effective with the July 2008 distribution. We believe the revised rate of monthly distributions is sustainable provided that we do not experience a further deterioration of market conditions.

Looking ahead, we anticipate a continuation of challenging conditions over at least the next 12 months, with depressed housing starts and general economic weakness reducing demand for furniture, cabinets, recreational vehicles and other products that utilize hardwood lumber and sheet goods. Prices for hardwood lumber are also expected to remain low, despite production curtailments by many lumber mills.

Our import program, which is a key contributor of higher margin sales, is also feeling pressure from reduced North American demand and from higher prices in the Chinese wood market. Our year-to-date import volumes are down by 33%. The price inflation is related to the rising value of the Yuan and increased costs for raw material, labour and transportation in China. While these factors are expected to put pressure on gross margin percentage as the year progresses, overall, imports are expected to remain an important and high-margin segment of our business.

Since inception, the Fund has maintained a hedging program designed to assist us in forward planning for currency fluctuations that arise related to conversion of that portion of our Distributable Cash that is generated in the United States in US dollars. In anticipation of significantly reduced US cash flow through the balance of 2008 and 2009, we plan to discontinue this program. We expect that existing contracts, currently valued at approximately \$0.7 million, will be realized during the third quarter. We will review our hedging strategy regularly and will reinstate currency hedges if and when appropriate.

With the expectation of more challenges ahead, our focus will remain on tight management of the business. We will maintain our sharp focus on gross margin performance and work to ensure expenditures are matched as appropriately as possible to sales levels. Inventory levels and working capital will also continue to be managed closely and we will work to minimize customer credit risk, which typically becomes elevated in a weak economy. These initiatives, together with the reduction in monthly cash distributions, are expected to help us sustain a strong balance sheet and emerge in stable condition from the current business cycle.

3.0 Results of Operations

3.1 Three Months Ended June 30, 2008 and June 30, 2007

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

	For the three months Ended June 30, 2008	For the three months Ended June 30, 2007
Total sales	\$ 66,488	\$ 89,400
<i>Sales in the US (US\$)</i>	42,584	55,596
<i>Sales in Canada</i>	23,464	28,329
Gross profit	11,962	16,994
<i>Gross profit %</i>	18.0%	19.0%
Selling and administrative expenses	(9,225)	(11,069)
Realized gain on foreign currency contracts	354	425
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	3,091	6,350
Add (deduct):		
Amortization	(422)	(475)
Interest	(310)	(625)
Mark-to-market adjustment on foreign currency contracts	(108)	940
Intangibles impairment	(5,468)	-
Goodwill impairment	(64,606)	-
Non-controlling interest	14,182	(499)
Income recovery (expense)	19,925	(891)
Net earnings (loss) for the period	\$ (33,716)	\$ 4,800
Basic and fully diluted earnings (loss) per Class A Unit	\$ (2.340)	\$ 0.333
Average US\$ exchange rate to C\$	1.0101	1.0986

Sales

For the three months ended June 30, 2008, total sales were \$66.5 million, down from \$89.4 million in the second quarter of 2007. The 25.6% decrease in total sales reflects a 21.4% decrease in underlying sales activity, and a 4.2% decrease in sales due to the negative impact of a stronger Canadian dollar.

Sales in the United States, as measured in US dollars, decreased 23.4% to \$42.6 million, compared to \$55.6 million during the second quarter of 2007. As discussed in section 2.0 of this report, our sales were negatively impacted by the extremely challenging US market conditions, including a weak residential construction environment and general slowing in the broader US economy. Although some areas were more heavily impacted than others, sales were down in all five of our US geographic regions in Q2 compared to the same period in the prior year.

Sales in Canada, as measured in Canadian dollars, were \$23.5 million, down 17.2% from \$28.3 million during the second quarter of 2007. As was the case with our US results, sales in Canada were down in all regions across the country. A number of our Canadian customers that rely in part on exporting their manufactured product to the US continue to be negatively impacted by the stronger Canadian dollar, as well as by reduced product demand from the US as described in section 2.0 of this report.

Gross Profit

Gross profit for the three months ended June 30, 2008 was \$12.0 million, down \$5.0 million compared to \$17.0 million in the second quarter of 2007. The decrease in gross profits reflects lower sales, as well as a decrease in gross profit percentage to 18.0%, from 19.0% in Q2 2007. Our second quarter gross profit percentage came under pressure in the form of product price reductions in response to more intense competition as market demand slowed and higher delivery charges from our trucking carriers related to elevated fuel costs. Some quarter-to-quarter variation in our gross profit percentage is considered normal, with 18% to 19% representing a typical range. Our goal is to adjust our business to obtain a gross profit margin of 18.5% or better over the business cycle.

Selling and Administrative Expenses

Selling and Administrative (S&A) expenses were \$9.2 million for the three months ended June 30, 2008, a decrease of \$1.9 million or 16.7% from \$11.1 million in the comparative 2007 period. This improvement reflects the \$0.5 million benefit of a stronger Canadian dollar on the conversion of S&A expenses at our US operations. The remainder of the decrease in S&A expenses is primarily reduced people costs, which is the Fund's largest expense item. S&A expenses represented 13.9% of sales in the second quarter of 2008, compared to 12.4% in the same period in 2007, reflecting lower sales. Discussion of the Fund's efforts to control costs is described in section 2.0 of this report.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of \$0.4 million on foreign currency contracts which matured in the second quarter of 2008, unchanged compared to realized gains of \$0.4 million in the same period in 2007. The terms of our foreign currency contracts and the Fund's use of currency derivatives to mitigate the economic impact of fluctuations between the Canadian and US dollar are described in section 5.0 of this report.

EBITDA

Second quarter EBITDA was \$3.1 million, down from \$6.4 million in Q2 2007. The \$3.3 million decrease in EBITDA reflects the \$5.0 million decrease in gross profit, partially offset by the \$1.9 million reduction in S&A expenses.

Interest Expense

Interest expense was \$0.3 million in the second quarter 2008, compared to \$0.6 million in the second quarter of 2007. The change in interest charges reflects lower debt due to a reduction in working capital and related borrowing requirements as a result of lower demand and sales.

Mark-To-Market Adjustment on Foreign Currency Contracts

For the three months ended June 30, 2008, the mark-to-market valuation of our outstanding foreign currency contracts created an adjustment loss of \$0.1 million, compared to an adjustment gain of \$0.9 million in the same period in 2007. Further discussion of our foreign currency contracts can be found under Financial Instruments in section 5.0 of this report.

Intangible Assets and Goodwill Impairment

Impairment testing of intangibles and goodwill is undertaken annually, or more frequently in the event that circumstances occur that more likely than not reduces the fair value of a reporting unit below its carrying amount. In the first six months of 2008, Hardwoods experienced a significant change in circumstances in the form of reduced sales demand for its products, and a resulting decline in its net earnings. This change of circumstance caused management to reduce its expectations for future cash flows from the Fund's US and Canadian subsidiary operations. Consequently, during the quarter ended June 30, 2008, management reviewed for impairment the recoverability of the carrying value of intangible assets and the carrying value of goodwill. Results of testing indicated impairment in the carrying value of intangible assets in the Fund's US reporting unit of \$5.5 million (US\$5.4 million). Testing also indicated impairment in the carrying

value of goodwill in the Fund's US reporting unit of \$47.6 million (US\$46.7 million), and in the Fund's Canadian reporting unit of \$17.0 million.

Non-controlling Interest

Non-controlling interest ("NCI") was reduced by \$14.2 million in the second quarter of 2008, compared to an increase in NCI of \$0.5 million in the comparable period in 2007. NCI includes the Class B Unit's interest in pretax earnings or loss in the period, less an adjustment to NCI to reflect the value of subordinated distributions that were not made to the Class B Units and that can no longer be recovered by the Class B Units under the terms of the Fund's subordination feature. The Fund's subordination feature is further described in section 4.0 of this report and in the Interim Financial Statements. The \$14.2 million reduction to NCI in Q2 2008 reflects the NCI's share of the \$70.1 million in goodwill and intangibles impairment recognized in the period.

Income taxes

Income tax recovery was \$19.9 million in the second quarter of 2008, compared to a \$0.9 million income tax expense in the comparable period in 2007. The income tax recovery in Q2 2008 primarily reflects a \$20.1 million future income tax recovery related to accounting book to tax differences arising from the goodwill and intangibles impairment recorded during the period. In addition, current income tax expense was less than \$0.1 million in the second quarter of 2008, due to lower taxable income and the utilization of tax loss carry-forwards available to a subsidiary of the Fund.

Net Loss

Net loss for the three months ended June 30, 2008 was \$33.7 million, compared to net earnings of \$4.8 million in the comparable period in 2007. The \$38.5 million decrease in net earnings primarily reflects the \$3.3 million decrease in EBITDA, the \$1.0 million decrease in mark-to-market adjustment gains on foreign currency contracts, and the \$70.1 million goodwill and intangibles impairment. These losses were partially offset by the \$0.3 million reduction in interest expense, the \$14.7 million reduction in non-controlling interest, and the \$20.8 million decrease in income tax expense.

3.2 Six Months Ended June 30, 2008 and June 30, 2007

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

	For the six months Ended June 30, 2008	For the six months Ended June 30, 2007
Total sales	\$ 137,536	\$ 181,120
<i>Sales in the US (US\$)</i>	88,776	110,895
<i>Sales in Canada</i>	48,103	55,255
Gross profit	25,598	33,862
<i>Gross profit %</i>	18.6%	18.7%
Selling and administrative expenses	(20,543)	(22,819)
Realized gain on foreign currency contracts	949	694
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	6,004	11,737
Add (deduct):		
Amortization	(847)	(967)
Interest	(698)	(1,334)
Mark-to-market adjustment on foreign currency contracts	(1,309)	771
Intangibles impairment	(5,468)	-
Goodwill impairment	(64,606)	-
Non-controlling interest	14,590	201
Income taxes	28,147	(1,602)
Net earnings (loss) for the period	\$ (24,187)	\$ 8,806
Basic and fully diluted earnings (loss) per Class A Unit	\$ (1.678)	\$ 0.611
Average US\$ exchange rate to C\$	1.0074	1.135

Sales

For the six months ended June 30, 2008, total sales were \$137.5 million, down from \$181.1 million in the first half of 2007. The 24.1% decrease in total sales reflects a 17.8% decrease in underlying sales activity, and a 6.3% decrease in sales due to the negative impact of a stronger Canadian dollar. The decrease in underlying sales is as a result of the challenging business conditions outlined previously in section 2.0. First-half sales activity at our US operations, as measured in US dollars, declined 19.9% year-over-year, and sales in Canada were down by 12.9%.

Gross Profit

First-half gross profit was \$25.6 million, down from the \$33.9 million reported in the first six months of 2007. The reduction in gross profit primarily reflects lower sales. As a percentage of sales, gross profit was relatively steady at 18.6% in the first half of 2008, compared to 18.7% during the same period in 2007.

Selling and Administrative Expenses

S&A expenses decreased \$2.3 million to \$20.5 million in the first six months of 2008, from \$22.8 million during the same period in 2007. The improvement in S&A expenses primarily reflects lower people costs due to reduced employee headcount and bonus accruals, and the benefit of the stronger Canadian dollar on the conversion of S&A expenses at our US operations. These S&A reductions were partially offset by \$0.7 million of non-recurring expenses that were incurred in the first quarter of 2008 related to the Fund's internal reorganization as well as branch closure costs. As a percentage of sales, first-half S&A expenses were 14.9% of sales, compared to 12.6% in 2007.

Realized Gain on Foreign Currency Contracts

Foreign currency contracts which matured during the first half of 2008 provided \$0.9 million in gains, compared to \$0.7 million realized in the first six months of 2007. This improvement was driven by the strengthening value of the Canadian dollar in the first half of 2008, compared to the same period in 2007. The terms of our foreign currency contracts and the Fund's use of currency derivatives to mitigate the economic impact of fluctuations between the Canadian and US dollar are described in section 5.0 of this report.

EBITDA

First-half EBITDA was \$6.0 million, down from \$11.7 million in the same period in 2008. The \$5.7 million decrease in EBITDA reflects the \$8.3 million decrease in gross profit, partially offset by the \$2.3 million reduction in S&A and the \$0.2 million increase in realized gains on foreign currency contracts.

Interest Expense

Interest expense was \$0.7 million in the six months ended June 30, 2008, compared to \$1.3 million in the comparable period in 2007. The decrease in interest expense primarily reflects lower outstanding bank indebtedness (due to reduced working capital financing requirements as a result of lower inventory) and lower interest rates.

Mark-To-Market Adjustment on Foreign Currency Contracts

For the six months ended June 30, 2008, the mark-to-market valuation of our outstanding foreign currency contracts created an adjustment loss of \$1.3 million, compared to an adjustment gain of

\$0.8 million in the same period in 2007. Further discussion of our foreign currency contracts can be found under Financial Instruments in section 5.0 of this report.

Intangible Assets and Goodwill Impairment

As described previously in section 3.1 of this report, in the second quarter of 2008 the Fund completed impairment testing and determined that the value of intangibles and goodwill exceeded their carrying value by \$5.5 million and \$64.6 million respectively. No intangibles or goodwill impairment was determined in the comparative period in 2007.

Non-controlling Interest

NCI was reduced by \$14.6 million in the first half of 2008, compared to a reduction in NCI of \$0.2 million in the comparable period in 2007. The primary reason for the \$14.6 million reduction in NCI in 2008 is related to the NCI's share of the goodwill and intangible impairment recognized by the Fund in the second quarter of 2008, as explained in section 3.1 of this report.

Income taxes

Income tax recovery in the six months ended June 30, 2008 was \$28.1 million, compared to income tax expense of \$1.6 million in the same period in 2007. The \$28.1 million income tax recovery primarily reflects \$20.1 million in future income tax assets associated with recording the goodwill and intangibles impairment in the second quarter, as well as a \$7.0 million future income tax benefit and a \$0.8 million current income tax benefit resulting from the refinancing and reorganization of the Fund's internal affairs that was undertaken in the first quarter of 2008.

Net Loss

The net loss for the six months ended June 30, 2008 was \$24.2 million, compared to net earnings of \$8.8 million in the comparable period in 2007. The \$33.0 million decrease in net earnings primarily reflects the \$5.7 million decrease in EBITDA, the \$2.1 million decrease in mark-to-market adjustment gains on foreign currency contracts, and the combined \$70.1 million in writedowns to goodwill and intangibles. Partially offsetting these negative earnings impacts were a \$0.6 million decrease in interest expense, a \$14.4 million increase in recovery from non-controlling interest, and a \$29.7 million decrease in income tax expense.

4.0 Liquidity and Capital Resources

4.1 Distributable Cash and Cash Distributions

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

	3 months ended June 30, <u>2008</u>	3 months ended June 30, <u>2007</u>	6 months ended June 30, <u>2008</u>	6 months ended June 30, <u>2007</u>
Net cash provided by operating activities	\$ 7,663	\$ 5,380	\$ 10,260	\$ 6,254
Increase (decrease) in non-cash operating working capital	<u>(5,011)</u>	<u>(298)</u>	<u>(4,264)</u>	<u>3,061</u>
Cash flow from operations before changes in non-cash operating working capital	2,652	5,082	5,996	9,315
Capital expenditures	<u>(225)</u>	<u>(214)</u>	<u>(298)</u>	<u>(450)</u>
Distributable Cash	<u>\$ 2,427</u>	<u>\$ 4,868</u>	<u>\$ 5,698</u>	<u>\$ 8,865</u>
Distributions relating to the period:				
Class A Units	\$ 3,242 ⁽¹⁾	\$ 3,086	\$ 6,484 ⁽²⁾	\$ 6,026
Class B Units ⁽³⁾	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Units	<u>\$ 3,242</u>	<u>\$ 3,086</u>	<u>\$ 6,484</u>	<u>\$ 6,026</u>
Outstanding units and per unit amounts:				
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	<u>3,602,500</u>	<u>3,602,500</u>	<u>3,602,500</u>	<u>3,602,500</u>
Total Units outstanding	<u>18,012,500</u>	<u>18,012,500</u>	<u>18,012,500</u>	<u>18,012,500</u>
Distributable Cash per Total Units	\$ 0.135	\$ 0.270	\$ 0.316	\$ 0.492
Distributions relating to the period:				
Class A Units	\$ 0.225 ⁽¹⁾	\$ 0.214	\$ 0.450 ⁽²⁾	\$ 0.418
Class B Units ⁽³⁾	\$ -	\$ -	\$ -	\$ -
Total Units	\$ 0.180	\$ 0.171	\$ 0.360	\$ 0.335
Payout ratio ⁽⁴⁾	133.6%	63.4%	113.8%	68.0%
March 23, 2004 to June 30, <u>2008</u>				
Cumulative since inception:				
Distributable Cash	76,347			
Distributions relating to the period	65,673			
Payout ratio ⁽⁴⁾	86.0%			

¹ Includes the cash distributions of \$0.075 per Class A Unit per month which relate to the operations of the Fund for April, May and June 2008.

² Includes the cash distributions of \$0.075 per Class A Unit per month which relate to the operations of the Fund for January to June 2008.

³ On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the June 30, 2008 balance sheet.

⁴ Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

We pay distributions on Class A Units at the end of the month following the month in which the cash is earned. Distributions may also be made quarterly on Class B Units in an amount equivalent on an after-tax per-unit basis to distributions made on Class A Units, pursuant to the terms of a subordination agreement as outlined in the Fund's Annual Information Form. Except as outlined in the terms of the subordination agreement with the Class B Units, there are no

limitations on distributions from the subsidiaries of the Fund arising from the existence of a minority interest in a subsidiary of the Fund. Further description of the subordination arrangement is included in note 10 of the accompanying Interim Financial Statements.

The Fund's subordination feature is designed to stay in place until the EBITDA and certain distributable cash tests established at the time of the IPO are met. The terms of these tests are described in the notes to the accompanying Interim Financial Statements.

For the three months ended June 30, 2008, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of \$2.4 million, or \$0.135 per unit. Distributions relating to the period were \$3.2 million, or \$0.225 per unit, to our public unitholders (Class A Units). For the six months ended June 30, 2008, the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of \$5.7 million, or \$0.316 per unit, and declared distributions relating to the period of \$6.5 million, or \$0.450, to our public unitholders (Class A Units). In accordance with the terms of a subordination feature in place with the previous owners (Class B Units), no distributions were made to the previous owners related to the six months ended June 30, 2008. These distributions represent an overall payout ratio of 133.6% for the second quarter of 2008, 113.8% for the first six months of 2008, and 90.8% for the most recent 12-month period ended June 30, 2008.

On July 31, 2008 the Trustees of the Fund announced a 67% reduction in monthly cash distributions to public unitholders (Class A Units), from \$0.075 per unit to \$0.025 per unit on a monthly basis. The decrease will take effect with the July distribution to be paid on August 29, 2008, to unitholders of record as at August 20, 2008.

4.2 Standardized Distributable Cash and Cash Distributions

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

	3 months ended June 30, <u>2008</u>	3 months ended June 30, <u>2007</u>	6 months ended June 30, <u>2008</u>	6 months ended June 30, <u>2007</u>
Net cash provided by operating activities	\$ 7,663	\$ 5,380	\$ 10,260	\$ 6,254
Capital expenditures	(225)	(214)	(298)	(450)
Standardized Distributable Cash	<u>\$ 7,438</u>	<u>\$ 5,166</u>	<u>\$ 9,962</u>	<u>\$ 5,804</u>
Distributions relating to the period:				
Class A Units	\$ 3,242 ⁽¹⁾	\$ 3,086	\$ 6,484 ⁽²⁾	\$ 6,026
Class B Units ⁽³⁾	-	-	-	-
Total Units	<u>\$ 3,242</u>	<u>\$ 3,086</u>	<u>\$ 6,484</u>	<u>\$ 6,026</u>
Outstanding units and per unit amounts:				
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	<u>18,012,500</u>	<u>18,012,500</u>	<u>18,012,500</u>	<u>18,012,500</u>
Standardized Distributable Cash per Total Units	\$ 0.413	\$ 0.287	\$ 0.553	\$ 0.322
Distributions per Total Units	\$ 0.180	\$ 0.171	\$ 0.360	\$ 0.335
Standardized payout ratio ⁽⁴⁾	43.6%	59.7%	65.1%	103.8%

March 23, 2004 to June 30, 2008

Cumulative since inception:	
Standardized Distributable Cash	73,318 ⁽⁵⁾
Distributions relating to the period	65,673
Standardized Payout ratio ⁽⁴⁾	89.6%

¹ Includes the cash distributions of \$0.075 per Class A Unit per month which relate to the operations of the Fund for April, May and June 2008.

² Includes the cash distributions of \$0.075 per Class A Unit per month which relate to the operations of the Fund for January to June 2008.

³ On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the March 31, 2008 balance sheet.

⁴ Payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.

⁵ Calculation of cumulative Standardized Distributable Cash since inception excludes a \$10.3 million increase in non-cash operating working capital, which relates to a final working capital adjustment payment made to the former owners to complete the initial purchase of the Business.

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

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

Selected Unaudited Consolidated Financial Information
(in thousands of dollars)

	3 months ended June 30, <u>2008</u>	3 months ended June 30, <u>2007</u>	6 months ended June 30, <u>2008</u>	6 months ended June 30, <u>2007</u>
Standardized Distributable Cash	\$ 7,438	\$ 5,166	\$ 9,962	\$ 5,804
Increase (decrease) in non-cash operating working capital	<u>(5,011)</u>	<u>(298)</u>	<u>(4,264)</u>	<u>3,061</u>
Distributable Cash	<u>\$ 2,427</u>	<u>\$ 4,868</u>	<u>\$ 5,698</u>	<u>\$ 8,865</u>

4.3 Working Capital

Our business requires an ongoing investment in working capital, comprised of accounts receivable, income taxes recoverable, inventory, and prepaid expenses, partly offset by short term credit provided by suppliers in the form of accounts payable and accrued liabilities. Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal 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, 2008 is provided below.

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Accounts receivable	\$ 927	\$ (2,162)	\$ (2,577)	\$ (6,652)
Income taxes recoverable/payable	(1)	(491)	(858)	2
Inventory	5,395	1,211	8,638	2,666
Prepaid expenses	(585)	(279)	(327)	(198)
Accounts payable and accrued liabilities	(725)	2,019	(612)	1,121
Decrease (increase) in working capital	<u>\$ 5,011</u>	<u>\$ 298</u>	<u>\$ 4,264</u>	<u>\$ (3,061)</u>

4.4 Capital Expenditures and Productive Capacity

Our capital expenditures are typically low as we lease all of our buildings and contract out all freight delivery services. Capital expenditures are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Annual maintenance capital requirements are expected to average approximately \$1.0 million per year, but may be higher or lower than this in a particular year based on the needs of the business. Management believes this annual amount is sufficient to maintain the existing productive capacity of the

business as it relates to our needs for property, plant and equipment. Our actual capital expenditures in the second quarter of 2008 totalled \$0.2 million, compared to \$0.2 million in the same period in 2007. Our actual capital expenditures in the first half of 2008 totalled \$0.3 million, compared to \$0.5 million in the same period in 2007. We anticipate capital expenditures in 2008 will not exceed \$0.6 million.

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

Available distribution infrastructure refers to the physical capacity of the distribution network maintained by our business, and may be measured in terms of the number and total square footage of distribution centres in operation. Since the Fund's IPO in March 2004, we have made a number of adjustments to our distribution network, including opening, closing, and relocating some of our distribution facilities. However as shown in the table below, productive capacity, as measured by the distribution infrastructure available to our business, has been largely sustained at levels consistent with the Fund's IPO. From time to time the Fund may increase or decrease its number of facilities and distribution square footage, in response to changes in market demand for hardwood products sold by our business.

	Selected Unaudited Consolidated Financial Information						IPO
	June 30, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	March 23, 2004	
Number of distribution centres in operation	34	36	36	39	37	37	
Total square footage of distribution centres	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	1.3 million s.f.	

Maintenance of a skilled workforce is also critical to managing the productive capacity of our business. We utilize a number of strategies to attract, train, retain and reward our employees. Our staffing levels reflect decisions regarding our distribution network and our expectations for sales demand based upon prevalent economic conditions. Trends in our workforce capacity, as measured in terms of number of employees and average annual sales dollars per employee, are summarized below. Although the productive capacity of our human capital is difficult to measure directly, we believe the productive capacity of our business in terms of our human

capital has been largely sustained since the Fund's IPO in March 2004.

Selected Unaudited Consolidated Financial Information						IPO
	June 30, 2008	December 31, 2007	December 31, 2006	December 31, 2005	December 31, 2004	March 23, 2004
Number of employees	220	236	252	259	224	216
Annual sales per employee (\$ millions)	13 ⁽¹⁾	14	14	14	17	

⁽¹⁾ Six months sales to June 30, 2008 annualized.

4.5 Utilization of Distributable Cash

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	3 months ended June 30, 2008	3 months ended June 30, 2007	6 months ended June 30, 2008	6 months ended June 30, 2007
Distributable Cash	\$ 2,427	\$ 4,868	\$ 5,698	\$ 8,865
Cash Distributions paid in the period	(3,242)	(3,037)	(6,484)	(5,977)
Distributable Cash retained (shortfall)	\$ (815)	\$ 1,831	\$ (786)	\$ 2,888
Decrease (increase) in non-cash operating working capital	5,011	298	4,264	(3,061)
Decrease (increase) in long-term receivables	(303)	818	(116)	1,143
Proceeds from disposal of property, plant and equipment	-	10	-	21
Decrease (increase) in bank indebtedness, net of cash	\$ 3,893	\$ 2,957	\$ 3,362	\$ 991

Our utilization of Distributable Cash and its relation to working capital use and bank line financing are summarized above. For the three months ended June 30, 2008 the Fund generated Distributable Cash of \$2.4 million, and paid cash distributions of \$3.2 million. We decreased our investment in non-cash operating working capital (primarily accounts receivable and inventory, less accounts payable and accrued liabilities) by \$5.0 million, and increased our investment in long-term receivables by \$0.3 million. Taking these factors together, the Fund reduced its bank indebtedness (net of cash) by \$3.9 million in the second quarter of 2008.

For the six months ended June 30, 2008 the Fund generated Distributable Cash of \$5.7 million, and paid cash distributions of \$6.5 million. We decreased our investment in non-cash operating working capital by \$4.3 million, and increased our investment in long-term receivables by \$0.1 million. Taking these factors together, the Fund reduced its bank indebtedness (net of cash) by \$3.4 million in the first six months of 2008.

We believe that our credit facilities, combined with the retained portion of our Distributable Cash, are sufficient to meet our current working capital requirements. The terms of our revolving credit facilities are addressed in section 4.6 of this report.

4.6 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	<u>As at</u> <u>June 30, 2008</u>	<u>As at</u> <u>December 31, 2007</u>
Cash and cash equivalents	\$ (1,234)	\$ (295)
Bank indebtedness	23,620	25,515
Net Debt	\$ 22,386	\$ 25,220
Unitholders' Equity	\$ 76,726	\$ 105,994
Total Capitalization	\$ 99,112	\$ 131,214
Net debt to total capitalization	22.6%	19.2%
Previous 12 months EBITDA	\$ 15,527	\$ 21,260
Net debt to previous 12 months EBITDA	1.44	1.19

We have independent credit facilities in both Canada and the U.S. In Canada, our operating line extends to November 30, 2009 and comprises a maximum facility of \$22.0 million. The balance outstanding on the Canadian operating line as at June 30, 2008 was \$5.2 million. In the US, our operating line extends to March 31, 2010 and comprises a maximum facility of US\$35 million. As at June 30, 2008 the US credit facility had a balance outstanding of \$17.6 million (US \$17.3 million). The amount made available under these revolving credit facilities from time to time is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund. At June 30, 2008 the Canadian and US credit facilities have \$10.5 million and \$7.4 million (US\$7.3million), respectively of available borrowing capacity. The principal terms of the credit facilities available to Hardwoods LP and Hardwoods US LP are described in more detail in the Fund's Annual Information Form.

As discussed previously in section 4.5 of this report, the Fund paid down its net debt by \$3.4 million in the six months ended June 30, 2008. The impact of the weaker Canadian dollar (as at June 30, 2008 compared to December 31, 2007) on the conversion of our US dollar-bank line increased our net debt by \$0.6 million. Taken together, the Fund's net debt balance decreased by \$2.8 million, from \$25.2 million at December 31, 2007 to \$22.4 million at June 30, 2008.

Overall net debt compared to total capitalization stood at 22.6% as of June 30, 2008, compared to 19.2% at December 31, 2007. The Fund's overall ratio of net debt to EBITDA in the previous 12 months is 1.44 times at June 30, 2008 compared to 1.19 times at December 31, 2007. Net

debt to EBITDA serves as an indicator of our financial leverage. The maximum ratio of net debt to EBITDA allowed under our Canadian credit facility is 2.50 times, and the maximum ratio of net debt to EBITDA allowed under our US credit facility is 2.85 times.

The terms of the agreements with our lenders provide that distributions cannot be made to our unitholders in the event that our subsidiaries did not meet the foregoing leverage as well as some additional credit ratios. Our operating subsidiaries were fully compliant with all required credit ratios as at June 30, 2008, and accordingly there were no restrictions on distributions arising from compliance with financial covenants. However during the quarter ended June 30, 2008, the Fund negotiated an amendment to the financial covenants governing the US credit facility. The amendment, which was effective April 1, 2008, temporarily reduced the minimum fixed charge coverage ratio and increased the maximum funded debt coverage ratio permitted as defined under the terms of the US credit facility. The amendment is effective until September 29, 2008, at which time the financial covenants revert back to their original amounts. Absent of this amendment, due to making loan payments on inter-corporate debt instruments the Fund's US subsidiary would have been in violation of its fixed charge coverage ratio at June 30, 2008.

The Fund is currently negotiating with its US bank to make changes to its US revolving credit facility, as without modifications it is likely that the Fund's US subsidiary will not be in compliance with its covenants at its next financial reporting date of September 30, 2008. Under the terms of the US subsidiary's loan agreement, non-compliance with a covenant may result in the bank demanding immediate repayment of all indebtedness under the revolving credit facility.

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 November 2009 and March 2010, respectively. We do not intend to restrict future distributions in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn upon our available revolving credit facilities will depend upon the seasonal needs of the business and cash generating capacity of the Fund. When making distribution decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate for the Fund given existing and expected market conditions and available business opportunities. We do not target a specific financial leverage amount.

4.7 Contractual Obligations

The table below sets forth our contractual obligations as at June 30, 2008. These obligations relate to operating leases on various premises and automobiles, and become due in the fiscal years indicated:

(in thousands of Canadian dollars)

<u>Total</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013 & thereafter</u>
\$ 16,464	\$ 3,538	\$ 5,945	\$ 3,993	\$ 1,398	\$ 737	\$ 854

4.8 Off-Balance Sheet Arrangements

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

5.0 Financial Instruments

Up to June 30, 2008, the Fund used currency contracts to assist in forward planning for the business as it related to managing the Fund's exposure to fluctuations in exchange rates between the Canadian dollar and the United States dollar. In particular, monthly foreign currency contracts were purchased to cover the estimated amount of US dollar denominated Distributable Cash that must be converted to Canadian dollars to pay distributions to Class A Unitholders. The foreign currency contracts are recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of earnings. At June 30, 2008 a subsidiary of the Fund held foreign currency contracts covering the period 24 months into the future as follows:

Month	Sell US dollars	Contract exchange rate (\$C/\$US)	Receive Canadian dollars
July 2008	US\$675,000	1.1255	C\$759,712
August 2008	US\$675,000	1.1255	C\$759,712
September 2008	US\$675,000	1.1255	C\$759,712
October 2008	US\$675,000	1.1255	C\$759,712
November 2008	US\$675,000	1.1255	C\$759,712
December 2008	US\$675,000	1.1255	C\$759,712
January 2009	US\$675,000	1.1255	C\$759,712
February 2009	US\$675,000	1.1255	C\$759,712
March 2009	US\$675,000	1.1255	C\$759,712
April 2009	US\$675,000	1.1255	C\$759,712
May 2009	US\$675,000	1.0882	C\$734,535
June 2009	US\$675,000	1.0595	C\$715,162
July 2009	US\$675,000	1.0625	C\$717,187
August 2009	US\$675,000	1.0560	C\$712,800
September 2009	US\$675,000	1.0010	C\$675,675
October 2009	US\$675,000	0.9315	C\$628,762
November 2009	US\$675,000	0.9901	C\$668,317
December 2009	US\$675,000	1.0119	C\$683,032
January 2010	US\$675,000	1.0450	C\$705,375
February 2010	US\$675,000	1.0272	C\$693,360
March 2010	US\$675,000	1.0190	C\$687,825
April 2010	US\$675,000	1.0110	C\$682,425
May 2010	US\$675,000	0.9875	C\$666,563
June 2010	US\$675,000	1.0119	C\$683,033

The fair value of the 24 monthly currency contracts covering the period July 2008 to June 2010 has been reflected in the financial statements and represents a current asset of \$0.7 million, a long-term asset of \$0.1 million, and a long-term liability of \$0.1 million as at June 30, 2008.

As discussed previously in sections 2.0 and 4.1, effective July 2008, monthly distributions were reduced to \$0.025 per unit. It is intended that the monthly distribution of \$0.025 per unit will be funded primarily from cash flows generated from Canadian subsidiary operations of the Fund, and little or no cash flows will be converted from the Fund's US subsidiaries to pay distributions until such time as sales demand and associated business results for the Fund's US subsidiaries improve. Accordingly, the Fund does not intend to purchase additional foreign exchange contracts until the amount and timing of resumption of distributions from the Fund's US subsidiaries are known. Additionally, the Fund is investigating in the third quarter of 2008 realizing upon the existing 24 currency contracts above, which are no longer hedging the conversion of anticipated US dollar cash flows, and collectively represent a net \$0.7 million asset to the Fund.

6.0 Related Party Transactions

Related parties refers to affiliates of the previous owners of the Business who have retained a 20% interest in Hardwoods through ownership of Class B Hardwoods LP units and Class B Hardwoods USLP units, respectively. For the three months ended June 30, 2008, sales of \$0.1 million were made to related parties, and the subsidiaries of the Fund purchased \$24,000 from related parties. For the six months ended June 30, 2008, sales of \$0.2 million were made to related parties, and the subsidiaries of the Fund purchased \$41,000 from related parties. These sales and purchases took place at prevailing market prices. Subsidiaries of the Fund also paid \$27,000 in the second quarter and \$54,000 in the six months ended June 30, 2008 to related parties to provide services for management information systems.

7.0 Critical Accounting Estimates and Adoption of Changes in Accounting Policies

7.1 Critical Accounting Estimates

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

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

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

Valuation of Other Intangible Assets and Goodwill: Other intangible assets represent customer relationships acquired at the time of our IPO and are recorded at cost, less accumulated amortization. Amortization is provided for on a straight line basis over 15 years. Goodwill is recorded at cost and is not amortized. Management reviews the carrying value of goodwill and

of other intangible assets annually, or more frequently if events or changes in circumstances indicate that an asset may be impaired. An excess of carrying value over fair value is charged to income in the period in which the impairment is determined.

Future Income Taxes: In response to the Canadian federal government's legislation to tax publicly traded income trusts, which was substantively enacted in the second quarter of 2007, the Fund is now required to recognize the value of future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Management is required to make estimates and assumptions regarding future business results as well as the amount and timing of certain future discretionary tax deductions available to the Fund. These management estimates and assumptions can have a material impact upon the amount of future income tax assets and liabilities that are recognized by the Fund.

All significant accounting policies have been included in note 2 to the consolidated audited financial statements of the Fund for the year ended December 31, 2007.

7.2 Adoption of Changes in Accounting Policies

In the second quarter of 2008 the Canadian Accounting Standards Board confirmed January 1, 2011, as the date International Financial Reporting Standards (“IFRS”) will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles (Canadian GAAP) for public companies. Changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect the Fund’s reported financial position and results of operations. It may also affect certain business functions. The Fund has adopted an IFRS changeover plan. It is expected that the Fund’s changeover plan will be modified and updated as the Fund proceeds through the changeover process. Key elements of the Fund’s present changeover plan include:

Year	Key Activities
2008	Complete IFRS education and training with Hardwoods accounting staff. Identify an IFRS project manager. Determine intended use of outside consultants, if any. Analyze differences between Fund accounting policies and IFRS. Make preliminary selections of IFRS accounting policies. Identify one-time elective exemptions available on initial IFRS adoption.
2009	Identify the information required to deliver the preliminary selections of IFRS accounting policies. Identify system changes (accounting, policies, procedures, information technology) required to get that information. Develop a master conversion plan for changes identified. Adopt formal project plan. Automate and test data collection. Identify and address the impact of changes IFRS makes to the Fund’s business drivers, including debt covenants, incentive plans, and management reporting, budgeting, and other items. Link IFRS to CEO/CFO certification processes and update certification documentation. Estimate anticipated impacts of IFRS adoption on the Fund’s financial statements.
2010	Commence IFRS accounting to provide comparative figures for 2011 IFRS startup date. Prepare IFRS communication plan for stakeholders.
2011	Commence IFRS reporting.

Effective January 1, 2008, the Fund adopted four new Canadian Institute of Chartered Accountants (“CICA”) accounting standards: (a) Handbook Section 1535, Capital Disclosures; (b) Handbook Section 3031, Inventories; (c) Handbook Section 3862, Financial Instruments - Disclosures; and Handbook Section 3863, Financial Instruments - Presentation. The main requirements of these new standards and the resulting financial statement impact are described below.

(a) Capital Disclosures (Section 1535):

CICA Section 1535 requires disclosure of: (i) an entity’s objectives, policies and process for managing capital; (ii) quantitative data about what the entity considers as capital; (iii) whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. Refer to note 4 of the Interim Financial Statements for additional disclosures.

(b) Inventories (Section 3031):

CICA Section 3031 provides significantly more guidance on the measurement of inventories, with an expanded definition of cost and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition the section has additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory write-downs. Refer to note 5 Interim Financial Statements for additional disclosures.

Consistent with the transitional rules for Section 3031, the Fund has not restated any prior period amounts as a result of adopting the accounting changes. As allowed under the transition rules, the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policy related to inventory. The adoption of this new standard resulted in a decrease in the carrying value of opening inventory of \$317,000, a decrease in non-controlling interests of \$62,000, and an increase in deficit of \$255,000 on the balance sheet at January 1, 2008, to reflect trade discounts from suppliers for inventory purchases that previously had been recognized in earnings when received.

(c) Financial Instruments – Disclosures (Section 3862) and Financial Instruments - Presentation (Section 3863):

CICA Section 3032 and 3063 replaces CICA Handbook Section 3861, Financial Instruments – Disclosures and Presentation, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the entity is exposed and how it manages those risks. Refer to note 6 for additional disclosures.

Effective January 1, 2009, the Fund will adopt new CICA Handbook Section 3064, *Goodwill and Intangible Assets*. This section replaces CICA Handbook Section 3062, *Goodwill and Intangible Assets*, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Fund is still evaluating the impact of this standard on its consolidated 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 17, 2008, which is available to readers at www.sedar.com.

The development and introduction of import products into our sales mix continues to be a key strategic focus. In the year ended December 31, 2007, our import business comprised approximately \$40 million of our annual sales, with substantially all of this product originating from China. Several factors arose in 2007 that could impair or reduce the economic attractiveness of trade with China or other foreign jurisdictions, and therefore represent a risk to our import business. Two items discussed below represent updates or changes to the trade risks discussion provide in our Annual Information Form.

(1) On February 2, 2007, the United States Trade Representative (“USTR”) filed a World Trade Organization (“WTO”) subsidies case against China which specifically identifies examination of the practices of the Chinese hardwood plywood industry. In March and June of 2007 consultations were held with China in accordance with WTO procedures, but discussions did not result in resolution of the USTR’s concerns. On August 31, 2007, the Dispute Settlement Body of the WTO agreed to establish a dispute settlement panel to assess alleged subsidies provided to China that may violate WTO rules. On December 19, 2007, China and the United States informed the WTO that they had reached an agreement in relation to this dispute, in the form of a

memorandum of understanding. Accordingly, this previously identified trade action is now considered resolved.

(2) On August 1, 2007, legislation titled the *Combat Illegal Logging Act of 2007* was introduced in the United States to amend the US *Lacey Act*. The *Lacey Act* currently regulates US trade in fish and wildlife, but under the proposed amendment would be extended to cover timber and timber products. The originally proposed amendments to the *Lacey Act* would have imposed potentially significant additional costs upon wood products importers to satisfy themselves through due diligence that wood they purchase from foreign mills originated from a legally harvested source. On May 28, 2008 the Farm Bill was adopted by Congress which included a modified version of the terms of the *Combat Illegal Logging Act of 2007*. The modified version adopted by Congress included significantly enhanced terms to protect innocent importers of wood products that practice due diligence in their purchasing practices. The burden of proof in civil forfeiture cases related to illegally harvested timber products was shifted onto government, rather than imposing potentially costly reporting requirements onto import businesses, and therefore resolving the key concern identified with the original legislative proposal.

9.0 Internal Control over Financial Reporting

During the three months ended June 30, 2008 no changes were made in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

10.0 Quarterly Financial Information

(in thousands of dollars)	Q2 2008		Q1 2008		Q4 2007		Q3 2007		Q2 2007		Q1 2007		Q4 2006		Q3 2006	
Total sales	\$	66,488	\$	71,048	\$	68,767	\$	81,878	\$	89,400	\$	91,720	\$	83,120	\$	90,974
Net earnings ⁽¹⁾	\$	(33,716)	\$	9,529	\$	2,115	\$	4,698	\$	4,800	\$	4,006	\$	(4,826)	\$	2,656
Basic and fully diluted earnings (loss) per Class A Unit ⁽¹⁾	\$	(2.340)	\$	0.661	\$	0.147	\$	0.326	\$	0.333	\$	0.278	\$	(0.335)	\$	0.184
EBITDA	\$	3,091	\$	2,913	\$	3,112	\$	6,411	\$	6,350	\$	5,387	\$	4,088	\$	6,727
Distributable Cash	\$	2,427	\$	3,271	\$	3,205	\$	5,211	\$	4,868	\$	3,997	\$	3,714	\$	4,921
Total distributions to Class A and Class B Units	\$	3,242	\$	3,242	\$	3,243	\$	3,086	\$	3,086	\$	2,940	\$	2,940	\$	2,940
Payout ratio		133.6%		99.1%		101.2%		59.2%		63.4%		73.6%		79.2%		59.7%

¹ Quarterly net earnings and basic and fully diluted earnings per Class A Unit for 2007 have been restated to reflect an adjustment to the non-controlling interest's share of earnings resulting from the Fund's subordination feature, further discussion of which is provided in section 3.1 of the Fund's Annual Report and in the consolidated audited financial statements of the Fund dated December 31, 2007. The impact of the adjustment is to increase net earnings by \$1.5 million in Q1 2007, \$0.7 million in Q2 2007 and \$0.6 million in Q3 2007. The adjustment has no impact on the Fund's EBITDA, cash flow from operations, or distributable cash for any period presented.

The table above provides selected quarterly financial information for the eight most recently completed fiscal quarters of the Fund. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in our opinion, necessary to present a fair statement of the results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of future performance. Historically, the first and fourth quarters have been seasonally slower periods for our business. In addition, net earnings reported in each quarter may be impacted by changes to the foreign exchange rate of the Canadian and US dollar, write-downs in the carrying value of goodwill and other intangible assets (which occurred in the three months ended December 31, 2006, and in the three months ended June 30, 2008), and gains or losses on foreign currency contracts which are described under Financial Instruments in section 5.0 of this report.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

	June 30, 2008	December 31, 2007
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,234	\$ 295
Accounts receivable (note 6(c))	38,195	36,474
Income tax recoverable	1,902	1,041
Inventory (note 5)	30,080	38,400
Prepaid expenses	1,405	1,060
Foreign currency contracts (note 7)	706	1,533
	73,522	78,803
Long-term receivables (note 6(c))	3,989	2,191
Property, plant and equipment	2,276	2,413
Deferred financing costs	16	21
Foreign currency contracts (note 7)	136	528
Future income taxes	23,892	-
Intangible assets (note 8)	3,297	9,013
Goodwill (note 8)	17,477	80,758
	\$ 124,605	\$ 173,727
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 9)	\$ 23,620	\$ 25,515
Accounts payable and accrued liabilities	6,461	6,950
Distribution payable to Unitholders	1,081	1,081
	31,162	33,546
Foreign currency contracts (note 7)	136	47
Deferred gain on sale - leaseback of land and building	516	538
Non-controlling interests (note 10)	16,065	30,068
Future income taxes	-	3,534
Unitholders' equity:		
Fund Units	133,454	133,454
Deficit	(36,821)	(5,895)
Accumulated other comprehensive loss	(19,907)	(21,565)
	76,726	105,994
Subsequent event (note 4)		
Contingencies (note 17)		
	\$ 124,605	\$ 173,727

See accompanying notes to consolidated financial statements.
Approved on behalf of the Trustees:

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

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Earnings (Loss) and Retained Earnings (Deficit)

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
		(Restated - note 9)		(Restated - note 9)
Sales	\$ 66,488	\$ 89,400	\$ 137,536	\$ 181,120
Cost of sales	54,526	72,406	111,938	147,258
Gross profit	11,962	16,994	25,598	33,862
Expenses:				
Selling and administrative	9,225	11,069	20,543	22,819
Amortization:				
Plant and equipment	235	279	474	567
Deferred financing costs	3	3	5	6
Other intangible assets	203	213	405	436
Deferred gain on sale - leaseback of land and building	(18)	(20)	(37)	(42)
Interest	310	625	698	1,334
Foreign currency contracts	(247)	(1,365)	360	(1,465)
Intangibles impairment (note 8)	5,468	-	5,468	-
Goodwill impairment (note 8)	64,606	-	64,606	-
	79,785	10,804	92,522	23,655
Earnings (loss) before non-controlling interests and income taxes	(67,823)	6,190	(66,924)	10,207
Non-controlling interests (note 10)	14,182	(499)	14,590	201
Earnings (loss) before income taxes	(53,641)	5,691	(52,334)	10,408
Income tax expense (recovery) (note 15):				
Current	39	388	(752)	793
Future	(19,964)	503	(27,395)	809
	(19,925)	891	(28,147)	1,602
Net earnings (loss) for the period	(33,716)	4,800	(24,187)	8,806
Retained earnings (deficit), beginning of period (note 3(b))	137	(8,093)	(6,150)	(9,159)
Distributions declared to Unitholders	(3,242)	(3,086)	(6,484)	(6,026)
Deficit, end of period	\$ (36,821)	\$ (6,379)	\$ (36,821)	\$ (6,379)
Basic and diluted earnings (loss) per Unit	\$ (2.34)	\$ 0.33	\$ (1.68)	\$ 0.61
Weighted average number of Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Statement of Comprehensive Income (Loss)

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
		(Restated - note 9)		(Restated - note 9)
Net earnings (loss) for the period	\$ (33,716)	\$ 4,800	\$ (24,187)	\$ 8,806
Other comprehensive income:				
Unrealized gain (loss) on translation of self-sustaining foreign operations	(411)	(5,403)	1,658	(6,049)
Other comprehensive income (loss)	(411)	(5,403)	1,658	(6,049)
Comprehensive income (loss)	\$ (34,127)	\$ (603)	\$ (22,529)	\$ 2,757

Consolidated Statement of Accumulated Other Comprehensive Loss

(Unaudited)

(Expressed in thousands of Canadian dollars)

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
		(Restated - note 9)		(Restated - note 9)
Accumulated other comprehensive loss, beginning of period	\$ (19,496)	\$ (11,826)	\$ (21,565)	\$ (11,180)
Other comprehensive income (loss)	(411)	(5,403)	1,658	(6,049)
Accumulated other comprehensive loss, end of period	\$ (19,907)	\$ (17,229)	\$ (19,907)	\$ (17,229)

HARDWOODS DISTRIBUTION INCOME FUND

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

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
		(Restated - note 9)		(Restated - note 9)
Cash flows provided by (used in) operating activities:				
Net earnings for the period	\$ (33,716)	\$ 4,800	\$ (24,187)	\$ 8,806
Items not involving cash:				
Amortization	422	475	847	967
Imputed interest income in employee loans	(17)	(16)	(31)	(16)
Gain on sale of property, plant and equipment	-	(9)	-	(19)
Mark-to-market adjustment on unrealized foreign currency contracts	108	(940)	1,309	(771)
Non-controlling interests	(14,182)	499	(14,590)	(201)
Future income taxes	(20,037)	273	(27,426)	549
Intangibles impairment	5,468	-	5,468	-
Goodwill impairment	64,606	-	64,606	-
	2,652	5,082	5,996	9,315
Change in non-cash operating working capital (note 11)	5,011	298	4,264	(3,061)
Net cash provided by operating activities	7,663	5,380	10,260	6,254
Cash flows provided by (used in) investing activities:				
Additions to property, plant and equipment	(225)	(214)	(298)	(450)
Proceeds on disposal of property, plant and equipment	-	10	-	21
Increase (decrease) in long-term receivables, net	(303)	818	(116)	1,143
Net cash provided by (used in) investing activities	(528)	614	(414)	714
Cash flows provided by (used in) financing activities:				
Decrease in bank indebtedness	(3,012)	(4,730)	(2,423)	(1,188)
Distributions paid to Unitholders	(3,242)	(3,037)	(6,484)	(5,977)
Net cash used in financing activities	(6,254)	(7,767)	(8,907)	(7,165)
Increase (decrease) in cash	881	(1,773)	939	(197)
Cash, beginning of period	353	2,170	295	594
Cash, end of period	\$ 1,234	\$ 397	\$ 1,234	\$ 397
Supplementary information (cash amounts):				
Interest paid	\$ 310	\$ 625	\$ 698	\$ 1,334
Income taxes paid	43	785	752	791
Transfer of accounts receivable to long- term customer notes receivable, net of write offs, being a non-cash transaction	35	1,135	2,270	1,135

See accompanying notes to consolidated financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

1. Nature of operations:

Hardwoods Distribution Income Fund (the "Fund") is an unincorporated, open ended, limited purpose trust established under the laws of the Province of British Columbia on January 30, 2004 by a Declaration of Trust. The Fund commenced operations on March 23, 2004 when it completed an initial public offering of Units and acquired an 80% interest in a hardwood lumber and sheet goods distribution business in North America (the "Business") from affiliates of Sauder Industries Limited ("SIL"). The Fund holds, indirectly, 80% of the outstanding limited partnership units of Hardwoods Specialty Products LP ("Hardwoods LP") and Hardwoods Specialty Products US LP ("Hardwoods USLP"), limited partnerships established under the laws of the Province of Manitoba and the state of Delaware, respectively.

2. Basis of presentation:

The Fund prepares its consolidated interim financial statements in accordance with Canadian generally accepted accounting principles on a basis consistent with those used and described in the annual consolidated financial statements for the year ended December 31, 2007 except as discussed in note 3. The disclosures contained in these consolidated interim financial statements do not include all the requirements of Canadian generally accepted accounting principles for annual financial statements, and accordingly, these consolidated interim financial statements should be read in conjunction with the annual consolidated financial statements for the period ended December 31, 2007. Certain comparative figures have been restated to conform to the current period's financial statement presentation.

3. Adoption of changes in accounting polices:

Effective January 1, 2008, the Fund adopted four new Canadian Institute of Chartered Accountants ("CICA") accounting standards: (a) Handbook Section 1535, *Capital Disclosures*; (b) Handbook Section 3031, *Inventories*; (c) Handbook Section 3862, *Financial Instruments - Disclosures*; and Handbook Section 3863, *Financial Instruments - Presentation*. The main requirements of these new standards and the resulting financial statement impact are described below.

(a) Capital Disclosures (Section 1535):

CICA Section 1535 requires disclosure of: (i) an entity's objectives, policies and process for managing capital; (ii) quantitative data about what the entity considers as capital; (iii) whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. Refer to note 4 for additional disclosures.

(b) Inventories (Section 3031):

CICA Section 3031 provides significantly more guidance on the measurement of inventories, with an expanded definition of cost and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition the section has additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory write-downs. Refer to note 5 for additional disclosures.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

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

(b) Inventories (Section 3031) (continued):

Consistent with the transitional rules for Section 3031, the Fund has not restated any prior period amounts as a result of adopting the accounting changes. As allowed under the transition rules, the opening deficit has been adjusted to reflect the cumulative impact of adopting the changes in accounting policy related to inventory. The adoption of this new standard resulted in a decrease in the carrying value of opening inventory of \$317,000, a decrease in non-controlling interests of \$62,000, and an increase in deficit of \$255,000 on the balance sheet at January 1, 2008, to reflect trade discounts from suppliers for inventory purchases that previously had been recognized in earnings when received.

The effect of the adoption of Section 3031 is summarized in the following table:

	As at December 31, 2007	Adjustment on adoption of new standards	As at January 1, 2008
Inventories	\$ 38,400	\$ (317)	\$ 38,083
Non-controlling interests	30,068	(62)	30,006
Unitholders equity:			
Deficit	\$ (5,895)	\$ (255)	\$ (6,150)

(c) Financial Instruments – Disclosures (Section 3862) and Financial Instruments - Presentation (Section 3863):

CICA Section 3032 and 3063 replaces CICA Handbook Section 3861, *Financial Instruments – Disclosures and Presentation*, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the entity is exposed and how it manages those risks. Refer to note 6 for additional disclosures.

4. Capital disclosures:

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

	June 30, 2008	December 31, 2007
Cash and cash equivalents	\$ (1,234)	\$ (295)
Bank indebtedness	23,620	25,515
Net debt	22,386	25,220
Unitholders' equity	76,726	105,994
Total capitalization	\$ 99,112	\$ 131,214

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

4. Capital disclosures (continued):

The Fund monitors on a monthly basis the ratio of net debt to earnings before interest, income taxes, depreciation and amortization ("EBITDA"). Net debt to EBITDA serves as an indicator of the Fund's financial leverage. The maximum ratio of net debt to EBITDA allowed under our Canadian credit facility is 2.50 times. The maximum ratio of net debt to EBITDA allowed under our US credit facility is 3.0 times for the period April 1, 2008 to September 29, 2008, and 2.85 times thereafter. Refer to note 9 for additional disclosures.

The terms of the agreements with the Fund's lenders provide that distributions cannot be made to its unitholders in the event that its subsidiaries did not meet the foregoing leverage as well as certain additional credit ratios. After negotiating a temporary adjustment to the US bank covenant (see note 9), our operating subsidiaries were fully compliant with all required credit ratios as at June, 30, 2008, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Distributions are one of the ways the Fund manages its capital. Distributions of the Fund's available cash are made to the maximum extent possible, subject to reasonable reserves established by the Trustees of the Fund. Distributions are made by the Fund having given consideration to a variety of factors including the outlook for the business, financial leverage, and the ratio of distributions to available cash of the Fund. There were no changes in the Fund's approach to capital management during the three and six month periods ended June 30, 2008. On July 31, 2008 the Trustees of the Fund approved a new monthly distribution rate of \$0.025 per Fund Unit, effective with the July 2008 distribution.

5. Inventory:

	June 30, 2008	December 31, 2007
Lumber	\$ 12,649	\$ 15,077
Sheet Goods	12,864	17,884
Specialty	2,976	3,067
Goods in-transit	1,591	2,372
	<hr/>	<hr/>
	\$ 30,080	\$ 38,400

Inventory is valued at lower of cost and net realizable value. Cost is determined using the weighted average cost method and includes invoice cost, duties, freight, and other directly attributable costs of acquiring the inventory.

Volume rebates and other supplier discounts are included in income when earned. Volume discounts and supplier trade discounts are accounted for as a reduction of the cost of the related inventory and are earned when inventory is sold.

During the three months ended June 30, 2008 inventory write-downs totaling \$0.7 million (six months ended June 30, 2008- \$1.3 million) were recorded to reduce certain inventory items to their net realizable value.

Cost of sales for the three months ended June 30, 2008 were \$54.5 million (six months ended June 30, 2008- \$111.9 million), which included \$52.5 million (six months ended June 30, 2008- \$108.5 million) of costs associated with inventory. The other \$2.0 million (six months ended June 30, 2008- \$3.4 million) related principally to freight and other related selling expenses.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments:

Financial instrument assets include cash and cash equivalents, which are designated as held-for-trading and measured at fair value, and current and long-term receivables which are designated as loans and receivables and measured at amortized cost. Financial instrument liabilities include bank indebtedness, accounts payable, accrued liabilities and distributions payable. All financial liabilities are designated as other liabilities and are measured at amortized cost. There are no financial instruments classified as available-for-sale or held-to-maturity. Financial instruments of the Fund also include foreign currency contracts which are derivative financial instruments (note 6(b)) and measured at fair value.

(a) Fair values of financial instruments:

The carrying values of cash and cash equivalents, accounts receivable, income tax recoverable, accounts payable and accrued liabilities and distributions payable approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of long-term receivables is not expected to differ materially from the carrying value. The carrying values of the credit facilities approximate their fair values due to the existence of floating market based interest rates. The foreign currency contracts are carried at market values as disclosed in note 7.

(b) Derivative financial instruments:

The Fund uses foreign currency contracts to assist in forward planning for the business as it relates to managing its exposure to fluctuations in exchange rates between the Canadian dollar and the US dollar. The foreign currency contracts are recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of earnings.

The foreign currency contracts have maturities of less than two years. The counterparty to these contracts is a major US financial institution and the Fund does not anticipate non-performance by the counterparty. Refer to note 7 for additional disclosure.

(c) Financial risk management:

Trustees of the Fund and the Board of Directors of the Fund's subsidiaries have the overall responsibility for the establishment and oversight of the Fund's risk management framework. The Fund's risk management policies are established to identify and analyze the risks faced by the Fund, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and in response to the Fund's activities. Through its standards and procedures management has developed a disciplined and constructive control environment in which all employees understand their roles and obligations. Management regularly monitors compliance with the Fund's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Fund.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments (continued):

(c) Financial risk management (continued):

The Fund has exposure to credit, liquidity and market risks from its use of financial instruments.

(i) Credit risk:

Credit risk is the risk of financial loss to the Fund if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Fund's receivables from customers. Employee housing loans, customer notes and security deposits also present credit risk to the Fund. The credit risk associated with foreign currency contracts is addressed in note 6(b).

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

	June 30, 2008	December 31, 2007
Accounts receivable		
Trade accounts receivable - Canada	\$ 12,322	\$ 11,086
Trade accounts receivable - United States	26,484	25,131
Sundry receivable	428	645
Current portion of long-term receivables	1,309	658
	40,543	37,520
Less: allowance for doubtful accounts	2,348	1,046
	\$ 38,195	\$ 36,474

	June 30, 2008	December 31, 2007
Long-term receivables		
Employee housing loans	\$ 1,451	\$ 1,130
Customer notes	3,261	1,166
Security deposits	587	553
	5,299	2,849
Less: current portion, included in accounts receivable	1,309	658
	\$ 3,990	\$ 2,191

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments (continued):

(c) Financial risk management (continued):

(i) Credit risk (continued):

Trade accounts receivable:

The Fund's exposure to credit risk is influenced mainly by individual characteristics of each customer. The Fund is exposed to credit risk in the event it is unable to collect in full amounts receivable from its customers. The Fund employs established credit approval practices and engages credit attorneys when appropriate to mitigate the credit risk. It is the Fund's policy to secure credit advanced to customers whenever possible by registering security interests in the assets of the customer and by obtaining personal guarantees. Credit limits are established for each customer and are regularly reviewed. In some instances the Fund may choose to transact with a customer on a cash-on-delivery basis. Our largest individual customer balance amounted to 5.5% of trade accounts receivable and customer notes receivable at June 30, 2008.

The aging of trade receivables was:

	June 30, 2008	December 31, 2007
Current	\$ 22,958	\$ 20,245
Past due 31-60 days	7,545	8,345
Past due 61-90 days	3,064	3,453
Past due 90+ days	5,239	4,174
	\$ 38,806	\$ 36,217

The Fund determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectable are written off. The total allowance at June 30, 2008 was \$2.3 million (December 31, 2007- \$1.0 million). The amount of the allowance is considered sufficient based on the past experience of the business, the security the Fund has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

Bad debt expense for the three months ended June 30, 2008 was \$0.5 million which equates to 0.8% of sales. For the six months ended June 30, 2008 bad debt expense was \$1.0 million which equates to 0.7% of sales. Historically bad debt as a percentage of sales has averaged approximately 0.5%.

Employee housing loans:

Employee loans are non-interest bearing and are granted to employees who are relocated. Employee loans are secured by a deed of trust or mortgage depending upon the jurisdiction. Employees are required to make an annual payment from their profit share. These loans are measured at their fair market value upon granting the loan and subsequently measured at amortized cost.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments (continued):

(c) Financial risk management (continued):

(i) Credit risk (continued):

Customer notes:

Customer notes are issued to certain customers to provide fixed repayment schedules for amounts owing that have been agreed will be repaid over longer periods of time. The terms of each note are negotiated with the customer. For notes issued the Fund requires a fixed payment amount, personal guarantees, general security agreements, and in some cases security over specific property or assets. Customer notes bear market interest rates ranging from 8%-18%.

Security deposits:

Security deposits are recoverable on leased premises at the end of the lease terms with which it relates to. The Fund does not believe there is any material credit risk associated with its security deposits.

(ii) Liquidity risk:

Liquidity risk is the risk that the Fund will not be able to meet its financial obligations as they fall due. The Fund's approach to managing liquidity is to ensure that it will have sufficient cash available to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Fund's reputation. In Canada, a subsidiary of the Fund has a revolving credit facility of up to an aggregate amount of \$22.0 million. In the US, a subsidiary of the Fund has a revolving credit facility of up to an aggregate amount of \$35.9 million (US\$35.0 million) less the net exposure under the foreign currency contracts facility as described in note 7. These credit facilities can be drawn down to meet short-term financing requirements, including fluctuations in non-cash working capital. The amount made available under the revolving credit facilities from time to time is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund. At June 30, 2008 the Canadian and US credit facilities have \$10.5 million and \$7.4 million (US\$7.3million), respectively of available borrowing capacity. Refer to note 9 for additional disclosure.

(iii) Market risk:

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates, and commodity prices will affect the Fund's net earnings or value of its holdings of financial instruments.

Interest rate risk:

The Fund is exposed to interest rate risk on its credit facilities which bear interest at floating market rates.

Based upon June 30, 2008 bank indebtedness balance of \$23.6 million, a 1% increase or decrease in the interest rates charged will result in decrease or increase to annual net earnings by \$0.2 million.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments (continued):

(c) Financial risk management (continued):

(iii) Market risk (continued):

Currency risk:

As the Fund conducts business in both Canada and the United States it is exposed to currency risk. Most of the hardwood lumber sold by the Fund in Canada is purchased in US dollars from suppliers in the United States. Although the Fund reports its financial results in Canadian dollars, approximately two-thirds of its sales are generated in the United States. Changes in the currency exchange rates of the Canadian dollar against the US dollar will affect the results presented in the Fund's financial statements and cause its earnings to fluctuate. In addition, while changes in the costs of hardwood lumber purchased by the Fund in the United States as a result of the appreciation of the Canadian dollar against the US dollar are usually absorbed by the Canadian market, when the hardwood lumber is resold in Canada it is generally sold at a lower Canadian dollar equivalent selling price, and accordingly revenues in Canada are effectively reduced. Increases in the value of the Canadian dollar against the US dollar will affect the amount of cash available to the Fund for distribution to its Unitholders.

The Fund maintains foreign currency contracts to mitigate the potential impact of foreign exchange on Canadian dollar distributions to be made by it. These contracts do not eliminate the Fund's exposure to fluctuations in the exchange rate between the Canadian dollar and the US dollar.

The foreign currency contracts allow the Fund to determine in advance, for the period and amount covered by the contracts, the rates of exchange that will be realized when translating into Canadian dollars that portion of distributable cash contributed by our United States operation.

At June 30, 2008 the Fund's Canadian subsidiaries exposure to foreign denominated working capital financial instruments was in relation to bank indebtedness (US\$ nil), accounts receivable from US customers (US\$0.2 million), income taxes recoverable (US\$1.9 million), and accounts payable to US suppliers (\$0.3 million). A subsidiary of the Fund is also exposed to foreign currency risk in relation to the outstanding foreign currency contracts described in note 7.

Based on the Fund's exposure to foreign denominated financial instruments, the Fund estimates a \$0.05 strengthening in the Canadian dollar as compared to the US dollar would have increased net earnings for the quarter ended June 30, 2008 by approximately \$0.4 million. A \$0.05 weakening of the Canadian dollar as compared to the US dollar would have had the equal but opposite effect.

This foreign currency sensitivity is focused solely on the currency risk associated with Fund's Canadian subsidiaries exposure to foreign denominated financial instruments as at June 30, 2008 and does not take into account the effect of a change in currency rates will have on the translation of the balance sheet and operations of the Fund's US subsidiaries nor is it intended to estimate the potential impact changes in currency rates would have on the Fund's sales and purchases.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

6. Financial instruments (continued):

(c) Financial risk management (continued):

(iii) Market risk (continued):

Commodity price risk:

The Fund does not enter in to any commodity contracts. Inventory purchases are transacted at current market rates based on expected usage and sale requirements and increases or decreases in prices are reflected the Fund's selling prices to customers.

7. Foreign currency contracts:

At June 30, 2008 a subsidiary of the Fund held foreign currency contracts covering the period 24 months into the future with terms as follows:

Month	Sell US dollars	Contract Exchange rate (\$Cdn / \$US)	Receive Canadian dollars
2008			
July	US\$675,000	1.1255	Cdn\$759,712
August	US\$675,000	1.1255	Cdn\$759,712
September	US\$675,000	1.1255	Cdn\$759,712
October	US\$675,000	1.1255	Cdn\$759,712
November	US\$675,000	1.1255	Cdn\$759,712
December	US\$675,000	1.1255	Cdn\$759,712
2009			
January	US\$675,000	1.1255	Cdn\$759,712
February	US\$675,000	1.1255	Cdn\$759,712
March	US\$675,000	1.1255	Cdn\$759,712
April	US\$675,000	1.1255	Cdn\$759,712
May	US\$675,000	1.0882	Cdn\$734,535
June	US\$675,000	1.0595	Cdn\$715,162
July	US\$675,000	1.0625	Cdn\$717,187
August	US\$675,000	1.0560	Cdn\$712,800
September	US\$675,000	1.0010	Cdn\$675,675
October	US\$675,000	0.9315	Cdn\$628,762
November	US\$675,000	0.9901	Cdn\$668,317
December	US\$675,000	1.0119	Cdn\$683,032
2010			
January	US\$675,000	1.0450	Cdn\$705,375
February	US\$675,000	1.0272	Cdn\$693,360
March	US\$675,000	1.0190	Cdn\$687,825
April	US\$675,000	1.0110	Cdn\$682,425
May	US\$675,000	0.9875	Cdn\$666,563
June	US\$675,000	1.0119	Cdn\$683,033

The fair value of the 24 monthly currency contracts covering the period July 2008 to June 2010 have been reflected in the financial statements and represent a current asset of \$706,000, a long-term asset of \$136,000 and a long-term liability of \$136,000 at June 30, 2008. The fair values were determined based on valuations obtained from the counter-party.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

8. Intangible assets and goodwill

Long lived assets, including intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of intangible assets is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount for the intangibles exceeds its estimated future cash flows, an impairment charge is recognized by the amount that the carrying amount for the asset exceeds its fair value. Other intangible assets represent customer relationships acquired by the Fund at the time of the business combination described in note 1.

The carrying value of goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. Any excess of carrying value over fair value is charged to income in the period in which the impairment is determined. The fair value of the goodwill was determined with reference to the present value of future cash flows.

In the first six months of 2008, the Business experienced a significant change in circumstances in the form of reduced sales demand for its products, and a resulting decline in its net earnings. This change of circumstance caused management to reduce its expectations for future cash flows from the Fund's US and Canadian subsidiary operations. Consequently, during the quarter ended June 30, 2008, management reviewed for impairment the carrying value of intangible assets and the carrying value of goodwill. Results of testing indicated impairment in the carrying value of intangible assets in the Fund's US reporting unit of \$5.5 million (US\$5.4 million). Testing also indicated impairment in the carrying value of goodwill in the Fund's US reporting unit of \$47.6 million (US\$46.7 million), and in the Fund's Canadian reporting unit of \$17.0 million.

9. Bank indebtedness:

	June 30, 2008	December 31, 2007
Checks issued in excess of funds on deposit	\$ 810	\$ 1,034
Credit facility, Hardwoods LP	5,184	5,538
Credit facility, Hardwoods USLP (June 30, 2008 – US\$17,286; December 31, 2007 - US\$19,109)	17,626	18,943
	\$ 23,620	\$ 25,515

During the quarter ended June 30, 2008, the Fund negotiated an amendment to the financial covenants governing the bank indebtedness of a US operating facility of the Fund. The amendment, which was effective April 1, 2008, temporarily reduced the minimum fixed charge coverage ratio and increased the maximum funded debt coverage ratio permitted under the terms of the US subsidiary's loan agreement. The amendment is effective until September 29, 2008, at which time the financial covenants revert back to their original amounts. Absent of this amendment, the Fund's US subsidiary would have been in violation of its fixed charge coverage ratio at June 30, 2008.

The Fund is currently negotiating with its US bank to make changes to its US revolving credit facility, as without modifications it is likely that the Fund's US subsidiary will not be in compliance with its covenants at its next financial reporting date of September 30, 2008. Under the terms of the US subsidiary's loan agreement, non-compliance with a covenant may result in the bank demanding immediate repayment of all indebtedness under the revolving credit facility.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

10. Non-controlling interests:

Balance, January 1, 2008 (note 3(b))	\$ 30,006
Interest in earnings:	
Interest in earnings before taxes	(13,385)
Adjustment to non-controlling interest from subordination of Class B Unit Holders	(1,205)
	(14,590)
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP	649
Balance, end of period	\$ 16,065

The previous owners of the Business (note 1) have retained a 20% interest in Hardwoods LP and Hardwoods USLP through ownership of Class B Hardwoods LP units ("Class B LP Units") and Class B Hardwoods USLP units ("Class B USLP Units"), respectively. The Fund owns an indirect 80% interest in Hardwoods LP and Hardwoods USLP through ownership of all Class A Hardwoods LP units ("Class A LP Units") and Class A Hardwoods USLP units ("Class A USLP Units"), respectively.

The Class A LP Units and Class B LP Units and the Class A USLP Units and Class B USLP Units, respectively, have economic and voting rights that are equivalent in all material respects except distributions on the Class B LP Units and Class B USLP Units are subject to the subordination arrangements described below until the date (the "Subordination End Date") on which:

- the consolidated Adjusted EBITDA, as defined in the Subordination Agreement dated March 23, 2004, of the Fund for the 12 month period ending on the last day of the month immediately preceding such date is at least \$21,300,000; and
- cash distributions of at least \$29,540,000 (\$2.05 per Unit) have been paid on the Units and a combined amount of cash advances or distributions of at least \$7,385,000 has been paid on the Class B LP Units and Class B USLP Units, being \$2.05 per combined Class B LP and Class B USLP Units (as adjusted for issuances, redemptions and repurchases of Units, LP Units and USLP Units subsequently and by converting the cash distributions or advances by Hardwoods USLP on the USLP Units at the rate of exchange used by the Fund to convert funds received by it in US dollars into Canadian dollars) for the 24 month period ending on the last day of the month immediately preceding such date.

The Subordinated End Date had not occurred at June 30, 2008.

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

- At the end of each month, cash advances or distributions will be made to the holders of Class A LP Units and Class A USLP Units in a combined amount that is sufficient to provide available cash to the Fund to enable the Fund to make cash distributions upon the Units for such month at least equal to \$0.08542 per Unit or, if there is insufficient available cash to make distributions or advances in such amount, such lesser amount as is available as determined by the board of directors of the general partners;
- At the end of each fiscal quarter of Hardwoods LP and Hardwoods USLP, including the fiscal quarter ending on the fiscal year end, available cash of Hardwoods LP and Hardwoods USLP will be advanced or distributed in the following order of priority:
 - First, in payment of the monthly cash advance or distribution to the holders of Class A LP Units and Class A USLP Units as described above, for the month then ended;

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

10. Non-controlling interests (continued):

- Second, to the holders of Class A LP Units and Class A USLP Units, to the extent that the combined monthly cash advances or distributions in respect of the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on Class A LP Units and Class A USLP Units were not made or were made in amounts less than a combined amount at least equal to \$1.025 per Unit, the amount of any such deficiency. As of June 30, 2008, the amount of such deficiency was \$2.0 million;
- Third, to the holders of Class B LP Units and Class B USLP Units in a combined amount for one Class B LP Unit and one Class B USLP Unit equal, on a pro-rated basis, to the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter or, if there is insufficient available cash to make advances or distributions in such amount, such lesser amount as is available;
- Fourth, to the holders of Class B LP Units and Class B USLP Units, to the extent only that combined advances or distributions in respect of any fiscal quarter(s) during the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on one Class B LP Unit and one Class B USLP Unit were not made, or were made in amounts less, on a pro-rated basis, that the combined amount advanced or distributed on one Class A LP Unit and one Class A USLP Unit during such 12 month period, the amount of such deficiency. As of June 30, 2008, the amount of such deficiency was \$3.2 million.
- Fifth, to the extent of any excess, to the holders of the Class A LP Units and Class B LP Units and Class A USLP Units and Class B USLP Units, respectively, so that the combined advances or distributions on one Class A LP Unit and one Class A USLP Unit are the same as the combined advances or distribution on one Class B LP Unit and one Class B USLP Unit in respect of the 12 month period then ended (and not, for greater certainty, any previous 12 month period).

After the Subordination End Date, the holders of the Class B LP Units and Class B USLP Units will generally be entitled to effectively exchange all or a portion of their Class B LP Units and Class B USLP Units together for up to 3,602,500 Units of the Fund, representing 20% of the issued and outstanding Units of the Fund on a fully diluted basis. In the event the Fund enters into an agreement in respect of an acquisition or a take-over bid of the Fund, the holders of the Class B LP Units and Class B USLP Units will be entitled to exchange such units for Units of the Fund.

The cumulative deficiency prior to June 30, 2007, which is no longer recoverable by the Class B LP Unitholders and the Class B USLP Unitholders, has been recorded as an adjustment to the non-controlling interest's share of earnings in the amount of \$0.6 million for the three-month period, and \$1.2 million for the six month period, ended June 30, 2008. This adjustment was first recorded during the fourth quarter of 2007, resulting in a reduction of the non-controlling interest's share of earnings of \$3.4 million for the year ended December 31, 2007. Of the amount recorded in 2007, \$1.5 million should have been recorded in the first quarter of 2007 and \$0.7 million should have been recorded in the second quarter of 2007 and as such the comparative amounts presented in the statements of earnings and retained earnings (deficit) and comprehensive income have been restated accordingly, resulting in an increase in net earnings and comprehensive income from the amounts previously reported.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

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

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Accounts receivable	\$ 927	\$ (2,162)	\$ (2,577)	\$ (6,652)
Income taxes recoverable/payable	(1)	(491)	(858)	2
Inventory	5,395	1,211	8,638	2,666
Prepaid expenses	(585)	(279)	(327)	(198)
Accounts payable and accrued liabilities	(725)	2,019	(612)	1,121
	\$ 5,011	\$ 298	\$ 4,264	\$ (3,061)

CICA 1540, *Cash Flow Statements*, require entities to disclose total cash distributions on financial instruments classified as equity in accordance with a contractual agreement and the extent to which total cash distributions are non-discretionary. The Fund has no contractual requirement to pay cash distributions to Unitholders' of the Fund. During the three month period ended June 30, 2008 \$3.2 million (2007 - \$3.0 million) in discretionary cash distributions were paid to Unitholders. During the six month period ended June 30, 2008 \$6.5 million (2007 - \$6.0 million) in discretionary cash distributions were paid to Unitholders.

12. Segment disclosure:

Information about geographic areas is as follows:

	Three months ended June 30, 2008	Three months ended June 30, 2007	Six months ended June 30, 2008	Six months ended June 30, 2007
Revenue from external customers:				
Canada	\$ 23,464	\$ 28,329	\$ 48,103	\$ 55,255
United States	43,024	61,071	89,433	125,865
	\$ 66,488	\$ 89,400	\$ 137,536	\$ 181,120

	June 30, 2008	December 31, 2007
Property, plant and equipment:		
Canada	\$ 883	\$ 1,003
United States	1,393	1,410
	\$ 2,276	\$ 2,413
Goodwill		
Canada	\$ 17,477	\$ 34,477
United States	-	46,281
	\$ 17,477	\$ 80,758

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

13. Pensions:

Hardwoods USLP maintains a defined contribution 401 (k) retirement savings plan (the "USLP Plan"). The assets of the USLP Plan are held and related investment transactions are executed by the Plan's Trustee, ING National Trust, and, accordingly, are not reflected in these consolidated financial statements. During the three months ended June 30, 2008, Hardwoods USLP contributed and expensed \$72,545 (US\$72,012) (three months ended June 30, 2007 - \$84,376 (US\$76,803)) in relation to the USLP Plan. During the six months ended June 30, 2008, Hardwoods USLP contributed and expensed \$216,923 (US\$215,330) (six months ended June 30, 2007 - \$240,663 (US\$212,037)) in relation to the USLP Plan.

Hardwoods LP does not maintain a pension plan. Hardwoods LP does, however, administer a group registered retirement savings plan ("LP Plan") that has a matching component whereby Hardwoods LP makes contributions to the LP Plan which match contributions made by employees up to a certain level. The assets of the LP Plan are held and related investment transactions are executed by LP Plan's Trustee, Sun Life Financial Trust Inc., and, accordingly, are not reflected in these consolidated financial statements. During the three months ended June 30, 2008, Hardwoods LP contributed and expensed \$60,775 (three months ended June 30, 2007 - \$52,629) in relation to the LP Plan. During the six months ended June 30, 2008, Hardwoods LP contributed and expensed \$176,969 (six months ended June 30, 2007 - \$143,504) in relation to the LP Plan.

14. Related party transactions:

For the three months ended June 30, 2008, sales of \$108,048 (three months ended June 30, 2007 - \$153,459) were made to affiliates of SIL, and the Fund made purchases of \$24,143 (three months ended June 30, 2007 - \$39,669) from affiliates of SIL. For the six months ended June 30, 2008, sales of \$235,123 (six months ended June 30, 2007 - \$374,128) were made to affiliates of SIL, and the Fund made purchases of \$40,628 (six months ended June 30, 2007 - \$160,261) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the three months ended June 30, 2008, the Fund paid \$27,000 (three months ended June 30, 2007 - \$27,000) to affiliates of SIL under the terms of an agreement to provide services for management information systems. During the six months ended June 30, 2009, the Fund paid \$54,000 (six months ended June 30, 2007 - \$54,000) to affiliates of SIL under the terms of an agreement to provide transitional services for management information systems. This cost is included in the selling and administrative expense in the statement of earnings.

15. Income taxes:

Effective, March 31, 2008 the Fund completed an internal reorganization that involved the refinancing of inter-corporate debt in the form of notes issued and held by subsidiaries of the Fund. The reorganization does not have any effect upon the management or business activities of the Fund's operating subsidiaries. As a result of the internal re-organization, income tax losses arose of approximately, US\$10.3 million which are available to reduce US taxable income. Based on statutory income tax rates in effect for the Fund's US subsidiary, this amounts to an estimated \$3.6 million tax benefit available to subsidiaries of the Fund. This \$3.6 million benefit was recorded at March 31, 2008 and is comprised of an estimated \$0.8 million current income tax recovery and \$2.8 million future income tax recovery.

In addition, during the quarter ending March 31, 2008, tax pools consisting principally of Canadian tax loss carry forward, of approximately \$16.0 million have been recorded by a subsidiary of the Fund as a result of the Fund's re-organization plan. The tax loss carry forwards will result in a reduction of tax otherwise payable under the Canadian federal government's tax on publicly traded income trusts. Based on tax rates expected to apply at the date such tax pools will be utilized, and additional \$4.2 million of future income tax benefit was recorded by the Fund at March 31, 2008.

HARDWOODS DISTRIBUTION INCOME FUND

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts expressed in thousands of Canadian dollars)

For the periods ended June 30, 2008 and 2007

15. Income taxes (continued):

During the quarter ended June 30, 2008, the Company recorded a future tax asset of approximately \$20.1 million as a result of the write-down of the goodwill and intangible assets. Goodwill and intangible assets remain deductible for Canadian and U.S. tax purposes.

16. Seasonality:

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

17. Contingencies:

The Fund and its subsidiaries are subject to legal proceedings that arise in the ordinary course of its business. Management is of the opinion, based upon information presently available, that it is unlikely that any liability, to the extent not provided for through insurance or otherwise, would be material in relation to the Fund's consolidated financial statements.

18. Future Accounting Changes

(a) International Financial Reporting Standards

The CICA will transition Canadian generally accepted accounting principles ("GAAP") for publicly accountable entities to International Financial Reporting Standards ("IFRS"). The Fund's consolidated financial statements are to be prepared in accordance with IFRS for the fiscal year commencing January 1, 2011. The impact of the transition to IFRS on the Fund's consolidated financial statements has not been determined.

(b) Goodwill and Intangible Assets

Effective January 1, 2009, the Fund will adopt new CICA Handbook Section 3064, Goodwill and Intangible Assets. This section replaces CICA Handbook Section 3062, Goodwill and Intangible Assets, and establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Fund is still evaluating the impact of this standard on its consolidated financial statements.

Unitholder Information

Trustees

R. Keith Purchase

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

R. Keith Purchase

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Vice Chair, Sauder Industries

William Sauder
Vice President, Sauder Industries

Officers

Maurice E. Paquette
President & Chief Executive Officer

Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California Region

Garry W. Warner
Vice President, Northwestern Region

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