HARDWOODS DISTRIBUTION

INCOME FUND

2006

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) at $10 per unit. Net proceeds of the IPO were used to acquire an 80% interest in a hardwoods lumber and sheet goods distribution business ("Hardwoods" or the "Business") from the previous owners. The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund's operating subsidiaries ("Class B Units"), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives.

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

About the Business

Hardwoods has been providing quality lumber, hardwood plywood and specialty products to customers for over 45 years. People love hardwood and find many different ways to bring it into their lives. We sell hardwood lumber and sheet goods to industrial customers that use it to manufacture a wide variety of wood products. Whether in kitchen cabinets, doors and mouldings, furniture, or custom interior millwork, consumers place a higher value on products crafted from real wood. It's a preference that doesn't change with the whims of fashion. Demand for hardwood has remained remarkably stable decade after decade, in part because hardwood has no real substitute. There's a warmth to the look and touch of hardwood that no other material can match.

Today, we are one of the largest distributors of hardwood lumber and sheet goods in North America. Headquartered in Langley, British Columbia, we operate a network of 37 distribution centers organized into nine regional clusters. With a proven track record of strong financial performance, Hardwoods plays a critical role linking suppliers and customers in a highly fragmented industry. The Business is diversified by geographic markets served, product mix, and customer type. Touching many areas of the economy, demand for hardwoods typically remains balanced through a range of economic conditions.

To Our Unitholders

The first six months of 2006 brought successes and challenges as we worked to grow sales and return our gross profit margin to historical levels.

Operating Results

Our sales performance remained very strong through the first half of 2006, particularly in our US operations. Before considering the impact of foreign exchange, first-half sales increased 12.8% compared to the first six months of 2005. The year-over-year strengthening of the Canadian dollar partially offset these gains, reducing our growth rate in the first half of 2006 to 6.5% when sales are expressed in Canadian dollars for reporting purposes.

Gross profit also increased during the first six months of 2006, but to a lesser degree than sales, reflecting a lower gross profit margin of 17.9% compared to 18.8% in 2005. Efforts by some of our branches to reduce inventory levels via lower selling prices during the period contributed to a reduced gross profit margin. While second quarter gross profit margin improved compared to the first quarter of 2006, it remained below the more typical 18.6% level achieved in 2004 and 2005. We anticipate gross profit margin will continue to improve in the third quarter.

Upward pressure across a range of expense categories continues to be a challenge for our business. We review our operations on an ongoing basis to identify areas to reduce costs. Many of the areas of expense increase, particularly personnel costs, are considered to be ongoing and in the normal course of business, which will need to be paid for through increased sales and gross profits. We are getting the job done on the sales growth front, and had our gross profit margin been consistent with historic levels, our year to date EBITDA performance would have been on par with 2005 results. However, due to the 0.9% decline in gross profit margin in the first half of 2006, the increase in our gross profits was not enough to offset the higher costs in the business. As a result, our year-to-date earnings were down. For the six months ended June 30, 2006, EBITDA decreased 9.8% to $11.0 million from $12.2 million and net income decreased 9.0% to $5.8 million from $6.4 million, compared to the same period in the prior year.

Distributable Cash

The Fund's distributable cash results were also affected by higher expenses and lower gross profit margin. For the three months ended June 30, 2006, we generated total distributable cash available to Class A and Class B Unitholders of $4.7 million, or $0.262 per unit. Distributions relating to the period were $3.7 million, or $0.256 per unit, to our public unitholders (Class A Units). For the six months ended June 30, 2006, the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of $8.1 million, or $0.450 per unit, and made distributions of $7.4 million, or $0.513 per unit, to our public unitholders (Class A Units). In accordance with the terms of a subordination feature in place with the previous owners (Class B Units), no distributions were made to the previous owners in the six months ended June 30, 2006. The Fund's subordination feature stays in place until EBITDA and distributable cash tests established at the time of the IPO have been met. These distributions represent an overall payout ratio of 78.3% for the second quarter, 91.0% for the first six months of 2006, and 91.6% since the Fund's inception.

Cash distributions are dependent upon the financial performance achieved by the Fund, and are made monthly at the discretion of the Fund's independently elected Trustees. The ability to continue to grow sales is considered important to the financial success of the Fund. To support sales growth comes the need to finance additional working capital, primarily in the form of inventory and accounts receivable. In order to retain sufficient cash to finance working capital needs necessary for the business to maintain sales growth, the Fund's Trustees have reduced monthly distributions by 20% to $0.068 per unit. This distribution cut will take effect with the July 2006 distribution, to be paid on August 31, 2006 to unitholders of record as at August 18, 2006. Had monthly distributions been at this reduced rate of $0.068 per unit in the first half of 2006, the payout ratio would have been 72%, and the Fund anticipates operating with a payout ratio in this range moving forward. This initiative is intended to provide our business with the ability to support additional sales and associated working capital while maintaining a prudent financial base.

Outlook

Moving into the second half of 2006, we anticipate continued strong sales growth in the US supported by sales from our two new branches opened in 2005 and our continued introduction of import products into our sales mix. We expect flat-to-moderate sales growth in Canada. The third quarter of 2006 will include approximately four fewer selling days than the comparative quarter in 2005, a difference of approximately 6%, which will have an impact on third-quarter comparative results.

Following the improvement in gross profit margin achieved in the second quarter of 2006, we anticipate that more progress will be made in this area during the third quarter. Our ongoing review of operations to contain expenses will also continue. Maintaining sales growth and returning gross profit margin back to historic levels will remain key areas of operational focus as we work to offset higher costs of doing business.

Maurice E. Paquette

President and Chief Executive Officer

Management’s Discussion and Analysis

July 31, 2006

This management’s discussion and analysis (“MD&A”) covers our unaudited interim consolidated financial statements as at and for the three and six months ended June 30, 2006 (“Interim Financial Statements”). As well, it provides an update to the MD&A section contained in our 2005 Annual Report. The information below should be read in conjunction with the Interim Financial Statements and the audited consolidated financial statements for the year ended December 31, 2005. Dollar amounts are in Canadian dollars unless otherwise stated, and the consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

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 totaling $31.6 million, were used to acquire an 80% interest in the hardwood lumber and sheet goods distribution business (“Hardwoods” or the “Business”) from the previous owners.

The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund’s operating subsidiaries (“Class B Units”), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. Distributions by the Fund’s operating subsidiaries to the previous owners are subject to subordination arrangements until certain financial tests established at the time of the IPO and described in the Interim Financial Statements are met. As at June 30, 2006, the following units of the Fund were issued and outstanding:

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

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

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, 2006 we operated from 37 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.

Our product mix includes higher grades of hardwood lumber, as well as sheet goods, consisting primarily of hardwood plywood, as well as 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.

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

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

Non-GAAP Measures – EBITDA and Distributable Cash

References to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustments on foreign currency contracts and the non-controlling interest in earnings. Management believes that, in addition to net income or loss, EBITDA is a useful supplemental measure of performance and cash available for distribution prior to debt service, changes in working capital, capital expenditures and income taxes.

EBITDA is not an earnings measure recognized by generally accepted accounting principles in Canada (“GAAP”) and does not have a standardized meaning prescribed by GAAP. Investors are cautioned that EBITDA should not replace net income or loss (as determined in accordance with GAAP) as an indicator of our performance, or to cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA may differ from the methods used by other issuers. Therefore, our EBITDA may not be comparable to similar measures presented by other issuers.

Distributable Cash of the Fund is a non-GAAP measure generally used by Canadian open-ended income funds as an indicator of financial performance. We define Distributable Cash as net earnings before depreciation, amortization, future income taxes, non-controlling interest, gains or losses on the sale of property, plant and equipment, and mark-to-market adjustments on foreign currency contracts, and after capital expenditures and contributions to any reserves that the Board of Trustees deem to be reasonable and necessary for the operation of the Fund.

Our Distributable Cash may differ from similar computations as reported by other similar entities and, accordingly, may not be comparable to distributable cash as reported by such entities. We believe that our Distributable Cash is a useful supplemental measure that may assist prospective investors in assessing the return on their investment in Class A Units.

Second Quarter Overview and Outlook

Half way through 2006, market demand for Hardwood’s products continues to be solid. Our US business, which accounts for approximately two-thirds of our sales, is achieving particularly strong results. Our two new branches opened in the third quarter of 2005 in Minneapolis and Illinois are performing in line with expectations, and all of our US regions are experiencing increased sales demand.

US sales for both the second quarter and first half of 2006, before considering the impact of foreign exchange, increased 18% compared to the same periods in 2005. While the strengthening Canadian dollar undermined some of this growth when sales were converted to Canadian dollars, we are pleased with these results and see the opportunity for continued growth in the US.

Demand in Canada, which accounts for approximately one third of our sales, is more subdued. During the first half of 2006, sales in our Canadian business grew by just 1.9%. A stronger Canadian dollar is a factor in this more moderate sales performance, and affects our Canadian business on two fronts. First, for those hardwood products which are sourced from the United States in US dollars, a stronger Canadian dollar reduces the Canadian dollar purchase price that we pay to buy hardwood lumber from mills in the United States. When this product is resold to our Canadian customers, it is also at a lower Canadian dollar equivalent selling price, which effectively reduces our revenues in Canada. Second, the competitiveness of some of our customers comes under pressure with the continued strengthening of the Canadian dollar. To the extent our Canadian customers rely on selling their products into the US market, these customers see their revenues effectively reduced as the Canadian dollar gains strength. Although we would like to achieve stronger growth in our Canadian business, we believe that maintaining and modestly growing sales in Canada represents a solid result.

Our gross profit margin was below expectations for the first six months of 2006, averaging 17.9%, compared to 18.8% during the same period in 2005. The benefit of sales gains on gross profits has been largely lost due to the 0.9% decline in gross profit margin. Efforts to reduce inventory at some locations during the first quarter of 2006 were a key factor in this result. While second quarter margins of 18.2% were higher than the 17.7% achieved in the first quarter of 2006, our objective is to return our gross margin percentage to the 18.6% range, which we consider to be more typical and appropriate for our business. Aside from basic disciplined selling practices, the continued introduction of import products, which is discussed later, is expected to play a longer term role in helping us achieve our objective.

During the first six months of 2006, we continued to experience increased operating costs, particularly in the area of personnel costs. Although our ratio of the number of employees to the dollar volume of underlying sales activity remains in line with historical performance, the cost of employees continues to rise. Competitive wage pressures, along with rising costs associated with delivery of our US medical plan to employees, have been significant contributors to the higher costs. Other factors in the higher cost base include an increase in bad debt expense, reflecting increased sales activity and estimates regarding current and expected collection trends. Premises expense is also up, primarily reflecting rent increases in the ordinary course of business at our leased facility locations. With respect to borrowing costs, our year-to-date interest expense increased 69%. Higher bank borrowings to finance increased sales activity and associated working capital growth is a primary driver of the increased interest expense, along with a continued upward trend in interest rates.

Overall, cost increases have outpaced gross profit growth during the first half of 2006, exerting downward pressure on bottom line results. EBITDA and net income for the first six months were down by 9.8% and 9.0%, respectively, compared to the same period a year ago. To help offset this trend, every effort is being made to stabilize or reduce costs within our control. As an example, we closed our Regina, Saskatchewan operation at the end of the second quarter. This location had limited opportunity for growth, and the resources in that location can be better used in markets with higher potential for sales and profit expansion.

A significant portion of the cost increases affecting our business are driven by the competitive and economic environment, and accordingly are not expected to abate. Maintaining sales growth at disciplined gross profit margins is important to offset cost pressures in the business and ultimately improve the bottom line. Sales growth has already been well established in 2006. But as described earlier, gross profit margin needs to improve, and is a focus area for management. Had our year-to-date gross profit margin performed at its historic level of approximately 18.6%, EBITDA for the first six months of 2006 would have been on par with the same period in 2005.

With growth in sales comes the need for additional working capital in the form of inventory and accounts receivable. On July 31, 2006, the Trustees of the Fund announced a 20% reduction to the current rate of monthly distributions paid to public unitholders. This step was taken to retain more cash, which will allow us to finance the additional working capital necessary to maintain sales growth. Had monthly distributions been at the reduced monthly distribution rate of $0.068 per unit in the first half of 2006, the payout ratio would have been 72%. The Fund anticipates operating with a payout ratio in this range moving forward.

Strategically, we continue to focus on China as an emerging source of high quality, value-added products to introduce into our product mix. In addition to our established Dragon Ply™ hardwood plywood products, we are making progress in the introduction of our branded Rely-A-Form™ film faced plywood for use in the concrete forming industry. Additional new import products from China are also in development. Sourcing products from China typically carries a cost advantage, and our import program is expected to make a positive contribution to sustaining or increasing Hardwoods' gross profit margin. To support our commitment to our Chinese import program, we intend to establish a full-time representative in China in the third quarter of 2006.

Looking ahead, we are pleased with our sales momentum thus far in 2006. We expect continued strong sales growth in the US, and flat to moderate sales growth in Canada in the latter half of 2006. The third quarter of 2006 will have approximately four fewer selling days than the comparative quarter in 2005, a difference of approximately 6%, which will have an impact on third quarter comparative results. We improved our gross profit margin in the second quarter and expect to continue to progress in this area in the third quarter. Ongoing review of operations to contain expenses will continue. Maintaining sales growth and getting gross profit margin back to historic levels to offset our higher costs of doing business will remain key areas of operational focus for the balance of the year.

Results of Operations
Three months ended June 30, 2006 and June 30, 2005

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

	For the three months Ended June 30, 2006	For the three months Ended June 30, 2005
Total sales	$ 95,054	$ 91,852
Sales in the US (US$)	*58,660*	*49,577*
Sales in Canada	*29,199*	*30,223*
Gross profit	17,259	17,413
Gross margin %	*18.2%*	*19.0%*
Selling and administrative expenses	11,196	10,835
Realized gain on foreign currency contracts	(364)	(113)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest ("EBITDA")	$ 6,427	$ 6,691
Add (deduct):		
Amortization	(526)	(567)
Interest	(827)	(478)
Mark-to-market adjustment on foreign currency contracts	754	(410)
Non-controlling interest	(1,165)	(1,047)
Income taxes	(724)	(747)
Net earnings for the period	$ 3,939	$ 3,442
Basic and fully diluted earnings per Class A Unit	$ 0.273	$ 0.239
Average Canadian dollar/US dollar exchange rate	1.1219	1.2431

Sales

For the three-month period ended June 30, 2006, sales were $95.1 million, up 3.5% from $91.9 million in the second quarter of 2005. The growth in our sales reflects an 11.2% increase in underlying sales activity, partially offset by a 7.7% reduction to sales due to the negative foreign exchange impact of a strengthening Canadian dollar. Approximately two-thirds of Hardwoods sales are generated in the United States in US dollars. Accordingly, a strengthening Canadian dollar has a negative top line impact when we translate US sales to Canadian dollars for reporting purposes. The average Canadian dollar exchange rate in the second quarter of 2006 was $1.1219, compared to $1.2431 in the second quarter of the prior year. Had exchange rates remained consistent with 2005 levels, total sales for the second quarter of 2006 would have been $7.0 million higher, at $102.1 million.

The 11.2% increase in underlying sales activity reflects continued strong sales growth in our US business and a slight decline in sales in our Canadian business. Sales in the United States, as measured in US dollars, increased 18.3% to $58.7 million, compared to $49.6 million during the same quarter in 2005. This improvement reflects the contribution of two new branches opened in late 2005 in Minneapolis, Minnesota and Arthur, Illinois. In addition, all regions in the US recorded positive sales growth in the quarter, benefiting from investments in personnel and facility enhancements made in 2005.

Hardwoods sales in Canada as measured in Canadian dollars declined 3.4% to $29.2 million, from $30.2 million during the second quarter of 2005. The change in Canadian sales is due largely to impacts related to the strengthening Canadian dollar.

Gross Profit

Gross profit for the three months ended June 30, 2006 was $17.3 million, a decrease of $0.1 million, or 0.9%, from $17.4 million in the second quarter of 2005. The decrease in gross profit reflects the 3.5% increase in sales being fully offset by a lower gross profit margin of 18.2%, compared to 19.0% in the second quarter of 2005. The 18.2% gross profit margin in the second quarter of 2006 is an improvement from the 17.7% gross profit margin achieved in the first quarter of 2006.

Selling and Administrative Expenses

For the three-month period ended June 30, 2006, selling and administrative expenses were $11.2 million, up $0.4 million, or 3.3%, from $10.8 million in the three-month period ended June 30, 2005. The benefit of the stronger Canadian dollar on the conversion of selling and administrative expenses at our US operations reduced costs by $0.8 million. Higher people costs as a result of competitive wage pressures and higher US medical expenses were significant contributors to the cost increase in the quarter. Second quarter selling and administrative expenses, as a percentage of sales, was 11.8% in both the 2005 and 2006 periods.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of $0.4 million on maturing foreign currency contracts during the second quarter, up $0.1 million from the same period in 2005. This improvement reflects the strengthening of the Canadian dollar in the second quarter of 2006, compared to the second quarter of 2005. 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 United States dollar is described under Financial Instruments on page 22 of this report.

EBITDA

EBITDA was $6.4 million in the second quarter of 2006, down $0.3 million from $6.7 million in the same period in 2005. The decrease in EBITDA reflects the $0.1 million decrease in gross profit and the $0.4 million increase in selling and administrative expenses, partially offset by the $0.3 million increase in realized gains on foreign currency contracts.

Interest Expense

Interest expense for the three-month period ended June 30, 2006 was $0.8 million, up $0.3 million, or 73%, from $0.5 million in Q2 2005. The increase in interest expense reflects higher average advances under operating lines of credit available to subsidiaries of the Fund, and increases in market borrowing rates. Higher borrowing reflects the financing of additional working capital (accounts receivable and inventory) to support sales growth within the Business. Further discussion of our borrowing arrangements can be found under Revolving Credit Facilities on page 20 of this report.

Other Income

The mark-to-market valuation of our outstanding foreign currency contracts resulted in an adjustment gain of $0.8 million in the second quarter of 2006, compared to a $0.4 million adjustment loss in the same period in 2005. As of June 30, 2006, our foreign currency contracts continued to be an asset to the Fund, having a fair value of $3.0 million. We continue to monitor our foreign currency contract policy to mitigate the impact of foreign exchange fluctuations on Canadian dollar distributions generated by our US operations. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 22 of this report.

Net Earnings

Net earnings for the three months ended June 30, 2006 were $3.9 million, compared to $3.4 million in the comparative period in 2005. The $0.5 million increase in net earnings primarily reflects a $1.2 million increase in mark-to-market adjustment on foreign currency contracts, partially offset by a $0.3 million decrease in EBITDA, and a $0.3 million increase in interest expense.

Results of Operations - Six month period ended June 30, 2006 and June 30, 2005

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

	For the six months Ended June 30, 2006	For the six months Ended June 30, 2005
Total sales	$ 188,434	$ 176,879
Sales in the US (US$)	*114,293*	*96,837*
Sales in Canada	*58,345*	*57,247*
Gross profit	33,768	33,232
Gross margin %	*17.9%*	*18.8%*
Selling and administrative expenses	23,415	21,320
Realized gain on foreign currency contracts	(653)	(287)
Earnings before interest, taxes, depreciation and amortization and non-controlling interest (“EBITDA”)	$ 11,006	$ 12,199
Add (deduct):		
Amortization	(1,048)	(1,150)
Interest	(1,531)	(905)
Mark-to-market adjustment on foreign currency contracts	300	(683)
Non-controlling interest	(1,745)	(1,892)
Income taxes	(1,175)	(1,185)
Net earnings for the period	$ 5,807	$ 6,384
Basic and fully diluted earnings per Class A Unit	$ 0.403	$ 0.443
Average Canadian dollar/US dollar exchange rate	1.1382	1.2354

Sales

Sales for the six-month period ended June 30, 2006 were $188.4 million, up 6.5% from $176.9 million in the same period in 2005. The improvement in total sales reflects a 12.8% increase in underlying sales activity, partially offset by a 6.3% reduction to sales due to a negative foreign exchange impact.

The negative foreign exchange impact reflects a strengthening Canadian dollar, which had an average exchange value of $1.1382 relative to the US dollar during the six months ended June 30, 2006, compared to $1.2354 in the first half of 2005. Had exchange rates remained consistent with 2006 levels, total sales for the first quarter of 2006 would have been $11.1 million higher, at $199.5 million.

The 12.8% increase in underlying sales activity reflects strong year-to-date sales growth in our US business and modest growth in our Canadian business. Sales in the United States, as measured in US dollars, increased 18.0% to $114.3 million in the first six months of 2006, compared to $96.8 million during the same period in 2005. All regions of our US business have experienced positive sales growth in 2006.

In Canada, first-half sales, as measured in Canadian dollars, were $58.3 million, up 1.9% from $57.2 million in the comparative period in 2005. Sales growth in Canada did not match that achieved in the United States, in part due to the strengthening Canadian dollar.

Gross Profit

Gross profit for the six-month period ending June 30, 2006 was $33.8 million, an increase of $0.6 million, or 1.6%, from $33.2 million in the first six months of 2005. The modest increase in gross profit reflects the benefit of a 6.5% increase in sales being substantially offset by a lower gross profit margin. Gross profit margin was 17.9% in the first half of 2006, compared to 18.8% in the same period in 2005. First-quarter efforts to reduce inventory through lower selling prices at some locations contributed to the reduction in gross profit margin. Gross profit margin improved in the second quarter compared to the first quarter of 2006, and is expected to strengthen further in the third quarter.

Selling and Administrative Expenses

For the six months ended June 30, 2006, selling and administrative expenses were $23.4 million, up $2.1 million, or 9.8%, from $21.3 million in the first half of 2005. The benefit of the stronger Canadian dollar on the conversion of our selling and administrative expenses at our US operations reduced expenses by $1.3 million. As a percentage of sales, selling and administrative expenses in the first six months of 2006 were 12.4% of sales, compared to 12.1% in the comparative period in 2005.

Higher costs continue to be a challenge. Rising people costs is the most significant area of expense increase. Although the ratio of the number of employees in the business compared to the dollar volume of underlying sales activity remains in line with historic performance for the Business, the cost of those employees continues to rise. Competitive wage pressures, along with rising costs associated with delivery of our US medical plan to employees, have been significant contributors to higher people costs. Bad debt expense is also up from the prior year, reflecting increased sales activity in 2006 as well as estimates regarding current and expected collection trends. Premises expense is a third area of notable cost increase, primarily reflecting rent increases in the ordinary course of business at our leased facility locations.

Realized Gain on Foreign Currency Contracts

The Fund realized gains of $0.7 million on foreign currency contracts which matured during the six months ended June 30, 2006, compared to $0.3 million in the comparative period in 2005. The higher gains on realized foreign currency contracts reflect the continued strengthening of the

Canadian dollar in the first half of 2006 compared to the first half of 2005. The terms of our foreign currency contracts and the Fund's use of currency contracts to mitigate the economic impact of fluctuations between the Canadian and United States dollar is described under Financial Instruments on page 22 of this report.

EBITDA

EBITDA was $11.0 million for the six-month period ended June 30, 2006, down $1.2 million from $12.2 million in the same period in 2005. The decrease in EBITDA reflects the $2.1 million increase in selling and administrative expenses, partially offset by the $0.6 million improvement in gross profit and a $0.4 million increase in realized gains on foreign currency contracts.

Interest Expense

First half interest expense was $1.5 million, up $0.6 million from $0.9 million in the comparative period in 2005. Higher average advances on operating lines of credit were the primary driver of increased interest expense, along with higher borrowing rates in the market. The increased draw on our operating lines of credit was used to finance higher sales activity and associated working capital growth. Further discussion of our borrowing arrangements can be found under Revolving Credit Facilities on page 20 of this report.

Other Income

The mark-to-market valuation of our outstanding foreign currency contracts resulted in an adjustment gain of $0.3 million in the six months ended June 30, 2006, compared to a $0.7 million adjustment loss in the same period in 2005. As of June 30, 2006, our foreign currency contracts continued to be an asset to the Fund, having a fair value of $3.0 million. We continue to monitor our foreign currency contract policy to mitigate the impact of foreign exchange fluctuations on Canadian dollar distributions generated by our U.S. operations. Further discussion of our foreign currency contracts can be found under Financial Instruments on page 22 of this report.

Net Earnings

Net earnings for the six months ended June 30, 2006 were $5.8 million, compared to $6.4 million in the first half of 2005. The $0.6 million decrease in net earnings primarily reflects the $1.2 million decrease in EBITDA and a $0.6 million increase in interest expense. This was partially offset by a $1.0 million increase in mark-to-market adjustment on foreign currency contracts, a

$0.1 million reduction in amortization expense, and a $0.1 million reduction in non-controlling interest as a result of lower profits during the first six months of the year.

Liquidity

Distributable Cash and Cash Distributions

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

	For the three months June 30, 2006	For the three months June 30, 2005	For the six months June 30, 2006	For the six months June 30, 2005
Net cash provided by operating activities	$ 3,263	$ 7,736	$ 2,054	$ 9,534
Increase (decrease) in non-cash operating working capital	1,959	(2,037)	6,818	1,117
Cash flow from operations before changes in non-cash operating working capital	5,222	5,699	8,872	10,651
Capital expenditures	(506)	(226)	(759)	(455)
Distributable cash	$ 4,716	$ 5,473	$ 8,113	$ 10,196
Distributions relating to the period:				
Class A Units	3,693 (1)	3,890	7,386 (1)	7,781
Class B Units	- (2)	1,019	- (2)	2,005
	$ 3,693	$ 4,909	$ 7,386	$ 9,786
Outstanding units and per unit amounts:				
Class A Units outstanding	14,410,000	14,410,000	14,410,000	14,410,000
Class B Units outstanding	3,602,500	3,602,500	3,602,500	3,602,500
Total Units outstanding	18,012,500	18,012,500	18,012,500	18,012,500
Distributable Cash per Unit	$ 0.262	$ 0.304	$ 0.450	$ 0.566
Distributions relating to the period:				
Class A Units	$ 0.256 (1)	$ 0.270	$ 0.513 (1)	$ 0.540
Class B Units	$ - (2)	$ 0.283	$ - (2)	$ 0.557
Total Units	$ 0.205	$ 0.273	$ 0.410	$ 0.543
Payout ratio (3)	78.3%	89.7%	91.0%	96.0%

[1] Includes the cash distribution which relates to June 2006 operations of the Fund. The cash distribution of $0.08542 per Class A Unit related to June 2006 operations of the Fund was declared on July 11, 2006, to be paid on July 31, 2006 to unitholders of record as of July 20, 2006. As this distribution was not declared until after June 30, 2006, it has not been reflected in the unaudited interim financial statements of the Fund for the three and six months ended June 30, 2006.

[2] On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, partnerships in which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the subordinated units, represented by the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in the combined business of Hardwoods, which is subordinated to the Fund's ownership interest in the business. Accordingly, no distributions were declared payable relating to the fourth quarter of 2005, and the first and second quarters of 2006 to the non-controlling interests and no current liability for distributions payable to the non-controlling interests is reflected in the June 30, 2006 balance sheet.

[3] Payout ratio measures the ratio of distributions relating to the period to distributable cash in the period. Comparative distributable cash and payout ratio figures have been restated to conform with presentation adopted in the six month period ended June 30, 2006 as a result of the suspension of quarterly distributions on the Class B Units.

We pay distributions on Class A Units at the end of the month following the month in which the cash is earned. Distributions may also be made quarterly on Class B Units in an amount equivalent on an after-tax per-unit basis to distributions made on Class A Units, pursuant to the terms of a subordination agreement as outlined in the Fund's Annual Information Form dated March 20, 2006.

Effective for the fourth quarter of 2005, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, partnerships in which the Fund owns an 80% interest, suspended quarterly distributions on the subordinated units, represented by the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in the combined business of Hardwoods, which is subordinated to the Fund's ownership interest in the business. The quarterly distributions suspended and not declared to Class B Units amounted to $1.0 million for the fourth quarter of 2005, $1.0 million for the first quarter of 2006, and $1.0 million for the second quarter of 2006. The subordination feature allows for these suspended distributions to be made up to the Class B Units in the 12 months following the suspension under certain circumstances. In addition, monthly distributions to Class A public unitholders cannot be increased above the IPO level of $0.08542 per unit during any month in which a suspension of distributions remains in effect for Class B Units in a preceding twelve-month period. The Fund's subordination feature is designed to stay in place until the EBITDA and distributable cash tests established at the time of the IPO are met. The terms of these EBITDA and distributable cash tests are described in note 5 to the accompanying financial statements of the Fund.

For the three months ended June 30, 2006, the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of $4.7 million, or $0.262 per unit. Distributions relating to the period were $3.7 million, or $0.256 per unit to our public unitholders (Class A Units). For the six months ended June 30, 2006, the Fund and its subsidiaries generated total distributable cash available to Class A and Class B Unitholders of $8.1 million, or $0.450 per unit, and made distributions of $7.4 million, or $0.513 per unit, to our public unitholders (Class A Units). In accordance with the terms of a subordination feature in place with the previous owners (Class B Units), no distributions were made to the previous owners in the six months ended June 30, 2006. The Fund's subordination feature stays in place until EBITDA and distributable cash tests established at the time of the IPO have been met. These distributions represent an overall payout ratio of 78.3% for the second quarter, 91.0% for the first six months of 2006, and 91.6% since the Fund's inception.

Cash distributions are dependent upon the financial performance achieved by the Fund, and are made monthly at the discretion of the Fund's independently elected Trustees. In order to retain sufficient cash to finance working capital needs necessary for the business to maintain sales growth, the Fund's independently elected Trustees have reduced monthly distributions by 20% to $0.068 per unit. This distribution cut will take effect with the July 2006 distribution, to be paid on August 31, 2006 to unitholders of record as at August 18, 2006. Had monthly distributions been at this reduced rate of $0.068 per unit in the first half of 2006, the payout ratio would have been 72%, and the Fund anticipates operating with a payout ratio in this range moving forward. This initiative is intended to provide the business with the ability to support additional sales and associated working capital while maintaining a prudent financial base.

Capital Expenditures

Capital expenditures were $0.5 million in the second quarter and $0.8 million during the six months ended June 30, 2006. As Hardwoods now leases all of its buildings and contracts out all freight delivery services, we have minimal capital requirements. Our most significant expenditure item is typically the ongoing replacement of forklifts that we operate in our warehouses. As at June 30, 2006, the majority of our 2006 forklift replacement program has been completed. Substantially all furniture and fixtures expenditures associated with the relocation of our Southern California hub distribution facility have also been incurred. Accordingly, we continue to estimate our full-year maintenance capital expenditures will be approximately $1.2 million.

Revolving Credit Facilities

We have independent credit facilities in each of Canada and the US. In Canada, the term of our three-year operating line extends to March 23, 2007 and comprises a maximum facility of $22.0 million. The balance outstanding on the Canadian operating line as at June 30, 2006 was $15.5 million. In the US, the term of our three-year operating line extends to March 31, 2007, comprises a maximum facility of US$35 million, and as at June 30, 2006 had a balance outstanding of $32.7 million (US $29.3 million).

On June 9, 2006 the Fund announced an amendment to the terms and conditions of the credit facilities available to its operating subsidiaries, Hardwoods LP and Hardwoods US LP. Under the amended terms, the ratio of allowable funded debt to EBITDA was increased to a maximum of 2.85 to 1, compared to 2.5 to 1 previously. The amendment was undertaken to enhance financing flexibility, and has been made available to the operating subsidiaries with no increase in interest rates. The principal terms of the credit facilities available to Hardwoods LP and Hardwoods US LP are described in more detail in the Fund's Annual Information Form dated March 20, 2006.

Contractual Obligations

The table below sets forth other remaining contractual obligations of the Fund as at June 30, 2006, due in the fiscal years indicated, which relate to operating leases on various premises:

(in thousands of Canadian dollars)

Total	2006	2007	2008	2009	2010	2011 & thereafter
$ 23,383	$ 3,000	$ 5,626	$ 5,191	$ 4,369	$ 2,556	$ 2,641

Off-Balance Sheet Arrangements

The Fund has no off balance sheet arrangements. The foreign currency contracts discussed under Financial Instruments on page 22 of this report are marked-to-market at the end of each quarter, with the fair value recorded on the balance sheet.

Quarterly Financial Information

(in thousands of dollars)	For the three months ended June 30, 2006	For the three months ended March 31, 2006	For the three months ended December 31, 2005	For the three months ended September 30, 2005	For the three months ended June 30, 2005	For the three months ended March 31, 2005	For the three months ended December 31, 2004	For the three months ended September 30, 2004
Total sales	$ 95,054	$ 93,380	$ 84,130	$ 94,766	$ 91,852	$ 85,027	$ 93,730	$ 97,040
Net earnings	$ 3,939	$ 1,868	$ 2,370	$ 4,597	$ 3,442	$ 2,942	$ 5,568	$ 4,351
Basic and fully diluted earnings per Class A Unit	$ 0.273	$ 0.130	$ 0.164	$ 0.319	$ 0.239	$ 0.204	$ 0.386	$ 0.302
EBITDA	$ 6,427	$ 4,579	$ 4,706	$ 6,679	$ 6,691	$ 5,508	$ 6,422	$ 6,947
Distributable cash	$ 4,716	$ 3,397	$ 3,324	$ 5,193	$ 5,473	$ 4,723	$ 5,645	$ 5,201

The table above provides selected quarterly financial information for the eight most recently completed fiscal quarters of the Fund. This information is unaudited, but reflects all adjustments of a normal, recurring nature which are, in our opinion, necessary to present a fair statement of the results of operations for the periods presented. Quarter-to-quarter comparisons of our financial results are not necessarily meaningful and should not be relied upon as indication of future performance. Historically, the first quarter and fourth quarter have been seasonally slower periods for our business. In addition, net earnings reported in each quarter will be impacted by changes to the foreign exchange rate of the Canadian and US dollar and gains or losses on foreign currency contracts, which are described under Financial Instruments on page 22 of this report.

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.

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, 2006, sales of $0.2 million were made to related parties, and the subsidiaries of the Fund purchased $38,000 from related parties. For the six months ended June 30, 2006, sales of $0.6 million were made to related parties, and the subsidiaries of the Fund purchased $67,000 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, 2006 to related parties under the terms of an agreement to provide services for management information systems.

Financial Instruments

The Fund uses currency contracts to assist in managing its exposure to fluctuations in exchange rates between the Canadian dollar and the United States dollar. The foreign currency contracts are recognized in the balance sheet and measured at their fair value, with changes in fair value recognized currently in the statement of operations. At June 30, 2006, a subsidiary of the Fund had 22 monthly foreign currency contracts to exchange US$675,000 into approximately $878,000, reflecting an exchange rate of Cdn$1.30 to US$1.00, each month until April 2008. The subsidiary of the Fund also had an additional 12 monthly foreign currency contracts to exchange US$675,000 into approximately Canadian $760,000 each month from May 2008 until April 2009, reflecting an exchange rate of $1.1255. Taken together, the fair value of the Fund's 34 remaining monthly currency contracts covering the period until April 2009 have been reflected in the financial statements and represent a current asset of $1.5 million and a long term asset of $1.5 million at June 30, 2006.

Based on the Fund's revised monthly distribution of $0.068 per unit to public unitholders, during the term of the monthly foreign currency contracts the principal value of the monthly foreign currency contracts is sufficient to fully cover the amount of expected US dollar denominated distributable cash which is necessary to be converted to Canadian dollars to pay distributions to Class A Unitholders.

Forward-looking Statements

This MD&A may contain forward-looking statements, which reflect our expectations regarding the future growth, results of operations, performance and business prospects, and opportunities of the Fund. Forward-looking statements contain such words as “anticipate”, “believe”, “continue”, “could”, “expects”, “intend”, “may”, “plans” or similar expressions suggesting future conditions or events. Such forward-looking statements reflect our current beliefs and are based on information currently available to us. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from results discussed in the forward-looking statements, including the effects, as well as changes in: national and local business conditions; political or economic instability in local markets; competition; consumer preferences, spending patterns and demographic trends; legislation and governmental regulation. Although the forward-looking statements contained in this MD&A are based on what we believe to be reasonable assumptions, we cannot assure readers that actual results will be consistent with these forward-looking statements.

Additional Information

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

HARDWOODS DISTRIBUTION INCOME FUND

Consolidated Balance Sheets
(Expressed in thousands of Canadian dollars)

	June 30, 2006	December 31, 2005
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 130	$ 2,203
Accounts receivable	50,840	46,166
Income tax receivable	364	86
Inventory	45,556	47,666
Prepaid expenses	1,631	1,222
Foreign currency contracts (note 3)	1,489	1,134
	100,010	98,477
Long-term receivables	2,525	2,634
Property, plant and equipment	3,582	3,519
Deferred financing costs	45	77
Foreign currency contracts (note 3)	1,463	1,519
Other intangible assets	11,349	12,103
Goodwill	94,155	96,340
	$ 213,129	$ 214,669
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank indebtedness (note 4)	$ 49,627	$ 46,925
Accounts payable and accrued liabilities	8,159	9,231
	57,786	56,156
Deferred gain on sale – leaseback of land and building	730	804
Non-controlling interests (note 5)	32,849	32,047
Future income taxes	1,947	1,364
Unitholders' equity:		
Fund Units	133,454	133,454
Retained earnings	307	1,886
Cumulative foreign currency translation account	(13,944)	(11,042)
	119,817	124,298
	$ 213,129	$ 214,669

Contingencies (note 11)
Subsequent event (note 12)

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 Statements of Operations and Retained Earnings
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three month period ended June 30, 2006	Three month period ended June 30, 2005	Six month period ended June 30, 2006	Six month period ended June 30, 2005
Sales	$ 95,054	$ 91,852	$ 188,434	$ 176,879
Cost of sales	77,795	74,439	154,666	143,647
Gross profit	17,259	17,413	33,768	33,232
Expenses:				
Selling and administrative	11,196	10,835	23,415	21,320
Amortization:				
Plant and equipment	307	312	608	643
Deferred financing costs	16	16	31	32
Other intangible assets	224	239	451	475
Deferred gain on sale – leaseback of land and building	(21)	-	(42)	-
Interest	827	478	1,531	905
Realized gain on foreign currency contracts	(364)	(113)	(653)	(287)
Mark-to-market adjustment on foreign currency contracts (note 3)	(754)	410	(300)	683
	11,431	12,177	25,041	23,771
Earnings before non-controlling interests and income taxes	5,828	5,236	8,727	9,461
Non-controlling interests (note 5)	1,165	1,047	1,745	1,892
Earnings before income taxes	4,663	4,189	6,982	7,569
Income taxes:				
Current	308	475	526	597
Future	416	272	649	588
	724	747	1,175	1,185
Net earnings for the period	3,939	3,442	5,807	6,384
Retained earnings, beginning of period	61	1,852	1,886	2,801
Distributions declared to Unitholders	(3,693)	(3,890)	(7,386)	(7,781)
Retained earnings, end of period	$ 307	$ 1,404	$ 307	$ 1,404
Basic and diluted earnings per Unit	$ 0.27	$ 0.24	$ 0.40	$ 0.44
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 Statements of Cash Flows
(Unaudited)
(Expressed in thousands of Canadian dollars)

	Three month period ended June 30, 2006	Three month period ended June 30, 2005	Six month period ended June 30, 2006	Six month period ended June 30, 2005
Cash flows provided by (used in) operating activities:				
Net earnings for the period	$ 3,939	$ 3,442	$ 5,807	$ 6,384
Items not involving cash:				
Amortization	526	567	1,048	1,150
Gain on sale of property, plant and equipment	(6)	(41)	(11)	(45)
Mark-to-market adjustment on foreign currency contracts	(754)	410	(300)	683
Non-controlling interests	1,165	1,047	1,745	1,892
Future income taxes	352	274	583	587
	5,222	5,699	8,872	10,651
Change in non-cash operating working capital (note 6)	(1,959)	2,037	(6,818)	(1,117)
Net cash provided by operating activities	3,263	7,736	2,054	9,534
Cash flows provided by (used in) investing activities:				
Additions to property, plant and equipment	(506)	(226)	(759)	(455)
Proceeds on disposal of property, plant and equipment	7	2,186	13	2,190
Increase in long-term receivables, net	(252)	(415)	(11)	(209)
Net cash provided by (used in) investing activities	(751)	1,545	(757)	1,526
Cash flows provided by (used in) financing activities:				
Increase (decrease) in bank indebtedness	1,056	(4,372)	4,016	(1,274)
Distributions paid to Unitholders	(3,693)	(3,890)	(7,386)	(7,781)
Distributions paid to non-controlling interests	-	(1,019)	-	(2,005)
Net cash used in financing activities	(2,637)	(9,281)	(3,370)	(11,060)
Decrease in cash	(125)	-	(2,073)	-
Cash, beginning of period	255	-	2,203	-
Cash, end of period	$ 130	$ -	$ 130	$ -
Supplementary information (cash amounts):				
Interest paid	$ 827	$ 478	$ 1,531	$ 905
Income taxes paid	765	190	809	234

See accompanying notes to consolidated financial statements.

(Tabular amounts expressed in thousands of Canadian dollars)

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, 2005. 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, 2005. Certain comparative figures have been restated to conform to the current period’s financial statement presentation.

3. Foreign currency contracts:

In order to manage the Fund’s exposure to exchange rate fluctuations on United States dollar denominated distributable cash, a subsidiary of the Fund has entered into foreign currency contracts to exchange US$675,000 each month for approximately $878,000 until April 2008, reflecting an exchange rate of $1.30. The subsidiary of the Fund has also entered into additional monthly foreign currency contracts which require the subsidiary to exchange, beginning in May 2008, US$675,000 into approximately $760,000 each month until April 2009, reflecting an exchange rate of $1.1255. The fair value of the Fund’s 34 remaining monthly foreign currency contracts at June 30, 2006 represent a cumulative current asset of $1,489,000 and a cumulative long term asset of $1,463,000.

4. Bank indebtedness:

	June 30, 2006	December 31, 2005
Checks issued in excess of funds on deposit	$ 1,488	$ 753
Credit facility, Hardwoods LP	15,458	13,201
Credit facility, Hardwoods USLP (June 30, 2006-US$29,279; December 31, 2005-US$28,350)	32,681	32,971
	$ 49,627	$ 46,925

(Tabular amounts expressed in thousands of Canadian dollars)

5. Non-controlling interests:

Balance, January 1, 2006	$	32,047
Interest in earnings for the period		1,745
Foreign currency translation adjustment of non-controlling interest in Hardwoods USLP		(943)
Balance, end of period	$	32,849

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, 2006.

Distributions are to be made monthly on the Class A LP Units and Class A USLP Units equal to at least $0.08542 per Unit to the extent cash is available to make cash distributions and as determined by the board of directors of the general partners. Distributions on the Class B LP Units and Class B USLP Units will be subordinated and will be made quarterly 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 distributed on one Class A LP Unit and one Class A USLP Unit during such fiscal quarter, only after the distributions have been made on the Class A LP Units and Class A USLP Units and to the extent cash is available to make such distributions, as determined by the board of directors of the general partners.

(Tabular amounts expressed in thousands of Canadian dollars)

5. Non-controlling interests (continued):

In January 2006, distributions on the Class B LP Units and the Class B USLP Units were suspended in accordance with the terms of the subordination arrangements. The suspended distributions relating to the three months ended December 31, 2005 of $1.0 million and the six months ended June 30, 2006 of $2.0 million may be declared and paid to the Class B LP Units and the Class B USLP Units in the twelve months following the suspension under certain circumstances. Monthly distributions by the Fund cannot exceed $0.08542 per Unit during any month in which suspended distributions exist on Class B LP Units and Class B USLP Units in a preceding twelve 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.

6. Changes in non-cash operating working capital:

	Three month period ended June 30, 2006	Three month period ended June 30, 2005	Six month period ended June 30, 2006	Six month period ended June 30, 2005
Accounts receivable	$ (466)	$ 434	$ (6,019)	$ (2,725)
Income taxes receivable/payable	(454)	408	(278)	363
Inventory	(891)	(717)	761	(448)
Prepaid expenses	(555)	(610)	(441)	(375)
Accounts payable and accrued liabilities	407	2,522	(841)	2,068
	$ (1,959)	$ 2,037	$ (6,818)	$ (1,117)

(Tabular amounts expressed in thousands of Canadian dollars)

7. Segment disclosure:

Information about geographic areas is as follows:

	Three month period ended June 30, 2006	Three month period ended June 30, 2005	Six month period ended June 30, 2006	Six month period ended June 30, 2005
Revenue from external customers:				
Canada	$ 29,199	$ 30,223	$ 58,345	$ 57,247
United States	65,855	61,629	130,089	119,632
	$ 95,054	$ 91,852	$ 188,434	$ 176,879

	June 30, 2006	December 31, 2005
Property, plant and equipment:		
Canada	$ 1,386	$ 1,559
United States	2,196	1,960
	$ 3,582	$ 3,519
Goodwill		
Canada	$ 42,043	$ 42,043
United States	52,112	54,297
	$ 94,155	$ 96,340

8. 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, 2006, Hardwoods USLP contributed and expensed $76,604 (US$68,280) (2005 - $78,051(US$62,787)) in relation to the USLP Plan. During the six month period ended June 30, 2006, Hardwoods USLP contributed and expensed $220,126 (US$193,398) (2005 - $237,914 (US$192,580)) 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.

8. Pensions (continued):

During the three months ended June 30, 2006, Hardwoods LP contributed and expensed $55,998 (2005 - $52,657) in relation to the LP Plan. During the six month period ended June 30, 2006, Hardwoods LP contributed and expensed $162,749 (2005 - $160,447) in relation to the LP Plan.

9. Related party transactions:

For the three months ended June 30, 2006, sales of $246,046 (2005 - $495,876) were made to affiliates of SIL, and the Fund made purchases of $37,702 (2005 - $40,522) from affiliates of SIL. For the six months ended June 30, 2006, sales of $646,194 (2005 - $1,359,996) were made to affiliates of SIL, and the Fund made purchases of $67,267 (2005 - $132,846) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

During the three months ended June 30, 2006, the Fund paid $27,000 (2005 - $25,704) to affiliates of SIL under the terms of an agreement to provide services for management information systems. During the six months ended June 30, 2006, the Fund paid $54,000 (2005 - $58,976) to affiliates of SIL under the terms of an agreement to provide services for management information systems. This cost is included in the selling and administrative expense in the statement of operations.

10. 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.

11. 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.

12. Subsequent event:

On July 11, 2006 the Fund declared a cash distribution of $0.08542 per Unit to holders of its Units related to the month of June 2006. The Fund's policy is to pay cash distributions at the end of the month that follows the month when the cash was earned. The cash distribution was paid on July 31, 2006 to holders of record at the close of business on July 20, 2006. Although this cash distribution relates to cash generated in June 2006, because this cash distribution was declared and became payable after the end of the June 30 quarter end, it is not reflected as a liability or distributions to Unitholders in the June 30, 2006 consolidated financial statements.

Unitholder Information

Trustees

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

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

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

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Vice Chair, Sauder Industries

Richard N. McKerracher
President, Sauder Industries

Officers

Maurice E. Paquette
President & Chief Executive Officer

Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California Region

Garry W. Warner
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KPMG LLP
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Listings

The Toronto Stock Exchange
Trading under **HWD.UN**

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