



HARDWOODS DISTRIBUTION
INCOME FUND

2011

First Quarter

Report To Unitholders



About the Fund

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

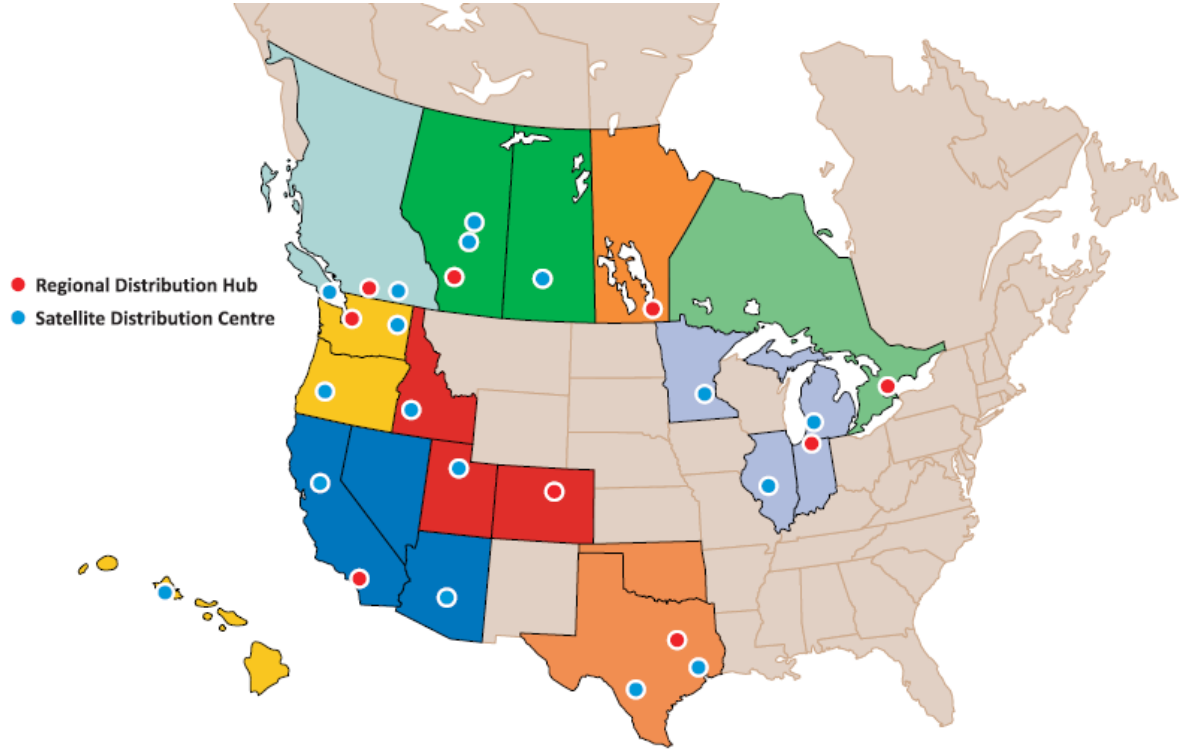


About the Business

Hardwoods has been in business for over 50 years. We sell quality lumber, hardwood plywood and specialty products to cabinet makers, custom millworkers, furniture makers and other industrial customers that manufacture products made from hardwood. Demand for products made from hardwood comes from multiple sectors of the North American economy, including new home construction, renovation, non-residential construction, and institutional markets. There is warmth to the look and touch of hardwoods that no other material can match, and people place a high value on products crafted from real wood. Hardwood products are a part of our daily lives in the homes we live in (cabinets, mouldings, custom finishing, and home furniture) and places we visit (furniture, cabinetry, and finishing millwork for office buildings, restaurant and bar interiors, hotel lobbies, retail point-of-purchase displays, schools, hospitals, custom motor coaches, yacht interiors and other specialty areas).

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

We are one of the largest distributors of hardwood lumber and sheet goods in North America. We are larger than most of our suppliers, customers, and direct competitors. The hardwood distribution industry is highly fragmented. While there are a number of hardwood distributors that operate from multiple locations, most are small, privately held companies serving discrete local markets.



As shown in the map above, we operate 26 distribution centres organized into nine regions, providing geographic coverage in 14 states and 5 provinces across the US and Canada. To maximize inventory management, we operate utilizing a hub-and-spoke distribution system. Our major hub distribution centres hold the bulk of our inventory, and make regular truck transfers to

replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third-party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

The North American economy recently experienced a significant economic downturn, particularly in housing and construction, which are key markets for the hardwoods products that we distribute. This reduction in hardwood demand reduced our sales and financial performance in 2008 and 2009. A partial recovery in our sales and earnings was achieved in 2010, despite the fact that current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends. We believe that when a sustained economic recovery takes hold prospects for our industry are attractive.



To Our Unitholders

The first quarter of 2011 brought important developments for Hardwoods, including a proposal to convert the Fund to a corporate structure and subsequent announcement of a dividend policy; sales growth across all of our regions; and continued progress on our market expansion strategy.

Conversion to a Corporation

On April 5, 2011, our Board of Trustees announced that it will ask unitholders to approve the conversion of the Fund to a corporation at our annual general and special meeting of unitholders to be held on May 19, 2011. The proposal was created in response to changes to the taxation of income funds, which became effective January 1, 2011, and which make the income trust structure a less advantageous form of business enterprise. We feel that this is an appropriate time to simplify our structure by converting to a share corporation and exchanging the 20% retained interests of our previous owners into an 8.6% shareholding in the same class of securities to held by the public. If approved, the conversion is expected to be effective July 1, 2011, after which we will operate as Hardwoods Distribution Inc.

Based on our stronger financial performance in recent quarters and an improving outlook for the business, on May 5th, 2011 the Board also announced it intends to institute a quarterly dividend of \$0.02 per share once the Fund has converted to a corporation. Subject to no material changes in the business or its prospects, the first quarterly dividend is expected to commence in the third quarter of 2011.

Improving Sales Performance

I am pleased to report that we continued to generate revenue growth in the first quarter, with sales climbing 7.3% compared to Q1 2010, even after taking into account the negative sales impact of a stronger Canadian dollar. Excluding the impact of foreign exchange, our underlying sales improved by an even stronger 10.8%, with all nine of our geographic regions achieving year-over-year sales gains.

This growth is particularly satisfying in light of the challenging market conditions we faced during the quarter. According to the US Census Bureau, the seasonally adjusted annual rate of US residential housing starts was just 549,000 units at the end of the first quarter, a very low level by historical standards. The broader North American economy also remained fragile. Meanwhile competition among hardwood distributors continued to place pressure on pricing and gross profit

margins. During the first quarter, our gross margin percentage was 17.5%, compared to 17.8% in the same period last year.

Despite generating higher sales and gross profit dollars, our bottom-line results were down in the first quarter compared to prior year. We generated \$0.5 million of Distributable Cash in the first quarter, compared to \$1.0 million in the same period last year. Impacting upon our results was \$0.3 million of higher expenses related to our conversion proposal, as well as the absence of a \$0.3 million recovery from a lawsuit settlement which was received in the first quarter of 2010, but not repeated in the 2011 period. Adjusting for these unusual items, our Distributable Cash result would have shown an improvement year-over-year.

Strategy Update

Going forward, we expect to further strengthen our financial performance as we capitalize on gradually improving market conditions and make progress with the market expansion strategy we launched in late 2010.

End-Market Diversification: As part of this strategy, we are increasing our emphasis on the commercial and institutional construction markets to help offset the slow recovery anticipated for the residential construction market. Both the commercial and institutional markets fared better than residential construction during the downturn and are currently enjoying a more robust recovery. During the first quarter we made adjustments to our product roster to better meet the needs of customers in the commercial and institutional construction markets, while continuing to target key customers in these sectors. We are already beginning to see new sales generated as a result of our efforts.

Leveraging Import Products: We believe we have one of the strongest import programs in the industry, offering branded products with a high quality-to-price ratio. During the first quarter we grew import sales by 30.8% compared to Q1 2010, and continued to implement high potential new product programs. We intend to continue seeking out new products and introducing our import line to a broader range of customers through the balance of 2011.

Focusing on High-Potential Geographic Markets: We are focused on increasing market share in three densely populated geographies where hardwood demand is significant, but where we currently hold a relatively small market share. We used the first quarter to further assess these specific growth opportunities.

Looking Forward

While 2011 will see us increase investment in the strategies outlined above, I want to reiterate that we will maintain our careful approach to managing our business.

Market conditions are gradually improving and we see opportunities to expand our business, but our outlook remains cautious. Housing starts remain near historical lows in the US and are expected to moderate this year in Canada. Market competition also remains intense and our results could continue to be negatively affected by the stronger Canadian dollar. Accordingly, we intend to maintain tight control of our business through 2011.

Longer term, we recognize that current levels of housing and construction activity in North America are low relative to expected longer-term population and housing trends. We believe that when a sustained economic recovery takes hold, prospects for our industry will become increasingly attractive. We intend to participate fully in the recovery with both a strong market position and financial position.



Lance R. Blanco

President and Chief Executive Officer

This management's discussion and analysis ("MD&A") covers our unaudited interim condensed consolidated financial statements as at and for the three month period ended March 31, 2011 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in our 2010 Annual Report. The information below should be read in conjunction with the Interim Financial Statements, and the audited consolidated financial statements and accompanying notes of Hardwoods Distribution Income Fund (the "Fund") for the years ended December 31, 2010 and 2009. Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting" and IFRS 1 "First Time Adoption of IFRS." For comparative purposes all financial amounts related to the quarter ended March 31, 2010 and the year ended December 31, 2010 have been restated in accordance with IFRS. All other periods remain unchanged from the numbers originally reported under Canadian generally accepted accounting principles. For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

This MD&A includes the following sections:

- 1.0 Background
 - 1.1 About the Fund
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- 4.0 Liquidity and Capital Resources
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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: our perspective that market conditions are gradually improving and there are opportunities to expand our business, but that our outlook remains cautious; our perspective that market competition remains intense and our results could continue to be negatively affected by the stronger Canadian dollar; our intention to maintain tight control of our business through 2011; our belief that when a sustained economic recovery takes hold, prospects for our industry will become increasingly attractive; our intent to participate fully in the recovery with both a strong market position and financial position; that we expect to achieve further performance improvements in 2011 as we pursue three key strategic objectives: (1) Increasing end-market diversification with a stronger focus on the commercial and institutional construction markets; (2) leveraging our successful import program to grow sales and build market share; and, (3) Achieving increased market share with a sharpened focus on larger, high-potential geographic markets; our expectation that operating expenses will trend somewhat higher in 2011 as we implement these strategies and support increased sales activity; our expectation that we will incur an additional \$0.3 million in expenses in the second quarter of 2011 related to our proposed conversion to a corporation; our intention to institute a post conversion dividend policy of \$0.02 per share with the first quarterly dividend expected to be paid in October 2011; that the Fund anticipates a positive year in 2011, with strategy implementation and continued tight management of the business helping to overcome the lingering impacts of the economic recession; our belief that we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment; our belief that the productive capacity of our business in terms of our human capital relative to available market demand, as measured by sales, has been largely sustained; our belief that based on discussion regarding renewal or replacement of our US credit facility which expires in September of this year, we do not anticipate any difficulties in renewing or securing replacement financing for this credit facility; and, our planned debt management strategy.

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: there are no material exchange rate

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

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

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

In this MD&A, references to “EBITDA” are to earnings before interest, income taxes, depreciation and amortization, where interest is defined as net finance expense as per the Fund’s consolidated statement of comprehensive income. In addition to profit 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 and cash income taxes, less capital expenditures, principle payments on finance lease obligation, 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 IFRS and they do not have a standardized meaning prescribed by IFRS. Investors are cautioned that EBITDA should not replace profit or loss (as determined in accordance with IFRS) as an indicator of our performance, nor should Distributable Cash replace cash flows from operating, investing and financing activities or as a measure of our liquidity and cash flows. Our method of calculating EBITDA and Distributable Cash may differ from the methods used by other issuers. Therefore, our EBITDA and Distributable Cash may not be comparable to similar measures presented by other issuers. For a reconciliation between EBITDA and profit or loss as determined in accordance with IFRS, please refer to the discussion of Results of Operations described in section 3.0 of this report. For a reconciliation between Distributable Cash and net cash provided by operating activities as determined in accordance with IFRS, please refer to the discussion of Distributable Cash and Cash Distributions described in section 4.1 of this report.

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

and National Policy 41-201 of the Canadian Securities Administrators “Income Trusts and Other Indirect Offerings” (collectively, the “Interpretive Guidance”). The Interpretive Guidance provides guidance on standardized preparation and disclosure of distributable cash for income trusts (“Standardized Distributable Cash”). The CICA calculation of Standardized Distributable Cash, which is also a non- IFRS measure, is defined, for the purposes of the Fund, as the periodic cash provided by operating activities as reported in the IFRS financial statements, including the effects of changes in non-cash working capital, less total capital expenditures. For a summary of our Standardized Distributable Cash, please refer to section 4.2 of this report. For a reconciliation between Standardized Distributable Cash and our Distributable Cash, please see section 4.2.

1.0 Background

1.1 About the Fund

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

The owners of the predecessor companies have retained a 20% interest in the Business in the form of Special Voting Units of the Fund and Class B Limited Partnership units of the Fund’s operating subsidiaries (“Class B Units”), which together are exchangeable into Class A Units provided that the Fund achieves certain objectives. Distributions by the Fund’s operating subsidiaries to the previous owners are subject to subordination arrangements until certain financial tests established at the time of the IPO and described in the Audited Financial Statements are met. As at March 31, 2011, the following units of the Fund were issued and outstanding:

Units	14,604,085
Special Voting Units	3,602,500

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

1.2 About our Business and Industry

Serving customers for over 50 years, Hardwoods is one of North America's largest distributors of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. At March 31, 2011 we operated 26 distribution facilities organized into nine geographic regions covering 14 states and 5 provinces throughout North America. To maximize inventory management, we utilize a hub and spoke distribution system, with major hub distribution centres holding the bulk of our inventory and making regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets. We operate using a low capital expenditure model. We lease all of our facilities, utilize third-party freight providers for all our product shipping needs, and focus strictly on wholesale distribution.

Approximately 40% of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods and other specialty products, including hardwood plywood, and including non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Our sheet goods are a key complementary product line as they are used by many purchasers of hardwood lumber in the manufacture of their end products.

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

Our customer base manufactures a range of end-use products, such as cabinetry, furniture and custom millwork. These products in turn are sold into multiple sectors of the economy, including new home construction, renovation, non-residential construction and institutional markets. As a result of this diversity, it is difficult to determine with certainty what proportion of our products ends up in each sector of the economy. We estimate at least 50% of our products are used in new residential construction, in the form of cabinets, mouldings, custom finishing,

and home furniture. We believe the balance of our products end up in other sectors of the economy not associated with new residential construction, such as home renovations, finishing millwork for office buildings, restaurant and bar interiors, hotel lobbies, retail point-of-purchase displays, schools, hospitals, custom motor coaches, yacht interiors and other specialty areas.

Approximately 95% of the hardwood lumber distributed in North America is harvested from North American hardwood forests, located principally in the Eastern United States, and is milled by hundreds of small mills. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. Sheet goods are generally produced in North America by large manufacturers using domestic hardwoods and other materials, although imported hardwood plywood volumes have been increasing. Both domestic and imported hardwood lumber and plywood are distributed principally by third parties such as us. Historically, balanced supply and demand conditions have resulted in a stable pricing environment for hardwood lumber and hardwood plywood. More recently, global economic conditions and weaker US housing markets have resulted in supply/demand imbalances and greater variability in product pricing.

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

2.0 Overview and Outlook

We grew sales by 7.3% and gross profit by 5.4% during the first quarter of 2011. All nine of our operating regions posted year-over-year sales gains compared to a year ago, despite the negative impact of a stronger Canadian dollar. We view these gains as particularly significant given the continued fragility of US residential construction markets. According to the US Commerce Department, the seasonally adjusted annual rate of new homes started in the US was 549,000 units as at the end of March, near minimum levels of activity by historic standards, while the seasonally adjusted annual rate of new homes actually under construction fell to a four-decade low.

Our stronger sales results reflect gradually improving conditions in non-residential construction sectors, as well as our shift to a market-expansion strategy. As part of this strategy, we are

successfully identifying and targeting new customers in the commercial and institutional construction sectors, while continuing to leverage our successful import program. Compared to the first quarter of last year, we achieved 30.8% growth in sales of our import products. We also further assessed opportunities related to our larger markets strategy, which focuses on expanding our market share in selected high potential geographic markets over the next two years.

While our bottom-line results were not as strong as a year ago, this was largely due to the impact of expenses related to our proposed conversion to a corporation of \$0.3 million and the absence of a one-time \$0.3 million recovery from a lawsuit settlement that helped our 2010 first quarter results. Factoring out these unusual items, our first quarter Distributable Cash performance would have improved by 25% as demonstrated in the table below. This improvement in the underlying cash generating performance of our business is the result of higher sales and continued discipline in investing in productive capacity while still watching costs closely.

Selected Unaudited Consolidated Financial Information
(in thousands of dollars)

	3 months ended March 31, 2011	3 months ended March 31, 2010
Distributable Cash as reported	\$ 537	\$ 992
Add (deduct):		
Corporate conversion expenses	300	-
Proceeds received from litigation settlement	-	(320)
Adjusted Distributable Cash	<u>\$ 837</u>	<u>\$ 672</u>

Looking forward, we anticipate continued market challenges in 2011. In the US, the pace of residential construction activity remains far below the 1.2 million units per annum that economists consider healthy. Meanwhile, non-residential construction segments of the US market continue to make a slow recovery from the recession.

In Canada, industry forecasts continue to call for a slight dip in Canadian housing starts in 2011 compared to 2010. The stronger Canadian dollar is also having a negative impact on the competitiveness of Canadian manufacturers selling finished products into the US, while simultaneously reducing our own selling prices for US-sourced lumber and panels in Canada.

Despite these challenges, we expect to achieve further performance improvements in 2011 as we pursue three key strategic objectives:

1. Increasing end-market diversification with a stronger focus on the commercial and institutional construction markets;
2. Leveraging our successful import program to grow sales and build market share; and,
3. Achieving increased market share with a sharpened focus on larger, high-potential geographic markets.

Operating expenses are expected to trend somewhat higher in 2011 as we implement these strategies and support increased sales activity. We also anticipate incurring an additional \$0.3 million in expenses in the second quarter of 2011 related to our proposed conversion to a corporation. Hardwoods' Board of Trustees has announced that it intends to seek unitholder approval for conversion of the Fund to a publicly traded corporation called "Hardwoods Distribution Inc." at our annual general and special meeting of unitholders to be held on May 19, 2011. If approved by unitholders at the meeting, and by the Supreme Court of British Columbia, the conversion is expected to be completed on July 1, 2011.

The Board of Trustees has subsequently announced that following the proposed conversion to a corporation it is intended to implement a quarterly dividend of \$0.02 per share, with the first quarterly dividend expected to be paid in October 2011. However, the actual amounts and timing of any future dividends will depend on various matters, including the new corporation's earnings and other factors.

Overall, the Fund anticipates a positive year in 2011, with strategy implementation and continued tight management of the business helping to overcome the lingering impacts of the economic recession.

3.0 Results of Operations

Three Months Ended March 31, 2011 and March 31, 2010

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

	For the three months Ended March 31, 2011	For the three months Ended March 31, 2010
Total sales	\$ 52,030	\$ 48,498
<i>Sales in the US (US\$)</i>	<i>31,840</i>	<i>27,703</i>
<i>Sales in Canada</i>	<i>20,642</i>	<i>19,685</i>
Gross profit	9,099	8,629
<i>Gross profit %</i>	<i>17.5%</i>	<i>17.8%</i>
Operating expenses	(8,772)	(7,719)
Profit from operating activities	327	910
Add: Depreciation	231	330
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	\$ 558	\$ 1,240
Add (deduct):		
Depreciation	(231)	(330)
Net finance expense	(735)	(126)
Income tax expense	(293)	(215)
Profit (loss) for the period	\$ (701)	\$ 569
Basic and fully diluted profit (loss) per Class A Unit	\$ (0.05)	\$ 0.04
Average Canadian dollar exchange rate for one US dollar	0.986	1.040

Sales

For the three months ended March 31, 2011, total sales were \$52.0 million, up 7.3% compared to \$48.5 million during the same period in 2009. The 7.3% increase in total sales reflects a 10.8% improvement in underlying sales activity, less a 3.5% reduction due to the negative impact of a stronger Canadian dollar on foreign exchange conversion of our US-based sales.

All nine of our geographic operating units achieved sales growth to contribute to the 10.8% improvement in underlying sales. Our shift to a market-expansion strategy, including increased focus on end-market diversification and continued leveraging of our import program, also contributed to our improved sales performance. Growth was strongest in our US operations where sales activity (as measured in US dollars) increased by 14.9%. Sales in Canada increased by a more modest 4.9%, reflecting the negative impact of the stronger Canadian dollar on product prices and on demand from Canadian manufacturing customers exporting to the US. Economic conditions influencing our sales are discussed in section 2.0 of this MD&A.

Gross Profit

Gross profit for the three months ended March 31, 2011 was \$9.1 million, an increase of \$0.5 million from the \$8.6 million reported in the same period in 2010. The increase in gross profit reflects higher sales, partially offset by a decrease in gross profit as a percentage of sales to

17.5% in the first quarter of 2011, compared to 17.8% in the same period in 2010. We view a gross profit margin of 17.5% as appropriate given competitive conditions at this point in the business cycle. Under normal market conditions, we target a gross profit margin of 18% to 19%.

Operating Expenses

Operating expenses were \$8.8 million in the first quarter of 2011, compared to \$7.7 million during the same period last year, an increase of \$1.1 million. This increase includes \$0.3 million in expenses associated with the proposed conversion of the Fund to a corporation, as discussed in section 2.0 of this report. A one-time credit related to proceeds from a lawsuit settlement that reduced expenses in the first quarter of 2010, but was not repeated in the 2011 period, accounts for a further \$0.3 million of the increase. The balance of the increase in operating expenses primarily reflects higher personnel costs, including higher benefit and incentive expense and an increase in number of employees required to support our market-expansion strategies. As a percentage of sales, first quarter 2011 operating expenses were 16.9% of sales, compared to 15.9% in 2010.

EBITDA

For the three months ended March 31, 2011, we recorded EBITDA of \$0.6 million, compared to \$1.2 million during the same period in 2010. The \$0.6 million decrease in EBITDA reflects the \$1.1 million increase in operating expenses, partially offset by the \$0.5 million increase in gross profit.

Net Finance Expense

For the three months ended March 31, 2011, net finance expense was \$0.7 million, compared to \$0.1 million in the three months ended March 31, 2010. The \$0.6 million increase in net finance expense is primarily due to an increase in the fair value of the non-controlling interest liability in the first quarter of 2011. The fair value of the non-controlling interest increased to \$3.8 million at March 31, 2011 from \$3.2 million at December 31, 2010, with the \$0.6 million increase in liability being recorded as a corresponding non-cash cost as part of net finance expense. No such change in fair value of the non-controlling interest occurred in the comparative 2010 period. In accordance with the accounting policies adopted under IFRS the non-controlling interest is now recorded at fair value, with the change in fair value being recorded in profit or loss for the period. Previously under Canadian GAAP the non-controlling interest was allocated its share of profit or loss (see section 6.2 of the report for further information).

Income Tax Expense

An income tax expense of \$0.3 million was recorded in the first quarter of 2011, compared to \$0.2 million in the same period in 2010. The income tax expense in both periods primarily reflects the use of future tax assets to offset taxable income generated during the period.

Profit (Loss) for the Period

Loss for the three months ended March 31, 2011 was \$0.7 million, compared to profit of \$0.6 million in 2010. The \$1.3 million reduction in profit primarily reflects the \$0.6 million decrease in EBITDA, the \$0.6 million increase in net finance expense, and the \$0.1 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)

	Three months ended March 31, 2011	Three months ended March 31, 2010
Net cash provided by (used in) operating activities	\$ 828	\$ (3,579)
Increase (decrease) in non-cash operating working capital and income taxes paid / received	(81)	4,797
	<u>747</u>	<u>1,218</u>
Principal repayments on finance lease obligation	(168)	(195)
Capital expenditures	(42)	(31)
Distributable Cash	<u>\$ 537</u>	<u>\$ 992</u>
Distributions relating to the period:		
Class A Units	\$ -	\$ -
Class B Units ⁽¹⁾	-	-
Total Units	<u>\$ -</u>	<u>\$ -</u>
Weighted average outstanding units and per unit amounts:		
Class A Units outstanding	14,524,749	14,410,000
Class B Units outstanding	<u>3,602,500</u>	<u>3,602,500</u>
Total Units outstanding	<u>18,127,249</u>	<u>18,012,500</u>
Distributable Cash per Total Units	\$ 0.030	\$ 0.055
Distributions relating to the period:		
Class A Units	\$ -	\$ -
Class B Units ⁽¹⁾	\$ -	\$ -
Total Units	\$ -	\$ -
Payout ratio ⁽²⁾	0.0%	0.0%

March 23, 2004 to March 31, 2011

Cumulative since inception:	
Distributable Cash	80,122 ⁽³⁾
Distributions relating to the period	66,754
Payout ratio ⁽²⁾	83.3%

¹ On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the March 31, 2011 balance sheet.

² Payout ratio measures the ratio of distributions by the Fund relating to the period to Distributable Cash for the period.

³ Information for Q1, 2010 and Q1, 2011 are in accordance with IFRS. All other periods are in accordance with Canadian GAAP.

In the three months ended March 31, 2011 the Fund and its subsidiaries generated total Distributable Cash available to Class A and Class B Unitholders of \$0.5 million, or \$0.03 per unit. No distributions were made relating to the period.

When distributions are declared by Trustees of the Fund, they are paid on Class A Units at the end of the month following the month in which the cash is earned. Distributions may also be made quarterly on Class B Units in an amount equivalent on an after-tax per-unit basis to distributions made on Class A Units, pursuant to the terms of a subordination agreement as outlined in the Fund's Annual Information Form. Except as outlined in the terms of the subordination agreement with the Class B Units, there are no limitations on distributions from the subsidiaries of the Fund arising from the existence of a minority interest in a subsidiary of the Fund. Further description of the subordination arrangement is included in the notes to the accompanying Interim Financial Statements.

On November 3, 2008, the Trustees of the Fund suspended monthly cash distributions until such time as market conditions strengthened and the Fund's financial performance stabilized. Since its initial public offering on March 23, 2004, the Fund has paid \$66.8 million in distributions, representing 83.3% of Distributable Cash generated since its inception. Since distributions were suspended ten fiscal quarters ago, cumulative Distributable Cash has been \$2.8 million. More recently, in the last four quarters, the Fund has generated \$3.7 million in Distributable Cash.

Based on this most recent four-quarter performance and a positive outlook for sustainable and more predictable cash generation by the Business, the Board has announced it intends to institute a quarterly dividend of \$0.02 per share in the third quarter of 2011, following the Fund's proposed conversion to a corporation. The first quarterly dividend is expected to be payable in October 2011. Confirmation of the actual amounts and timing of any future post-conversion dividends declared will vary depending on, among other things, earnings, financing requirements, and the satisfaction of solvency tests imposed by the new corporations governing statute for the declaration of dividends and other relevant factors.

4.2 Standardized Distributable Cash and Cash Distributions

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

	Three months ended March 31, 2011	Three months ended March 31, 2010
Net cash provided by (used in) operating activities	\$ 828	\$ (3,579)
Capital expenditures	(42)	(31)
Standardized Distributable Cash	<u>\$ 786</u>	<u>\$ (3,610)</u>
Distributions relating to the period:		
Class A Units	\$ -	\$ -
Class B Units ⁽¹⁾	-	-
Total Units	<u>\$ -</u>	<u>\$ -</u>
Weighted average outstanding units and per unit amounts:		
Class A Units outstanding	14,524,749	14,410,000
Class B Units outstanding	3,602,500	3,602,500
Total Units outstanding	<u>18,127,249</u>	<u>18,012,500</u>
Standardized Distributable Cash per Total Units	\$ 0.043	\$ (0.200)
Distributions per Total Units	\$ -	\$ -
Standardized payout ratio ⁽²⁾	0.0%	0.0%

March 23, 2004 to March 31, 2011

Cumulative since inception:		
Standardized Distributable Cash	90,813 ⁽³⁾	
Distributions relating to the period	66,754	
Standardized Payout ratio ⁽²⁾	<u>73.5%</u>	

¹ On January 10, 2006, Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, limited partnerships in each of which the Fund owns an 80% interest, announced that quarterly distributions were suspended on the Class B LP and Class B US LP units. The Class B LP units and Class B US LP units represent a 20% interest in Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP, respectively. No distributions are to be paid on the Class B LP units and Class B US LP units unless distributions in stipulated minimum amounts are paid on the units in the limited partnerships held by the Fund, and in certain other circumstances. Accordingly, no distributions have been declared since the third quarter of 2005 to the non-controlling interests. No liability for distributions payable to the non-controlling interests is reflected in the March 31, 2011 balance sheet.

² Payout ratio measures the ratio of distributions by the Fund relating to the period to Standardized Distributable Cash for the period.

³ Information for Q1, 2010 and Q1, 2011 are in accordance with IFRS. All other periods are in accordance with Canadian GAAP.

In addition to our Distributable Cash, the Interpretive Guidance also recommends disclosure of Standardized Distributable Cash. This is provided in the table above. We believe that the calculation of Standardized Distributable Cash distorts the Fund's quarter-to-quarter distributable cash and payout ratios, as our non-cash operating working capital fluctuates significantly as a result of the seasonality of our business and significant changes in market demand for our

products. The board of directors of our operating entities looks beyond quarter-to-quarter fluctuations in working capital when making decisions regarding monthly distributions. The definition of Standardized Distributable Cash also does not include principle payments on finance lease obligations, which in the case of the Fund is monthly auto lease expense. As a result, we believe that our historical measure of Distributable Cash 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)

	Three months ended March 31, <u>2011</u>	Three months ended March 31, <u>2010</u>
Standardized Distributable Cash	\$ 786	\$ (3,610)
Increase (decrease) in non-cash operating working capital and income taxes paid / received	(81)	4,797
Principal repayments on finance lease obligation	<u>(168)</u>	<u>(195)</u>
Distributable Cash	<u>\$ 537</u>	<u>\$ 992</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 months ended March 31, 2011 and 2010 is provided below.

(in thousands of Canadian dollars)

Source (use) of funds	Three months ended March 31, 2011	Three months ended March 31, 2010
Accounts receivable	\$ (5,500)	\$ (5,297)
Income taxes (paid) received	1,796	(59)
Inventory	808	(488)
Prepaid expenses	143	175
Accounts payable and accrued liabilities	2,904	967
Provisions	(70)	(95)
Decrease (increase) in non-cash operating working capital	<u>\$ 81</u>	<u>\$ (4,797)</u>

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

4.4 Capital Expenditures and Productive Capacity

Our capital expenditures are typically low as we lease all of our buildings and contract out all freight delivery services. Capital expenditures are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment. Between 2007 and 2010 we closed a total of 10 branch locations in response to weak economic conditions. These closures have freed up additional forklift capacity and reduced our need to purchase replacement forklift equipment. We also generally decreased our discretionary cash outlays for capital items during this period as we shifted our focus to cost reduction and cash conservation. As a result, our total capital expenditures amounted to just \$74,000 in 2010, and were \$42,000 in the first quarter of 2011. The Fund's subsidiaries also lease automobiles for the use of its outside sales representatives and certain managers. For the three months ended March 31, 2011 principle payments on automobile finance lease obligation was \$0.2 million (2010 - \$0.2 million). Despite the reduced spending on capital expenditures, we believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment.

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

Available distribution infrastructure refers to the physical capacity of the distribution network maintained by our business, and may be measured in terms of the number and total square footage of distribution centres in operation. Since the Fund's IPO in March 2004, we have made a number of adjustments to our distribution network, including opening, closing, and relocating some of our distribution facilities. In response to the lengthy market downturn, we downsized our distribution infrastructure, closing a total of ten branches between 2007 and 2010. We believe these reductions are appropriate to better match our productive capacity to current market demand.

Selected Unaudited Consolidated Financial Information

	March 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008	December 31, 2007	December 31, 2006
Number of distribution centres in operation	26	26	27	29	36	36
Total square footage of distribution centres	0.9 million s.f.	0.9 million s.f.	1.0 million s.f.	1.1 million s.f.	1.3 million s.f.	1.3 million s.f.

Maintenance of a skilled workforce is also important to managing the productive capacity of our business. Our staffing levels reflect decisions regarding our distribution network and our expectations for sales demand, based upon prevalent economic conditions. Trends in our workforce capacity, as measured in terms of number of employees and average annual sales dollars per employee, are summarized below. Although the productive capacity of our human capital is difficult to measure directly, we believe the productive capacity of our business in terms of our human capital relative to available market demand, as measured by sales, has been largely sustained. Our total number of employees increased by 3 in the first quarter of 2011.

Selected Unaudited Consolidated Financial Information

	March 31, <u>2011</u>	December 31, <u>2010</u>	December 31, <u>2009</u>	December 31, <u>2008</u>	December 31, <u>2007</u>	December 31, <u>2006</u>
Number of employees	175	172	159	190	236	252
Annual sales per employee (\$ millions)	1.2	1.1	1.2	1.3	1.4	1.4

4.5 Utilization of Distributable Cash

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	3 months ended March 31, <u>2011</u>	3 months ended March 31, <u>2010</u>
Distributable Cash	\$ 537	\$ 992
Cash Distributions paid in the period	-	-
Distributable Cash retained (shortfall)	<u>\$ 537</u>	<u>\$ 992</u>
Decrease (increase) in non-cash operating working capital and income taxes paid / received	81	(4,797)
Decrease (increase) in long-term receivables	46	163
Proceeds from disposal of property, plant and equipment	49	19
Decrease (increase) in bank indebtedness, net of cash	<u>\$ 713</u>	<u>\$ (3,623)</u>

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

For the three months ended March 31, 2011, the Fund generated Distributable Cash of \$0.5 million and paid no cash distributions. We decreased our investment in non-cash operating working capital and income taxes by \$0.1 million, and generated a further \$0.1 million in cash from reducing our investment in long-term receivables and from realizing proceeds from the sale of property, plant and equipment. Combined, these actions decreased our bank indebtedness (net of cash) by \$0.7 million in the first quarter of 2011.

4.6 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	As at March 31, 2011	As at December 31, 2010
Cash and cash equivalents	\$ (188)	\$ (43)
Bank indebtedness	6,062	6,745
Net Debt	5,874	6,702
Fund unit liability	144,588	144,366
Net deficit attributable to Unitholders	(85,097)	(83,557)
Total Capitalization	\$ 65,365	\$ 67,511
Net debt to total capitalization	9.0%	9.9%

The Fund considers its capital to be bank indebtedness (net of cash) and the Fund unit liability, less the net deficit attributable to Unitholders. As discussed previously in section 4.5 of this report, we decreased our net debt by \$0.7 million during the three months ended March 31, 2011. The impact of a stronger Canadian dollar (as at March 31, 2011 compared to December 31, 2010) on the conversion of our US dollar bank line reduced our debt by a further \$0.1 million. Combined, the Fund's net debt balance decreased by \$0.8 million to \$5.9 million at March 31, 2011, from \$6.7 million at December 31, 2010. Overall net debt compared to total capitalization stood at 9.0% as of March 31, 2011, compared to 9.9% at December 31, 2010.

We have independent credit facilities in both Canada and the U.S. These facilities may be drawn down to meet short-term financing requirements such as fluctuations in non-cash working capital, and in the case of the Canadian credit facility to also make capital contributions to the Fund's US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is, from time-to-time, limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Fund. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at March 31, 2011 is provided in the following table.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Canadian Credit Facility	US Credit Facility
Maximum borrowings under credit facility	\$15 million	\$24.9 million (US\$25 million)
Credit facility expiry date	August 7, 2012	September 30, 2011
Available to borrow	\$12.7 million	\$ 18.0 million (US\$18.5 million)
Credit facility borrowings	\$ 0.0 million	\$ 5.7 million (US\$ 5.8 million)
Unused credit facility available	<u>\$12.7 million</u>	<u>\$ 12.3 million (US\$ 12.7 million)</u>
Financial covenants:		
a. (EBITDA - Cash Taxes - Capital Expenditures) / Interest ⁽¹⁾		
Covenant minimum	1.1	
Covenant actual	14.8	
b. Minimum Trailing EBITDA covenant		Covenant does not apply when the unused credit facility available exceeds US\$4.0 million, which it did as at March 31, 2011

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

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

The terms of the agreements with our lenders provide that distributions cannot be made to our unitholders in the event that our subsidiaries are not compliant with their financial covenants. As shown in the preceding table, our operating subsidiaries were compliant with all required credit ratios as at March 31, 2011, and accordingly there were no restrictions on distributions arising from non-compliance with financial covenants.

Our debt management strategy is to roll and renew (as opposed to repay and retire) our revolving credit facilities in Canada and the US when they expire in August 2012 and September 2011, respectively. Discussions are presently underway with respect renewal or replacement of our US credit facility which expires in September of this year. Based upon such discussions, we do not anticipate any difficulties in renewing or securing replacement financing for this credit facility. We do not intend to restrict future distributions in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn upon our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and the cash generating capacity of the Fund. When making distribution decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate for the Fund given existing and expected market conditions and available business opportunities. Our focus has been on cash conservation and maximizing liquidity until such time as market

conditions and the Fund's financial performance and cash generating performance have stabilized. We do not target a specific financial leverage amount.

4.7 Contractual Obligations

The table below sets forth our contractual obligations as at March 31, 2010. These obligations relate to leases on various premises and automobiles, and become due in the fiscal years indicated.

(in thousands of Canadian dollars)

	Total	2011	2012	2013	2014	2015	2016 and thereafter
\$	15,082	\$ 3,849	\$ 4,199	\$ 3,267	\$ 2,511	\$ 1,205	\$ 51

4.8 Off-Balance Sheet Arrangements

The Fund has no off-balance sheet arrangements.

5.0 Related Party Transactions

Related parties refers to affiliates of the previous owners of the Business who have retained a 20% interest in Hardwoods through ownership of Class B Hardwoods LP units and Class B Hardwoods USLP units, respectively. For the three months ended March 31, 2011, sales of \$0.1 million were made to related parties, and the subsidiaries of the Fund purchased \$26,000 from related parties. These sales and purchases took place at prevailing market prices.

6.0 Critical Accounting Estimates and Adoption of Changes in Accounting Policies

6.1 Critical Accounting Estimates

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

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

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

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

Fair Value of Non-Controlling Interest: We are required to estimate the fair value of the non-controlling interest liability at each reporting date. Estimating the value of the non-controlling interest requires significant judgment, and we consider, amongst other things, the value of Fund Units as traded on the Toronto Stock Exchange, and the relative economic interests of non-controlling interests compared with Fund Units, including the terms of the subordination arrangements with the non-controlling interest which are more fully described in the notes to the Interim Financial Statements. As the changes in fair value determined at each reporting date are recorded in profit or loss for the period, our estimates of fair value may have a material impact upon our reported profit or loss.

6.2 Adoption of New Accounting Standards

On January 1, 2011 International Financial Reporting Standards (“IFRS”) replaced the previous Canadian standards and interpretations as Canadian generally accepted accounting principles

(“Canadian GAAP”). Due to the requirement to present comparative financial information, the effective transition date is January 1, 2010. The three months ended March 31, 2011 is our first reporting period under IFRS.

Commencing in 2008, we utilized an IFRS changeover plan to assist us with changing from previous Canadian GAAP to IFRS. We have now completed our changeover plan through to IFRS implementation, but will continue post-implementation to continuously monitor changes to IFRS that may impact upon future financial reporting periods.

The notes to our Interim Financial Statements provide detailed reconciliations and explanation of differences between our previous Canadian GAAP financial reporting and our current financial reporting under IFRS. The notes to our Interim Financial Statements also describe our accounting policy decisions, and our choices under IFRS 1 *First-Time Adoption of International Financial Reporting Standards*. As a result of the policy choices we have selected and the changes we were required to make under IFRS, a number of differences have arisen which impact upon our Interim Financial Statements. A summary discussion of the most significant differences is provided below:

- Under IFRS, the Fund units meet the definition of a liability as they impose an obligation on the Fund to distribute taxable income to unitholders. A liability at January 1, 2010 was recorded at the fair value of the Units at the inception of the liability, being \$144.1 million. Direct expenses associated with the initial issuance of the Fund Units, totaling \$10.6 million, were expensed retroactively as a financing cost at the date of issuance, increasing the deficit;
- The exchangeable Fund units held by the non-controlling interest are considered a liability as the units to be issued by the Fund in an exchange are themselves a puttable financial instrument. The non-controlling interest exchangeable units include an embedded derivative, being the ability of the non-controlling interest to convert the exchangeable units to full participating Fund units. The Fund has chosen not to separate the embedded derivative and instead records the non-controlling interest exchangeable unit liability at its estimated fair value as at each reporting date. The estimated fair value of the non-controlling interest at January 1, 2010 was reduced by \$6.0 million to \$2.7 million, with a corresponding

increase to deficit. Fluctuations in the estimated fair value of the non-controlling interest between reporting dates is recorded in income during each period;

- The Fund is required to classify its Long Term Incentive Plan units as a liability under IFRS, and has recognized a liability of \$0.3 million at December 31, 2010 and March 31, 2011. The Long Term Incentive Plan liability is fair valued each period end based on the current market price of the Fund's units. Long term incentive compensation expense is recognized each period based on the estimated number of awards that are expected to vest and in the case of Performance Units, based on the estimated number of Units to be issued provided that the performance conditions are considered probable of achievement;
- At the IFRS balance sheet transition date, the Fund elected under IFRS 1 to reduce to nil cumulative translation differences that existed related to translation of self sustaining foreign subsidiaries. The effect was to decrease the balance of accumulated other comprehensive loss by \$18.1 million at January 1, 2010, and make a corresponding increase to deficit;
- Subsidiaries of the Fund lease vehicles for employee use. Under IFRS such leases are classified as capital leases, rather than operating leases as accounted for previously under Canadian GAAP. The effect at January 1, 2010 was to increase property, plant and equipment by \$1.3 million, and to record a lease obligation liability of \$1.4 million with the difference increasing deficit. Amortization on the property, plant and equipment and finance costs associated with the lease obligation is now recorded in the statement of comprehensive income as compared to an operating lease expense;
- The deferred gain on sale-leaseback of land and building on the balance sheet will be transferred to Unitholders' deficit at January 1, 2010. The effect is a \$0.4 million decrease to liabilities and deficit on January 1, 2010;
- Corresponding deferred income tax impacts related to the above noted adjustments were also recorded at January 1, 2010 of \$0.2 million

In addition to the differences highlighted above, the transition to IFRS resulted in numerous financial statement presentation changes, most significantly in our condensed consolidated

statement of comprehensive income. The most notable presentational changes to our condensed consolidated statement of comprehensive income are described below:

- Expenses by function and nature – our statement of income presents expenses by function. Accordingly, depreciation and amortization is no longer presented as a separate item on the statement of income but is included in selling and distribution expense, and in administration expense;
- Finance expense – finance expense includes interest on bank indebtedness, amortization of deferred finance cost, accretion expense for finance lease obligations, change in fair value of non-controlling interest, and foreign exchange losses;
- Finance income – finance income includes imputed interest on employee loans receivable, and interest on trade receivables and customer notes.

The presentational changes discussed above, along with other presentational changes, resulted in certain items being reclassified within the cash flow statement between the categories of cash flow from operations, financing, and investing activities. However the transition to IFRS had no net impact on total cash and cash equivalents as recorded in our statement of cash flows under IFRS.

With respect to control activities, for all changes to policies and procedures that have been identified, the effectiveness of internal controls over financial reporting and disclosure controls and procedures has been assessed and any changes have been implemented, as necessary. The required accounting process changes that resulted from the application of IFRS accounting policies were not significant.

With respect to business activities and key performance metrics, we have assessed the impact of the IFRS transition project on our financial covenants and key ratios. The transition did not significantly impact our covenants and key ratios. The impact upon our compensation arrangements related to preparation of our financial statements in accordance with IFRS has been considered, and the impact of any identified changes will be assessed in a manner consistent with the intent of our compensation policies.

With respect to information technology and systems, the IFRS changeover did not have a significant impact on our information systems during the IFRS transition period. We also do not expect significant changes in the post-transition period as a result of converting to IFRS.

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

7.0 Risks and Uncertainties

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identified significant risks that we were aware of in our Annual Information Form dated March 24, 2010, and in our Information Circular and Proxy Statement dated April 15, 2011 relating to the proposed plan of arrangement to convert the Fund to a corporate structure, which are available to readers at www.sedar.com.

8.0 Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Any system of internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. There have been no changes in our internal control over financial reporting during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

9.0 Quarterly Financial Information

(in thousands of dollars)	Q1		Q4		Q3		Q2		Q1		Q4		Q3		Q2	
	2011		2010 ⁽¹⁾		2010 ⁽¹⁾		2010 ⁽¹⁾		2010		2009 ⁽¹⁾		2009 ⁽¹⁾		2009 ⁽¹⁾	
Total sales	\$	52,030	\$	46,392	\$	50,559	\$	52,206	\$	48,498	\$	41,577	\$	46,435	\$	49,489
Net earnings	\$	(701)	\$	(543)	\$	263	\$	822	\$	569	\$	(544)	\$	(11,072)	\$	(491)
Basic and fully diluted earnings (loss) per Class A Unit	\$	(0.05)	\$	(0.04)	\$	0.02	\$	0.06	\$	0.04	\$	(0.04)	\$	(0.77)	\$	(0.03)
EBITDA	\$	558	\$	(317)	\$	1,391	\$	2,374	\$	1,240	\$	(2,421)	\$	543	\$	(192)
Distributable Cash	\$	537	\$	(199)	\$	1,259	\$	2,055	\$	992	\$	(505)	\$	230	\$	(569)
Total distributions to Class A and Class B Units	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-	\$	-
Payout ratio		0.0%		0.0%		0.0%		0.0%		0.0%		0.0%		0.0%		0.0%

¹ Information for 2009 and the second, third, and fourth quarters of 2010 is presented in accordance with Canadian GAAP and has not been restated in accordance with IFRS.

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

HARDWOODS DISTRIBUTION INCOME FUND

Unaudited Condensed Consolidated Interim Statement of Financial Position
(Expressed in thousands of Canadian dollars)

	Note	March 31, 2011	December 31, 2010	January 1, 2010
Assets				
Current assets:				
Cash		\$ 188	\$ 43	\$ 463
Accounts receivable	6	31,648	26,656	25,585
Income taxes recoverable		8	1,820	2,286
Inventories	7	26,203	27,441	23,901
Prepaid expenses		615	768	878
Total current assets		58,662	56,728	53,113
Non-current assets:				
Long-term receivables	6	1,478	1,515	1,883
Property, plant and equipment	8	2,509	2,444	2,567
Deferred income taxes		14,980	15,463	17,417
Total non-current assets		18,967	19,422	21,867
Total assets		\$ 77,629	\$ 76,150	\$ 74,980
Liabilities				
Current liabilities:				
Bank indebtedness	9	\$ 6,062	\$ 6,745	\$ 4,564
Accounts payable and accrued liabilities		5,926	3,098	4,035
Income taxes payable		51	41	94
Provisions	10	101	301	385
Finance lease obligation	11	793	733	885
Total current liabilities		12,933	10,918	9,963
Non-current liabilities:				
Provisions	10	361	240	474
Finance lease obligation	11	778	722	267
Non-controlling interests	12	3,771	3,197	2,733
Long term incentive plan liability	13(b)	295	264	-
Fund Units	13(a)	144,588	144,366	144,100
Total non-current liabilities		149,793	148,789	147,574
Total liabilities		162,726	159,707	157,537
Net Deficit Attributable to Unitholders				
Deficit		(82,321)	(81,620)	(82,557)
Accumulated other comprehensive loss		(2,776)	(1,937)	-
Net deficit attributable to unitholders		(85,097)	(83,557)	(82,557)
Total net deficit attributable to unitholders and liabilities		\$ 77,629	\$ 76,150	\$ 74,980

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

Approved on behalf of the Trustees:

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

HARDWOODS DISTRIBUTION INCOME FUND

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

Three month periods ended March 31, 2011 and 2010

	Note	2011	2010
Sales		\$ 52,030	\$ 48,498
Cost of sales		(42,931)	(39,869)
Gross profit		9,099	8,629
Operating expenses:			
Selling and distribution		(6,467)	(6,267)
Administration		(2,005)	(1,772)
Other		(300)	320
		(8,772)	(7,719)
Profit from operating activities		327	910
Finance expense	15	(867)	(266)
Finance income	15	132	140
Net finance costs		(735)	(126)
Profit (loss) before income taxes		(408)	784
Income tax expense:			
Current	14	(13)	(26)
Deferred	14	(280)	(189)
		(293)	(215)
Profit (loss) for the period		(701)	569
Other comprehensive loss:			
Exchange differences translating foreign operations		(839)	(1,244)
Total comprehensive loss for the period		\$ (1,540)	\$ (675)
Basic and diluted profit (loss) per Unit		\$ (0.05)	\$ 0.04

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

Unaudited Condensed Consolidated Statement of Changes in Net Deficit Attributable to Unitholders
(Expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

	Accumulated other comprehensive income- translation reserve	Deficit	Total net assets (deficit) attributable to unitholders
Balance at January 1, 2010	\$ -	\$ (82,557)	\$ (82,557)
Profit for the period	-	569	569
Translation of foreign operations	(1,244)	-	(1,244)
Balance at March 31, 2010	\$ (1,244)	\$ (81,988)	\$ (83,232)
Balance at January 1, 2011	(1,937)	(81,620)	(83,557)
Loss for the period	-	(701)	(701)
Translation of foreign operations	(839)	-	(839)
Balance at March 31, 2011	\$ (2,776)	\$ (82,321)	\$ (85,097)

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

HARDWOODS DISTRIBUTION INCOME FUND

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

Three month periods ended March 31, 2011 and 2010

	Note	2011	2010
Cash flows from operating activities:			
Profit (loss) for the period		\$ (701)	\$ 569
Adjustments for:			
Depreciation	8	231	330
Gain on sale of property, plant and equipment	8	(33)	(2)
Non-cash employee incentive program		252	-
Income tax expense		293	216
Net finance costs		735	126
Interest received		128	133
Interest paid		(158)	(153)
		747	1,218
Changes in non-cash working capital:			
Accounts receivable		(5,500)	(5,297)
Inventories		808	(488)
Prepaid expenses		143	175
Provisions		(70)	(95)
Accounts payable and accrued liabilities		2,904	967
		(1,715)	(4,738)
Income taxes paid		-	(59)
Income tax refunds received		1,796	-
Net cash provided by (used in) operating activities		828	(3,579)
Cash flow from financing activities:			
Increase (decrease) in bank indebtedness		(568)	3,355
Principle payments on finance lease obligation		(168)	(195)
Net cash provided by (used in) financing activities		(736)	3,160
Cash flow from investing activities:			
Additions to property, plant and equipment		(42)	(31)
Proceeds on disposal of property, plant and equipment		49	19
Payments received on long-term receivables		46	163
Net cash provided by investing activities		53	151
Increase (decrease) in cash		145	(268)
Cash, beginning of period		43	463
Cash, end of period		\$ 188	\$ 195

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

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 principle and head office of the Fund is located in Langley, British Columbia. The Fund commenced operations on March 23, 2004 when it completed an Initial Public Offering (the "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 preparation:

(a) Statement of compliance:

These condensed consolidated interim financial statements are prepared in accordance with IAS 34, Interim Financial Reporting and thus do not include all of the information required for full annual financial statements. These are the Fund's first condensed consolidated interim financial statements prepared for part of the period covered by the first IFRS annual financial statements and IFRS 1, First Time Adoption of International Financial Reporting Standards ("IFRS 1"), has been applied. The preparation of these condensed consolidated interim financial statements resulted in changes to the accounting policies adopted by the Fund in its most recent annual financial statements, which were prepared under Canadian generally accepted accounting principals ("GAAP") as issued by the Canadian Institute of Chartered Accountants. An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Fund is explained in note 20 to these condensed consolidated interim financial statements.

The condensed consolidated interim financial statements were authorized for issue by the Board of Directors on May 5, 2011.

(b) Basis of measurement:

The condensed consolidated interim financial statements have been prepared on the historical cost basis, except for the non-controlling interest's exchangeable units liability which is recorded in the statement of financial position at its estimated fair value.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

2. Basis of preparation (continued):

(c) Functional and presentation currency:

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Fund's functional currency. All financial information presented in the financial statements, with the exception of per unit amounts, has been rounded to the nearest thousand.

(d) Use of estimates and judgment:

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual amounts may differ from the estimates applied in the preparation of these financial statements.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgments in applying policies that have the most significant effect on the amounts recognized in the condensed consolidated interim financial statements is included in the following notes:

- Note 6 – the determination of the allowance for doubtful accounts;
- Note 10 – the determination of provisions and contingencies
- Note 11 – the determination of finance lease obligations
- Note 12 – the valuation of the non-controlling interest exchangeable units; and
- Note 14 – the valuation of deferred income taxes and utilization of tax loss carry forwards.

3. Significant accounting policies:

The significant accounting policies that have been used in the preparation of these condensed consolidated interim financial statements are summarized below. These accounting policies have been applied consistently by the Fund and its subsidiaries to all periods presented in these financial statements and in preparing the opening IFRS statement of financial position at January 1, 2010, as required by IFRS 1.

(a) Principles of consolidation:

These condensed consolidated interim financial statements include the accounts of the Fund and its 80% owned subsidiaries, Hardwoods LP and Hardwoods USLP, and other wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

Wholly owned subsidiaries of the Fund are Hardwoods Trust, Hardwoods Specialty Products ULC, and Hardwoods Specialty Products (Washington) Corp.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(b) Foreign currencies:

Foreign currency transactions

Foreign currency transactions are translated into the respective functional currencies of the Fund and its subsidiaries, using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate in effect at the financial statement date. The foreign currency gain or loss on monetary items is the difference between the amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in the foreign currency translated at the exchange rate at the end of the period. Such exchange gains or losses arising from translation are recognized in profit and loss for the reporting period.

Translation of foreign operations for consolidation

For purposes of consolidation, the assets and liabilities of foreign operations with functional currencies other than the Canadian dollar are translated to Canadian dollars using the rate of exchange in effect at the financial statement date. Revenue and expenses of the foreign operations are translated to Canadian dollars at exchange rates at the date of the transactions with the average exchange rate for the period being used for practical purposes. Foreign currency differences resulting from translation of the accounts of foreign operations are recognized directly in other comprehensive income and are accumulated in the translation reserve as a separate component of net deficit attributable to unitholders.

Gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered in substance to form part of the net investment in a foreign operation and are recognized directly in other comprehensive income in the cumulative amount of foreign currency translation differences.

When a foreign operation is disposed of, the amount of the associated translation reserve is fully transferred to profit or loss.

(c) Segment reporting:

Operating segments are based on the information about the components of the entity that management uses to make decisions about operating matters. The subsidiaries of the Fund engage in one main business activity, hence operating segment information is not provided. Geographical segment information is provided by country of operations in note 16.

No one customer represents more than 2.7% of sales, so there is no disclosure of any significant customer information.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(d) Revenue recognition:

Revenue from the sale of hardwood lumber and sheet goods is measured by reference to the fair value of consideration received or receivable by the operating subsidiaries of the Fund, excluding taxes, rebates, and trade discounts. Revenue is recognized when persuasive evidence exists that the Fund has transferred to the buyer the significant risks and rewards of ownership of the goods supplied, recovery of the consideration is probable and the revenue and associated costs can be measured reliably. Significant risks and rewards are generally considered to be transferred when the customer has taken undisputed delivery of the goods.

(e) Finance costs and income:

Finance cost is primarily comprised of interest of the Fund's operating line of credit, distributions to Unitholders during the period, changes in the fair value of the non-controlling interest's exchangeable units, and the unwinding of the discount on the Fund's finance lease obligations. Finance costs also include the amortization of costs incurred to obtain credit facilities in Canada and the United States. Interest on bank indebtedness and accretion of the lease obligation is expensed using the effective interest method. Deferred finance costs are amortized on a straight-line basis over the term of the related debt facility as an effective interest rate method is not practicable given the revolving debt balances. The distributions and change in fair value of the non-controlling interest units are expensed in the period in which they are incurred.

Finance income is comprised of interest earned on cash balances, imputed interest income on employee loans receivable, and interest charged and received or receivable on trade accounts receivable and notes receivable from customers. Finance income is recognized as it accrues using the effective interest method.

Foreign exchange gains and losses are reported on a net basis as either finance income or finance expense.

(f) Inventories:

Inventories are measured at the 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. Net realizable value is the estimated selling price in the ordinary course of business less any applicable selling expenses.

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

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(g) Property, plant and equipment:

Items of property, plant and equipment are carried at acquisition cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Depreciation is provided at straight-line rates sufficient to depreciate the cost of the assets over their estimated useful lives less estimated residual value as follows:

Assets	Estimated useful life
Furniture and equipment	3 to 10 years
Mobile equipment	up to 15 years
Leased vehicles	Over the term of the lease
Leasehold improvements	Over the term of the lease

Leased assets are depreciated over the lease term unless the useful life is shorter than the lease term. If a component of an asset has a useful life that is different from the remainder of the asset, then that component is depreciated separately.

Depreciation methods, material residual value estimates and estimates of useful lives are reviewed at each financial year end and updated as required.

Gains or losses arising on the disposal of property, plant and equipment are determined as the difference between the disposal proceeds and the carrying amount of the assets and are recognized in profit or loss at the time of the disposal.

(h) Impairment:

Non-financial assets

The carrying values of the Fund's non-financial assets are reviewed at each reporting date to assess whether there is any indication of impairment. If any such indication is present, then the recoverable amount of the assets is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purposes of impairment testing, assets are grouped at the lowest levels that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in profit and loss. Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment charge is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(h) Impairment:

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the Fund on terms that the Fund would not consider otherwise, or indications that a debtor or issuer will enter bankruptcy.

The Fund considers evidence of impairment for financial assets, and in particular receivables, at both a specific asset and collective level.

All individually significant receivables are assessed for specific impairment. All individually significant receivables found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Receivables that are not individually significant are collectively assessed for impairment by grouping together receivables with similar risk characteristics. In assessing collective impairment of receivables, management considers the aging of receivables, the nature and extent of security held, historical trends of default, and current economic and credit conditions to estimate impairments.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss is recognized. For financial assets measured at amortized cost, this reversal is recognized in profit or loss.

(i) Financial instruments:

Financial assets and financial liabilities are recognized when the Fund becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. A financial liability is derecognized when it is extinguished, discharged, cancelled or expires.

Financial assets and financial liabilities are measured initially at fair value plus transactions cost, except for financial assets and financial liabilities carried at fair value through profit or loss, which are measured initially at fair value.

The classification and measurement of the Fund's financial instruments is disclosed in note 5 of these condensed consolidated interim financial statements.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(i) Financial instruments (continued):

Cash and cash equivalents

The Fund considers deposits in banks, certificates of deposit and short-term investments with original maturities of three months or less when acquired as cash and cash equivalents.

Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After recognition these are measured at amortized cost using the effective interest method, less provision for impairment. Discounting is omitted where the effect of discounting is immaterial.

Individual receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. Impairment of trade receivables are presented within "selling and distribution expenses".

Loans receivable consist of notes from customers discounted using the effective interest method, and loans to employees for relocation costs, also discounted. Interest revenue on these loans is recognized within "finance income".

Financial liabilities

Loans and payables are non-derivative financial liabilities with fixed or determinable payments that are not quoted in an active market. After initial recognition these liabilities are measured at amortized cost using the effective interest method, less provision for impairment. Discounting is omitted where the effect of discounting is immaterial. The revolving bank line of credit is not discounted; rather, actual interest accrued based on the daily balances is recorded each month.

(j) Income taxes:

Income tax expense comprises current and deferred tax and is recognized in profit and loss. Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of the previous years.

Deferred tax is recognized by the Fund and its subsidiaries in respect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss; differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and taxable differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset only when the Fund has a legally enforceable right and intention to set off current tax assets and liabilities from the same taxation authority.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(j) Income taxes (continued):

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

As the Fund allocates all of its net earnings to Unitholders and deducts these amounts in computing its taxable income, Unitholders, rather than the Fund, have generally been liable for any income tax obligations until December 31, 2010. Effective January 1, 2011, the Fund's distributions are subject to taxation to the extent that such earnings have not been taxed within a subsidiary of the Fund.

(k) Leases:

Automobile leases for which the Fund assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments and a lease obligation is recorded equal to the present value of the minimum lease payments.

Subsequent to initial recognition, the leased asset is accounted for in accordance with the accounting policy applicable to that asset. Minimum lease payments made under finance leases are apportioned between finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Other leases are operating leases and as such the leased assets are not recognized in the Fund's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(l) Provisions and contingent liabilities:

Provisions are recognized in the statement of financial position when the Fund has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

The Fund's provisions include amounts related to the settlement of litigation and onerous contracts where the expected benefits to be derived from a contract are lower than the unavoidable cost of meeting the obligations under the contract.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

3. Significant accounting policies (continued):

(m) Basic and diluted profit (loss) per unit:

The Fund presents basic and diluted profit (loss) per Unit data for its outstanding Fund Units. Basic profit (loss) per unit attributable to unitholders is calculated by dividing profit (loss) by the weighted average number of Fund Units outstanding during the reporting period. Diluted profit (loss) per unit is determined by adjusting the profit or loss attributable to common unitholders and then weighted average number of Fund Units outstanding for the effects of all dilutive potential units.

(n) Unit based compensation:

The Fund has a unit based long-term incentive plan as described in note 13(b). The fair value of the award payable to employees, in the form of Fund Units or cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees unconditionally become entitled to payment. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met. The liability is re-measured at its fair value each reporting date and at the settlement date. Any changes in the fair value of the liability are recognized as an employee expense in profit or loss.

4. Capital management:

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) and the Fund Unit liability, less the net deficit attributable to Unitholders. The Fund's capitalization is as follows:

	March 31, 2011	December 31, 2010	January 1, 2010
Cash and cash equivalents	\$ (188)	\$ (43)	\$ (463)
Bank indebtedness	6,062	6,745	4,564
Fund unit liability	144,588	144,366	144,100
Net deficit attributable to unitholders	(85,097)	(83,557)	(82,557)
Total capitalization	\$ 65,365	\$ 67,511	\$ 65,644

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

4. Capital disclosures (continued):

The terms of the Fund's US and Canadian credit facilities are described in note 9. 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 earnings and cash flow tests as well as certain additional credit ratios. The Fund's operating subsidiaries were compliant with all required credit ratios under the US and Canadian credit facilities as at March 31, 2011, and accordingly there were no restrictions on distributions arising from compliance with financial covenants.

Distributions are one of the ways the Fund manages its capital. Distributions of the Fund's available cash are made to the maximum extent possible, subject to reasonable reserves established by the Trustees of the Fund. Distributions are made by the Fund having given consideration to a variety of factors including the outlook for the business, financial leverage, and the ratio of distributions to available cash of the Fund. There were no changes in the Fund's approach to capital management during the period ended March 31, 2011. On November 3, 2008, the Trustees of the Fund suspended further monthly distributions until such time as market conditions and the Fund's generation of cash has improved.

5. Financial instruments:

Financial instrument assets include cash and cash equivalents, which are designated as fair value through profit and loss, 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, finance lease obligation and the Fund unit liability. 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.

Fair values of financial instruments

The carrying values of cash and cash equivalents, accounts receivable, income tax recoverable, and accounts payable accrued liabilities approximate their fair values due to the relatively short period to maturity of the instruments. The fair value of long-term receivables and finance lease obligations are not expected to differ materially from their respective carrying values, given the interest rates being charged. The carrying values of the credit facilities approximate their fair values due to the existence of floating market based interest rates. The fair value of these non-derivative financial assets and liabilities has been estimated based on the present value of future cash flows, discounted at a market rate of interest at the reporting date.

The fair value of the Fund unit liability at March 31, 2011 is \$40.3 million (December 31, 2010 - \$34.0 million; January 1, 2010 - \$28.8 million) based on the quoted market price of the Fund units at each respective reporting date.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

5. Financial instruments (continued):

Derivative financial instruments

The Fund's non-controlling interest exchangeable Unit liability (note 12) is recorded at fair value each reporting period.

6. Accounts receivable:

The following is a breakdown of the Fund's current and long term receivables and represents the Fund's principal exposure to credit risk.

	March 31, 2011	December 31, 2010	January 1, 2010
Trade accounts receivable - Canada	\$ 12,529	\$ 10,555	\$ 9,756
Trade accounts receivable - United States	21,369	17,726	16,117
Sundry receivable	105	200	203
Current portion of long-term receivables	453	413	919
	34,456	28,894	26,995
Less:			
Allowance for credit loss	2,808	2,238	1,410
	\$ 31,648	\$ 26,656	\$ 25,585
Long-term receivables:			
Employee housing loans	\$ 361	\$ 375	\$ 450
Customer notes	1,115	1,088	1,834
Security deposits	455	465	518
	1,931	1,928	2,802
Less:			
Current portion, included in accounts receivable	453	413	919
	\$ 1,478	\$ 1,515	\$ 1,883

The aging of trade receivables was:

	March 31, 2011	December 31, 2010	January 1, 2010
Current	\$ 22,646	\$ 16,791	\$ 14,557
Past due 31 - 60 days	5,217	5,460	5,283
Past due 61 - 90 days	1,709	2,059	2,181
Past due 90+ days	4,326	3,971	3,852
	\$ 33,898	\$ 28,281	\$ 25,873

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

6. Accounts receivable (continued):

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 March 31, 2010 was \$2.8 million (December 31, 2010 - \$2.2 million; January 1, 2010 - \$1.4 million). The amount of the allowance is considered sufficient based on the past experience of the business, the security the Fund has in place for past due accounts and management's regular review and assessment of customer accounts and credit risk.

Bad debt expense, net of recoveries, for the three month period ended March 31, 2011 was \$0.5 million which equates to 1.0% of sales (three month period ended March 31, 2010 - \$0.5 million, being 1.1% of sales).

7. Inventories:

	March 31, 2011	December 31, 2010	January 1, 2010
Lumber	\$ 9,816	\$ 9,868	\$ 8,224
Sheet goods	12,565	13,270	12,171
Specialty	1,847	2,307	2,099
Goods in-transit	1,975	1,996	1,407
	<u>\$ 26,203</u>	<u>\$ 27,441</u>	<u>\$ 23,901</u>

During the three month period ended March 31, 2011 inventory write-downs totaling \$0.2 million (three month period ended March 31, 2010 - \$0.3 million) were recorded to reduce certain inventory items to their net realizable value.

Cost of sales for the three month period ended March 31, 2011 were \$ 42.9 million (three month period ended March 31, 2010 - \$39.9 million), which included \$ 41.2 million (three month period ended March 31, 2010 - \$38.3 million) of costs associated with inventory. The other \$ 1.7 million (three month period ended March 31, 2010 - \$1.6 million) related principally to freight and other related expenses.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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8. Property, plant and equipment:

	Leased vehicles	Machinery and equipment	Mobile equipment	Leasehold improvements	Total
Cost					
Balance at January 1, 2010	\$ 2,456	\$ 2,095	\$ 3,225	\$ 786	\$ 8,562
Additions	1,476	61	-	13	1,550
Disposals	(1,416)	(137)	(134)	(2)	(1,689)
Adjustments:					
Foreign currency translation	(82)	(63)	(112)	(12)	(269)
Balance at December 31, 2010	2,434	1,956	2,979	785	8,154
Additions	374	9	-	27	410
Disposals	(250)	(2)	(37)	(31)	(320)
Adjustments:					
Foreign currency translation	(38)	(26)	(48)	(4)	(116)
Balance at March 31, 2011	\$ 2,520	\$ 1,937	\$ 2,894	\$ 777	\$ 8,128
Accumulated depreciation					
Balance at January 1, 2010	\$ 1,180	\$ 1,685	\$ 2,394	\$ 736	\$ 5,995
Depreciation during period	706	189	205	37	1,137
Disposals	(974)	(133)	(133)	(2)	(1,242)
Adjustments:					
Foreign currency translation	(31)	(53)	(85)	(11)	(180)
Balance at December 31, 2010	881	1,688	2,381	760	5,710
Depreciation during period	172	35	19	5	231
Disposals	(174)	(2)	(36)	(31)	(243)
Adjustments:					
Foreign currency translation	(13)	(24)	(38)	(4)	(79)
Depreciation March 31, 2011	\$ 866	\$ 1,697	\$ 2,326	\$ 730	\$ 5,619
Net book value:					
January 1, 2010	\$ 1,276	\$ 410	\$ 831	\$ 50	\$ 2,567
December 31, 2010	1,553	268	598	25	2,444
March 31, 2011	1,654	240	568	47	2,509

HARDWOODS INCOME DISTRIBUTION FUND

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8. Property, plant and equipment (continued):

Depreciation of property, plant and equipment for the three month period ended March 31, 2011 was \$ 0.2 million (three month period ended March 31, 2010 - \$0.3 million) and is included in the statement of comprehensive income as follows:

	2011	2010
Selling and distribution	\$ 224	\$ 290
Administration	7	40
	<u>\$ 231</u>	<u>\$ 330</u>

Gains and losses on disposal of property, plant and equipment for the three month period ended March 31, 2011 was \$ 33,491 (three month period ended March 31, 2010 - \$1,937) and is included in the statement of comprehensive income as follows:

	2011	2010
Selling and distribution	\$ 33	\$ 2
Administration	-	-
	<u>\$ 33</u>	<u>\$ 2</u>

9. Bank indebtedness:

	March 31, 2011	December 31, 2010	January 1, 2010
Checks issued in excess of funds on deposit	\$ 553	\$ 282	\$ 1,077
Credit facility, Hardwoods LP	-	548	1,945
Credit facility, Hardwoods USLP			
(March 31, 2011 - US\$5,857;			
December 31, 2010 - US\$6,162;			
January 1, 2010 - US\$1,844)	5,679	6,129	1,938
Deferred finance fees	(170)	(214)	(396)
	<u>\$ 6,062</u>	<u>\$ 6,745</u>	<u>\$ 4,564</u>

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

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

HARDWOODS INCOME DISTRIBUTION FUND

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9. Bank indebtedness (continued):

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

The amount made available under the Credit Facility to Hardwoods LP from time to time is limited to the extent of 85% of the book value of accounts receivable and the lesser of 60% of the book value or 85% of appraised value of inventories with the amount based on inventories not to exceed 60% of the total amount to be available. Certain identified accounts receivable and inventories are excluded from the calculation of the amount available under the Credit Facility. Hardwoods LP is required to maintain a fixed charge coverage ratio (calculated as the ratio of EBITDA less cash taxes less capital expenditures, divided by interest) of not less than 1.1 to 1. At March 31, 2011, the Hardwoods LP credit facility had \$ 12.8 million of additional borrowing capacity.

The amount to be made available under the Credit Facility to Hardwoods USLP from time to time is limited to the extent of 85% of the book value of certain accounts receivable and 50% of the book value of inventories (with certain accounts receivable and inventory being excluded). Hardwoods USLP is required to maintain a fixed charge coverage ratio (calculated as EBITDA less cash taxes less capital expenditures, divided by interest plus distributions) of 1.0 to 1. These covenants of the Hardwoods USLP Credit Facility do not need to be met however when the unused availability under the credit facility is in excess of US\$4.0 million. At March 31, 2011, the Hardwoods USLP credit facility had unused availability of \$ 12.3 million (US\$ 12.7 million).

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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10. Provisions:

	Legal	Onerous contracts	Total
Balance at January 1, 2010	\$ 203	\$ 656	\$ 859
Provisions made during the period	150	-	150
Provisions used during the period	(53)	(415)	(468)
Adjustments during the period	-	-	-
Balance at December 31, 2010	300	241	541
Provisions made during the period	-	-	-
Provisions used during the period	-	(74)	(74)
Adjustments during the period	(5)	-	(5)
Balance at March 31, 2011	\$ 295	\$ 167	\$ 462
Non-current	\$ 295	\$ 66	\$ 361
Current	-	101	101
	\$ 295	\$ 167	\$ 462

Legal

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

Onerous contracts

Due to the closure of some branches before the expiry of the lease the Fund has a legal obligation to pay the monthly lease until the expiry date. The Fund has mitigated the obligation by sub-leasing the properties. The Fund has made provision for the net lease obligation in the case that the sub-lease does not cover the entire obligation. The full expense was recognized in profit/loss in the period of the branch closure and subsequently the related liability is being reduced over the life of the obligation as cash payments are made. The liability is measured at the present value of the expected net cost of the remaining term of the contract.

Decommissioning

The Fund and its subsidiaries are not obligated in any material way for decommissioning or site restoration.

HARDWOODS INCOME DISTRIBUTION FUND

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11. Leases:

(a) Finance leases as lessee:

Subsidiaries of the Fund lease vehicles with terms ranging from 18 to 50 months. Hardwoods LP guarantees a residual value under the terms of the leases in Canada, and any difference between the amount realized and the guaranteed residual value is either paid to or paid by Hardwoods LP. In the US the lease payments cover the full capitalized cost over the term of the lease, and any proceeds from the sale of the vehicle are paid to Hardwoods USLP. The Fund and its subsidiaries have determined that these vehicle leases are considered finance leases and are recorded on the statement of financial position.

Finance lease liabilities are payable as follows:

Minimum lease payments due	Within one year	One to five years	Total
March 31, 2011:			
Future minimum lease payments	\$ 712	\$ 740	\$ 1,452
Interest	81	38	119
Present value of minimum payments	\$ 793	\$ 778	\$ 1,571
December 31, 2010:			
Future minimum lease payments	\$ 660	\$ 686	\$ 1,346
Interest	73	36	109
Present value of minimum payments	\$ 733	\$ 722	\$ 1,455
January 1, 2010:			
Future minimum lease payments	\$ 842	\$ 251	\$ 1,093
Interest	43	16	59
Present value of minimum payments	\$ 885	\$ 267	\$ 1,152

The present value of the lease payments is calculated using the interest rate implicit in the lease.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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11. Leases (continued):

(b) Operating leases as lessee:

The Fund's subsidiaries are obligated under various operating leases, mainly building leases that require future minimum rental payments as follows:

Minimum lease payments due	one year	Within One to five years	After five years	Total
Minimum lease payments due: March 31, 2011	\$ 4,213	\$ 9,493	\$ -	\$ 13,706
Minimum sublease revenue receivable: March 31, 2011	343	42	-	385

Minimum lease payments recognized as an expense during the period amount to \$1.0 million (2010 - \$1.3 million). Sublease payments received during the year were \$0.2 million (2010 - \$0.2 million) and are recognized as a reduction to sales and distribution costs on the statement of comprehensive income.

The Fund's operating lease agreements do not contain any contingent rent clauses. Some operating building lease agreements contain renewal options but none contains any restrictions regarding distributions, further leasing or additional debt. Renewal options are reviewed regularly by management.

12. Non-controlling interests:

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

HARDWOODS INCOME DISTRIBUTION FUND

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12. Non-controlling interests (continued):

- 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 U.S. 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 March 31, 2011.

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

- At the end of each month, cash advances or distributions will be made to the holders of Class A LP Units and Class A USLP Units in a combined amount that is sufficient to provide available cash to the Fund to enable the Fund to make cash distributions upon the Units for such month at least equal to \$0.08542 per Unit or, if there is insufficient available cash to make distributions or advances in such amount, such lesser amount as is available as determined by the Board of Directors of the general partners;
- At the end of each fiscal quarter of Hardwoods LP and Hardwoods USLP, including the fiscal quarter ending on the fiscal year end, available cash of Hardwoods LP and Hardwoods USLP will be advanced or distributed in the following order of priority:
 - First, in payment of the monthly cash advance or distribution to the holders of Class A LP Units and Class A USLP Units as described above, for the month then ended;
 - Second, to the holders of Class A LP Units and Class A USLP Units, to the extent that the combined monthly cash advances or distributions in respect of the 12 month period then ended (and not, for greater certainty, in any previous 12 month period) on Class A LP Units and Class A USLP Units were not made or were made in amounts less than a combined amount at least equal to \$1.025 per Unit, the amount of any such deficiency. As of March 31, 2011, the amount of such deficiency was \$14.8 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 March 31, 2011, the amount of such deficiency was nil; and

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12. Non-controlling interests (continued):

- 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.

For accounting purposes, the non-controlling interest exchangeable Units, being the Class B LP Units and the Class B USLP Units, are considered a liability as the Units to be issued by the Fund in an exchange are themselves a puttable financial instrument. The non-controlling interest exchangeable Units include an embedded derivative, being the ability of the non-controlling interest to convert the exchangeable Units to full participating Fund Units, subject to the conditions noted in the preceding paragraphs. The Fund has chosen not to separate the embedded derivative and is instead recording the non-controlling interest exchangeable unit liability at its estimated fair value as at the reporting date.

The fair value of the non-controlling interest exchangeable unit liability is estimated to be as follows:

	March 31, 2011	December 31, 2010	January 1, 2010
Non-controlling interest exchangeable unit liability	\$ 3,771	\$ 3,197	\$ 2,733

Changes in the fair value of the above noted liability are recorded in the statement of comprehensive income as part of net finance expense (note 15).

HARDWOODS INCOME DISTRIBUTION FUND

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13. Fund Units:

- (a) An unlimited number of Units and Special Voting Units may be created and issued pursuant to the Fund's Declaration of Trust. Each Unit is transferable and represents an equal undivided beneficial interest in any distributions from the Fund, whether of net income, net realized capital gains or other amounts and in the net assets of the Fund in the event of a termination or winding up of the Fund. Units of the Fund are redeemable at the holders' option for amounts based on the market price of the Units at the time of redemption, subject to a maximum of \$50,000 in cash redemptions by the Fund in any particular month. The Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund or in the net assets of the Fund in the event of a termination or winding up of the Fund. Each Unit, or Special Voting Unit, entitles the holder thereof to one vote at all meetings of voting Unitholders.

On March 23, 2004, the Fund issued 14,410,000 Units at a price of \$10 per Unit pursuant to the Offering. Proceeds from the Offering were \$144.1 million and expenses of the Offering of \$10.6 million were expensed at the time of the transaction. The holders of the Class B Units of Hardwoods LP and Hardwoods USLP were issued 3,602,500 Special Voting Units of the Fund, which are to be cancelled on the exchange of Class B Units of Hardwoods LP and Hardwoods USLP for Units of the Fund.

The Fund Units are classified as a liability under IFRS in accordance with IAS 32, Financial Instruments: Presentation. This classification is a result of the Units being puttable instruments as the holder has the option to redeem the Units for amounts based on the market prices at the time of redemption and the Units have a contractual obligation requiring delivery of income to the unitholders. The Fund has recorded the liability at the fair value of the Units at the inception of the liability, being \$144.1 million and has recorded the amounts subsequent to initial recognition on an amortized cost basis. Direct expenses associated with the initial issuance of the Fund Units, totaling \$10.6 million, were expensed as a financing cost at the date of issuance. Subsequent issuances of Fund units have been recorded at the fair value of the Units at the date of issuance.

A continuity of the Fund Unit liability is as follows:

	Units		Total
Balance at January 1, 2010	14,410,000	\$	144,100
Issued pursuant to long term incentive plan	113,858		266
Balance at December 31, 2010	14,523,858		144,366
Issued pursuant to long term incentive plan	80,227		222
Balance at March 31, 2011	14,604,085	\$	144,588

The income linked distribution stream arising from the Units is not considered to be an embedded derivative by the Fund as it is considered a non-financial variable specific to one of the parties to the contract and thus does not meet the criteria for a derivative.

HARDWOODS INCOME DISTRIBUTION FUND

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13. Fund Units (continued):

(b) Long Term Incentive Plan:

At the Annual General Meeting held on May 20, 2010, the Unitholders approved a long term incentive plan ("LTIP") which authorized the issuance of a maximum of 850,000 LTIP Units to qualified trustees, directors, officers, employees and consultants to align the interests of such persons with the interests of Unitholders. Terms of the Fund's LTIP are described in the Fund's most recent annual financial statements dated December 31, 2010.

In accordance with the IFRS 2, Share-based Payment, the Fund is required to classify its Restricted Units and Performance Units as cash settled awards as they convert into Units of the Fund which are redeemable at the holder's option. The amount of compensation cost is measured each period end based on the current market price of the Fund's Units and the expense is recognized each period during the requisite service period based on the estimated number of awards that are expected to vest and in the case of Performance Units, based on the estimated number of Units to be issued provided that the performance conditions are considered probable of achievement.

A continuity of the LTIP Units outstanding is as follows:

	Performance Units	Restricted Units
Balance at January 1, 2010	-	-
LTIP Units issued during the period	160,452	341,571
LTIP Units settled by exchange for free-trading Fund Units	-	(113,858)
Balance at December 31, 2010	160,452	227,713
LTIP Units issued during the period	-	-
LTIP Units settled by exchange for free-trading Fund Units	(80,227)	-
Balance at March 31, 2011	80,225	227,713

Restricted and Performance Units vest over a three year period from the grant dates. As of March 31, 2011, 80,227 Performance Units became fully vested and were settled by the issuance of Fund Units with a fair value of \$0.2 million.

A non-cash compensation expense and associated long-term incentive plan amount of \$ 252,446 was recorded for the three month period ended March 31, 2011 (2010 - nil).

14. Income taxes:

Income tax expense is recognized based on management's best estimate of the annual income tax rates expected for the full financial year applied to the pre-tax income earned in Canada and the United States for the interim period. The Fund's consolidated effective tax rate is affected by changes in the fair value of the non-controlling interest which results in no current or future taxes attributable to unitholders and other non deductible expenses of the Fund.

HARDWOODS INCOME DISTRIBUTION FUND

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15. Finance income and expense:

	Note	Three months ended March 31, 2011	Three months ended March 31, 2010
Finance expense:			
Interest on bank indebtedness	9	\$ 136	\$ 142
Amortization of deferred finance cost	9	44	45
Accretion of finance lease obligation	11	24	19
Change in fair value of non-controlling interest	12	574	-
Foreign exchange losses		89	60
Total finance expense		867	266
Finance income:			
Imputed interest on employee loans receivable	6	4	7
Interest on trade receivables and customer notes	6	128	133
Total finance income		132	140
Net finance costs		\$ 735	\$ 126

16. Segment reporting:

Information about geographic areas is as follows:

	Three months ended March 31, 2011	Three months ended March 31, 2010
Revenue from external customers:		
Canada	\$ 20,642	\$ 19,685
United States	31,388	28,813
	\$ 52,030	\$ 48,498
Non-current assets:		
Canada	\$ 8,234	\$ 8,340
United States	10,733	11,082
	\$ 18,967	\$ 19,422

HARDWOODS INCOME DISTRIBUTION FUND

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17. Employee remuneration:

(a) Employee benefits expense:

Expenses recognized for employee benefits are analyzed below.

	Three months ended March 31, 2011	Three months ended March 31, 2010
Wages, salaries, and benefits	\$ 4,347	\$ 3,750
Pensions - defined contribution plans	126	124
LTIP Unit compensation	252	-
	\$ 4,725	\$ 3,874

Employee benefit expenses are included in the consolidated statement of comprehensive income as follows:

	Three months ended March 31, 2011	Three months ended March 31, 2010
Selling and distribution	\$ 3,487	\$ 2,936
Administration	1,238	938
	\$ 4,725	\$ 3,874

(b) 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 condensed consolidated interim financial statements. During the three month period ended March 31, 2011, Hardwoods USLP contributed and expensed \$58,069 (US\$58,906) (three month period ended March 31, 2010 - \$59,618 (US\$57,320)) 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 condensed consolidated interim financial statements. During the three month period ended March 31, 2011, Hardwoods LP contributed and expensed \$68,343 (three month period ended March 31, 2010 - \$64,168) in relation to the LP Plan.

HARDWOODS INCOME DISTRIBUTION FUND

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18. Related party transactions:

The Fund's related parties include its non-controlling Class B unit holder, key management, and post-employment benefit plan for the employee's of the Fund's subsidiaries.

(a) Transactions with non-controlling interest:

For the three month period ended March 31, 2011, sales of \$121,894 (three month period ended March 31, 2010 - \$127,702) were made to affiliates of SIL, and the Fund's subsidiaries made purchases of \$26,390 (three month period ended March 31, 2010 - \$27,542) from affiliates of SIL. All these sales and purchases took place at prevailing market prices.

(b) Transactions with key management personnel:

Key management of the Fund includes members of the Board of Directors, the President, Chief Financial Officer, and regional Vice Presidents. Key management personnel remuneration includes the following expenses:

	Three months ended March 31, 2011	Three months ended March 31, 2010
Short-term employee benefits:		
Salaries and benefits including bonuses	\$ 312	\$ 325
Company car	9	14
LTIP Unit compensation	88	-
Termination benefits	106	-
Total remuneration	\$ 515	\$ 339

The Fund offers housing loans to employees required to relocate. Key management had no loans outstanding at either March 31, 2011 or December 31, 2010.

(c) Transactions with post-employment benefit plans:

The defined contribution plan referred to in note 17(b) is a related party to the Fund. The Fund's transactions with the pension scheme include contributions paid to the plan, which are disclosed in note 17(b). A subsidiary of the Fund paid US\$750 during 2011 for administration of the plan. The Fund has not entered into other transactions with the pension plan, neither has it any outstanding balances at the reporting dates under review.

19. 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.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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20. Explanation of transition to IFRS:

As stated in note 2(a), these are the Fund's first condensed consolidated interim financial statement prepared in accordance with IAS 34.

The accounting policies set out in note 2 have been consistently applied in preparing the interim financial statements for the three month period ended March 31, 2011, the comparative period ended March 31, 2010 and the year ended December 31, 2010 and in the preparation of an opening IFRS statement of financial position at January 1, 2010 (the Fund's date of transition).

Adjustments on transition to IFRS

In preparing its opening IFRS statement of financial position, the Fund has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Fund's financial position and financial performance is set out in the following tables and the accompanying notes thereto.

HARDWOODS INCOME DISTRIBUTION FUND

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20. Explanation of transition to IFRS (continued):

Reconciliation of Condensed Consolidated Statement of Financial Position at January 1, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets				
Current assets:				
Cash		\$ 463	\$ -	\$ 463
Accounts receivable		25,585	-	25,585
Income taxes recoverable		2,286	-	2,286
Inventories		23,901	-	23,901
Prepaid expenses		878	-	878
Total current assets		53,113	-	53,113
Non-current assets:				
Long-term receivables		1,883	-	1,883
Property, plant and equipment	e	1,291	1,276	2,567
Deferred financing costs	h	396	(396)	-
Deferred income taxes	i	17,587	(170)	17,417
Total non-current assets		21,157	710	21,867
Total assets		\$ 74,270	\$ 710	\$ 74,980
Liabilities				
Current liabilities:				
Bank indebtedness	h	\$ 4,960	\$ (396)	\$ 4,564
Accounts payable and accrued liabilities	g	4,988	(953)	4,035
Income taxes payable	g	-	94	94
Provisions	g	-	385	385
Finance lease obligation	e	-	885	885
Total current liabilities		9,948	15	9,963
Non-current liabilities:				
Deferred gain	d	416	(416)	-
Provisions	g	-	474	474
Finance lease obligation	e	-	267	267
Non-controlling interests	c	8,748	(6,015)	2,733
Fund Units	b	-	144,100	144,100
Total non-current liabilities		9,164	138,410	147,574
Total liabilities		19,112	138,425	157,537
Net Assets (Deficit) Attributable to Unitholders				
Fund Units	b	133,454	(133,454)	-
Deficit	k	(60,198)	(22,359)	(82,557)
Accumulated other comprehensive loss	a	(18,098)	18,098	-
Total net assets (deficit) attributable to unitholders		55,158	(137,715)	(82,557)
Total net assets (deficit) and liabilities		\$ 74,270	\$ 710	\$ 74,980

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Reconciliation of Condensed Consolidated Statement of Financial Position at March 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets				
Current assets:				
Cash		\$ 195	\$ -	\$ 195
Accounts receivable		30,148	-	30,148
Income taxes recoverable		2,209	-	2,209
Inventories		23,877	-	23,877
Prepaid expenses		689	-	689
Total current assets		57,118	-	57,118
Non-current assets:				
Long-term receivables		1,794	-	1,794
Property, plant and equipment	e	1,122	1,448	2,570
Deferred financing costs	h	348	(348)	-
Deferred income taxes	i	17,087	(168)	16,919
Total non-current assets		20,351	932	21,283
Total assets		\$ 77,469	\$ 932	\$ 78,401
Liabilities				
Current liabilities:				
Bank indebtedness	h	\$ 8,130	\$ (348)	\$ 7,782
Accounts payable and accrued liabilities	g	5,706	(798)	4,908
Income taxes payable	g	-	58	58
Provisions	g	-	401	401
Finance lease obligation	e	-	692	692
Total current liabilities		13,836	5	13,841
Non-current liabilities:				
Deferred gain	d	383	(383)	-
Provisions	g	-	342	342
Finance lease obligation	e	-	617	617
Non-controlling interests	c	8,502	(5,769)	2,733
Fund Units	b	-	144,100	144,100
Total non-current liabilities		8,885	138,907	147,792
Total liabilities		22,721	138,912	161,633
Net Assets (Deficit) Attributable to Unitholders				
Fund Units	b	133,454	(133,454)	-
Deficit	k	(59,784)	(22,204)	(81,988)
Accumulated other comprehensive loss	a	(18,922)	17,678	(1,244)
Total net assets (deficit) attributable to unitholders		54,748	(137,980)	(83,232)
Total net assets (deficit) and liabilities		\$ 77,469	\$ 932	\$ 78,401

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Reconciliation of Condensed Consolidated Statement of Financial Position at December 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Assets				
Current assets:				
Cash		\$ 43	\$ -	\$ 43
Accounts receivable		26,656	-	26,656
Income taxes recoverable		1,820	-	1,820
Inventories		27,441	-	27,441
Prepaid expenses		768	-	768
Total current assets		56,728	-	56,728
Non-current assets:				
Long-term receivables		1,515	-	1,515
Property, plant and equipment	e	891	1,553	2,444
Deferred financing costs	h	214	(214)	-
Deferred income taxes	i	15,594	(131)	15,463
Total non-current assets		18,214	1,208	19,422
Total assets		\$ 74,942	\$ 1,208	\$ 76,150
Liabilities				
Current liabilities:				
Bank indebtedness	h	\$ 6,959	\$ (214)	\$ 6,745
Accounts payable and accrued liabilities	g	3,680	(582)	3,098
Income taxes payable	g	-	41	41
Provisions	g	-	301	301
Finance lease obligation	e	-	733	733
Total current liabilities		10,639	279	10,918
Non-current liabilities:				
Deferred gain	d	320	(320)	-
Provisions	g	-	240	240
Finance lease obligation	e	-	722	722
Non-controlling interests	c	8,744	(5,547)	3,197
Long term incentive plan liability	j	-	264	264
Fund Units	b	-	144,366	144,366
Total non-current liabilities		9,064	139,725	148,789
Total liabilities		19,703	140,004	159,707
Net Assets (Deficit) Attributable to Unitholders				
Fund Units	b	133,653	(133,653)	-
Contributed surplus	j	198	(198)	-
Deficit	k	(59,242)	(22,378)	(81,620)
Accumulated other comprehensive loss	a	(19,370)	17,433	(1,937)
Net assets (deficit) attributable to unitholders		55,239	(138,796)	(83,557)
Total net assets (deficit) and liabilities		\$ 74,942	\$ 1,208	\$ 76,150

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Reconciliation of Condensed Consolidated Statement of Comprehensive Income for the three month period ended March 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Sales		\$ 48,498	\$ -	\$ 48,498
Cost of sales		(39,869)	-	(39,869)
Gross profit		8,629	-	8,629
Expenses:				
Selling and distribution	e,f	-	(6,267)	(6,267)
Administration	f,j	-	(1,772)	(1,772)
Other	f	-	320	320
Sales and administration	f	(7,460)	7,460	-
Depreciation	f	(156)	156	-
Deferred financing costs	f	(45)	45	-
Amortization of deferred gain	d	19	(19)	-
Interest	f	(145)	145	-
Foreign exchange gains (losses)	f	(57)	57	-
		(7,844)	125	(7,719)
Finance expense	c,e,f	-	(266)	(266)
Finance income	f	-	140	140
Net finance expense		-	(126)	(126)
Non-controlling interest	c	(157)	157	-
Profit before income taxes		628	156	784
Income tax expense				
Current	i	(26)	-	(26)
Deferred	i	(188)	(1)	(189)
		(214)	(1)	(215)
Profit for the period		414	155	569
Other comprehensive loss:				
Exchange differences translating foreign operations		(824)	(420)	(1,244)
Total comprehensive loss for the period		\$ (410)	\$ (265)	\$ (675)
Basic and diluted profit per Unit		\$ 0.03	\$ 0.01	\$ 0.04

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Reconciliation of Condensed Consolidated Statement of Comprehensive Income for the year ended December 31, 2010:

	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
Sales		\$ 197,655	\$ -	\$ 197,655
Cost of sales		(163,298)	-	(163,298)
Gross profit		34,357	-	34,357
Expenses:				
Selling and distribution	e,f	-	(24,268)	(24,268)
Administration	f,i	-	(6,857)	(6,857)
Other	f	-	317	317
Sales and administration	f	(29,740)	29,740	-
Depreciation	f	(431)	431	-
Deferred financing costs	f	(177)	177	-
Amortization of deferred gain	d	76	(76)	-
Interest	f	(709)	709	-
Foreign exchange gains (losses)	f	(161)	161	-
		(31,142)	334	(30,808)
Finance expense	c,e,f	-	(1,605)	(1,605)
Finance income	f	-	577	577
Net finance expense		-	(1,028)	(1,028)
Non-controlling interest	c	(643)	643	-
Profit before income taxes		2,752	(51)	2,521
Income tax expense:				
Current	i	(104)	-	(104)
Deferred	i	(1,512)	32	(1,480)
		(1,616)	32	(1,584)
Profit for the year		956	(19)	937
Other comprehensive loss:				
Exchange differences translating foreign operations		(1,272)	(665)	(1,937)
Total comprehensive loss for the year		\$ (316)	\$ (684)	\$ (1,000)
Basic and diluted profit per Unit		\$ 0.07	\$ 0.00	\$ 0.07

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(a) IFRS-1 “First-time Adoption of International Financial Reporting Standards (“IFRS 1”):

IFRS 1 generally requires that first-time adopters retrospectively apply all effective IFRS standards and interpretations in effect as at the reporting date. IFRS-1 also provides for certain optional exemptions and certain mandatory exceptions to this general principle. The Fund has made the following elections under IFRS-1:

- (i) The Fund has elected under IFRS 1 not to apply IFRS 3 Business Combinations (“IFRS 3”) retrospectively to business combinations that occurred prior to January 1, 2010 (the date of transition to IFRS). Accordingly, the Fund has continued with the same accounting treatment of previous business combinations under Canadian GAAP.
- (ii) The Fund has elected under IFRS 1 not to apply IAS 21 The Effects of Changes in Foreign Exchange Rates to the cumulative translation differences that arose prior to the date of transition to IFRS. The cumulative translation differences that existed for foreign subsidiaries at the date of transition to IFRS have been deemed to be nil and the amount recorded at December 31, 2009 under Canadian GAAP was transferred to deficit. Gains or loss on a subsequent disposal of foreign operations will exclude translation differences that arose before the date of transition to IFRS.

The effect of this election is to increase deficit and decrease accumulated other comprehensive loss by \$18.1 million at January 1, 2010, March 31, 2010, and December 31, 2010 as compared to amounts reported under previous Canadian GAAP.

- (b) Previously under Canadian GAAP, the Fund’s Units were classified as equity instruments. In Accordance with IAS 32, Financial Instruments: Presentation, the Fund Units are classified as a long-term liability as the Units are considered puttable financial instruments as the holder has the option to redeem the Units for amounts related to market prices at the time of the redemption and the Units impose an obligation requiring delivery of income to the unitholders. Certain exceptions provided in IAS 32 allow some puttable instruments to be classified as equity under IFRS, however these conditions are much more restrictive than previous Canadian GAAP. The Fund does not meet the exceptions in IAS 32 for equity presentation, as the Fund has a contractual obligation to distribute its taxable income to unitholders on an annual basis.

The Fund has made the following two accounting policy elections with respect to these units:

- (i) it has not separated the income distribution stream as an embedded derivative as it is considered to be dependent on a non-financial variable specific to a party to the contract, and
- (ii) it has elected to treat the distribution stream based on income as a floating rate financial instrument.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

(b) (continued):

As a result the Fund has recorded the liability at the cash amount originally exchanged for the Units, being \$144.4 million. The effect of classification of the Fund Units as a long-term liability is to reduce Unitholders' equity and increase long-term liabilities by \$144.4 million at January 1, 2010, March 31, 2010, and December 31, 2010 as compared to amounts reported under previous Canadian GAAP. The Fund has transferred \$10.6 million of related unit issuance costs previously netted against the Unitholders' equity balance to deficit as a financing cost expensed prior to the IFRS adoption date.

Consistent with the classification of the Fund units as a liability, distributions paid to Unitholder's are considered a financing cost in the statement of comprehensive income. As no distributions were paid during the year ended December 31, 2010, there is no impact to the comparative statement of comprehensive income. As the Fund units are treated as a floating rate liability, any changes in the distributions based on changes to income levels are expensed in the period in which they occur.

(c) The Fund's non-controlling interest is in the form of exchangeable Class B units that, under certain conditions, can be converted into units of the Fund, as described in note 12 to these financial statements. In accordance with IAS 32, if the instruments to be received on exchange are themselves puttable instruments, or instruments that impose an obligation to deliver a pro rata share of the net assets of the entity on liquidation, the exchangeable instruments are themselves considered a financial liability. As the Fund's units are themselves considered a liability, the non-controlling interest's exchangeable units are also considered a liability. As the non-controlling interest was previously presented in the statement of financial position as a liability there is no difference in classification arising from the transition to IFRS.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

(c) (continued):

As described in note 12, the non-controlling interest's exchangeable units are measured at fair value at each financial statement date and the difference is recorded as a gain or loss in the net finance cost section of the consolidated statement of comprehensive income. The impact resulting from the change in measurement of the non-controlling interest is as follows:

	Three months ended March 31, 2010	Year ended December 31, 2010	
Consolidated statement of comprehensive income			
Decrease in non-controlling interest share of net income	\$ 157	\$ 643	
Increase in finance income (expense)	-	(464)	
Increase in comprehensive income	\$ 157	\$ 179	
	January 1, 2010	March 31, 2010	December 31, 2010
Consolidated statement of financial position			
Decrease in non-controlling interest	\$ (6,015)	\$ (5,769)	\$ (5,547)
Decrease in deficit	\$ 6,015	\$ 5,769	\$ 5,547

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets (continued)

- (d) During the year ended December 31, 2005, a subsidiary of the Fund sold a building and related land to an unrelated third party and subsequently leased back the facilities. Canadian GAAP required the gain on the sale to be deferred and it was amortized in proportion to the rental payments until the changeover to IFRS. IFRS requires the gain on the sale to be recognized in income when the sale is made at fair market value and the leaseback is classified as an operating lease. The Fund has determined that under IFRS the gain on sale would have been recognized in its entirety in 2005.

The impact arising from the transition to IFRS is summarized as follows:

	Three months ended March 31, 2010	Year ended December 31, 2010	
Consolidated statement of comprehensive income			
Decrease in other income	\$ (19)	\$ (76)	
Increase in deferred income tax expense	(28)	(25)	
Decrease in comprehensive income	\$ (47)	\$ (101)	
	January 1, 2010	March 31, 2010	December 31, 2010
Consolidated statement of financial position			
Decrease in deferred gain on sale leaseback	\$ (416)	\$ (383)	\$ (320)
Reduction in deferred income tax asset	131	104	101
Decrease in deficit	\$ 285	\$ 279	\$ 219

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

- (e) Under previous Canadian GAAP, leases of automobiles used by the Fund's sales people were considered operating leases. Upon assessment of IAS 17 Leases, the Fund has concluded that the automobile leases are finance leases, primarily because the gains or losses from the fluctuation in the fair value of the automobiles residual values accrue to the Fund and its subsidiaries as a result of a residual value guarantee included in the lease agreement.

The effect of this change in classification has resulted in the Fund's subsidiaries recording a finance lease obligation and increasing its property, plant and equipment to reflect the depreciated value of the automobiles. Furthermore, the statement of comprehensive income now includes depreciation expense related to the automobiles and finance costs related to the lease obligation, as compared to an operating lease expense which had been previously recorded as a selling and distribution expense.

The impact arising from the change is summarized as follows:

	Three months ended March 31, 2010	Year ended December 31, 2010	
Consolidated statement of comprehensive income			
Increase (decrease) in selling and distribution:			
Decrease in operating lease expense	\$ 229	\$ 911	
Increase in amortization expense	(174)	(707)	
Decrease in gain on leased autos	(18)	(131)	
Decrease in expense related to leased autos	37	73	
Increase in finance costs	(19)	(94)	
(Increase) decrease in deferred income tax expense	27	(7)	
(Increase) decrease in comprehensive income	\$ 45	\$ (28)	
	January 1, 2010	March 31, 2010	December 31, 2010
Consolidated statement of financial position			
Increase in property, plant and equipment	\$ 1,276	\$ 1,448	\$ 1,553
Increase in capital lease obligation:			
Current portion	(885)	(692)	(733)
Long-term portion	(267)	(617)	(722)
Decrease in future tax asset	(39)	(64)	(30)
Decrease in deficit	85	75	68

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

- (f) Management has elected to present the Consolidated Statement of Comprehensive Income according to the expenses functional classification. Previously under GAAP, the sales and administrative expenses were presented together. Under IFRS, these categories have been separated and expenses such as employee expenses and benefits (note 17) and amortization (note 8) have been allocated between these functional categories.
- (g) In accordance with IAS 37, Provisions, *Contingent Liabilities and Contingent Assets*, management of the Fund reviewed its assessments relating to provisions for legal proceedings based on the probability-weighted average of the possible outcomes. There is no change to provisions at January 1, 2010, March 31, 2010 or December 31, 2010.

Other provisions and income taxes payable that were previously included in accounts payable and accrued liabilities have been separately disclosed on the IFRS statement of financial position. The impact of these reclassifications is as follows:

	January 1, 2010	March 31, 2010	December 31, 2010
Consolidated statement of financial position			
Decrease in accounts payable and accrued liabilities	\$ (953)	\$ (801)	\$ (582)
Reclassified to provisions:			
Current portion	385	402	301
Long-term portion	474	341	240
Reclassified to income taxes payable	94	58	41

- (h) In accordance with IAS 32, deferred finance costs that were directly incurred in attaining revolving credit facilities by subsidiaries of the Fund are to be netted against the associated bank indebtedness. Under previous Canadian GAAP, such charges were shown as a long-term asset. This reclassification has no impact on the Fund's deficit.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

- (i) The above changes increased (decreased) the deferred tax asset as follows based on a tax rate of 39.4% in the US and 26% in Canada:

	Note	January 1, 2010	March 31, 2010	December 31, 2010
Decrease to the deferred tax asset arising from:				
Elimination of deferred gain on sale lease-back financing charges	d	131	104	101
Recognition of finance lease obligation and corresponding adjustment to property, plant and equipment	e	39	64	30
Decrease in deferred tax asset		\$ (170)	\$ (168)	\$ (131)

- (j) In accordance with IFRS 2, Share-based Payment, the Fund is required to classify its Restricted Units and Performance Units, issued under the Fund's LTIP, as a liability as compared to equity (contributed surplus) under previous Canadian GAAP. In addition, unlike Canadian GAAP, the LTIP liability is remeasured each period end based on the current market price of the Fund's units.

The impact arising from the transition to IFRS is summarized as follows:

	Three months ended March 31, 2010	Year ended December 31, 2010
Consolidated statement of comprehensive income		
Increase in administration expense	\$ -	\$ (134)

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
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Three month periods ended March 31, 2011 and 2010

20. Explanation of transition to IFRS (continued):

Notes to the reconciliation of net assets

(j) (continued):

	January 1, 2010	March 31, 2010	December 31, 2010
Consolidated statement of financial position			
Increase in long term incentive plan liability	\$ -	\$ -	\$ 264
Increase in fund unit liability	-	-	68
Decrease in contributed surplus	-	-	(198)
Increase in deficit	\$ -	\$ -	\$ (134)

(k) The above noted changes decreased (increased) deficit (each net of related tax) as follows:

	Note	January 1, 2010	March 31, 2010	December 31, 2010
Reclassification of cumulative currency differences	a	\$ (18,098)	\$ (17,678)	\$ (17,433)
Unit issue costs	b	(10,646)	(10,646)	(10,646)
Fair value non-controlling interest	c	6,015	5,769	5,547
Deferred gain on sale leaseback	d	285	279	219
Finance leases	f	85	75	68
LTIP compensation	j	-	-	(134)
CTA on adjustment items			(3)	1
Increase in deficit		(22,359)	(22,204)	(22,378)

(l) The following table is a reconciliation of the change in classification of cash flows arising from the transition to IFRS for the three month period ended March 31, 2010:

	Canadian GAAP	Effect of transition to IFRS	IFRS
Net cash provided used in operating activities	\$ (3,785)	\$ 206	\$ (3,579)
Net cash provided by financing activities	3,355	(195)	3,160
Net cash provided by investing activities	162	(11)	151

The adjustments to the cash flow classification arise as a result of the presentation of the Fund's automobile leases as finance leases. In accordance with the Fund's lease classification, the principle repayments on the automobile leases are presented as a financing activity.

HARDWOODS INCOME DISTRIBUTION FUND

Notes to Unaudited Condensed Consolidated Interim Financial Statements
(Tabular amounts expressed in thousands of Canadian dollars)

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21. Subsequent event:

On April 15, 2011, the Board of Trustees of the Fund approved a proposed transaction providing for the reorganization of the Fund into a corporate structure. The conversion will be completed by way of a plan of arrangement under the Canada Business Corporations Act (the "Arrangement"). Pursuant to the Arrangement holders of Fund Units will receive common shares ("Common Shares") of the newly created corporation, Hardwoods Distribution Inc. (the "Corporation"), on a one-for-one basis. Concurrently with the Arrangement, holders of the Special Voting Units of the Fund and corresponding Class B limited partner units of Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP (together the "Exchangeable Units") shall directly or indirectly exchange each Exchangeable Unit for 0.3793 Common Shares of the Corporation. Upon completion of the Arrangement, the Corporation will hold all the assets previously held by the Fund and will wholly own Hardwoods Specialty Products LP and Hardwoods Specialty Products US LP. The Arrangement will result in the Corporation having approximately 15,970,513 Common Shares issued and outstanding after closing. Completion of the transactions contemplated by the Arrangement is subject to certain conditions, including regulatory approval and the approval of at least two thirds of votes cast by holders of Fund Units and Special Voting Units of the Fund at the annual general and special meeting of the Fund scheduled for May 19, 2011.

Unitholder Information

Trustees

R. Keith Purchase
Trustee

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

Directors

R. Keith Purchase
Director

Terry M. Holland
President, Krystal Financial Corp.

Graham M. Wilson
President, Grawil Consultants Inc.

E. Lawrence Sauder
Chair and CEO, Sauder Industries

William Sauder
Executive VP, Sauder Industries

Officers

Lance R. Blanco
President & Chief Executive Officer

Robert J. Brown
Vice President & CFO

Daniel A. Besen
Vice President, California

Garry W. Warner
Vice President, Canada

Head Office

#306 – 9440 202nd Street
Langley, BC Canada V1M 4A6
Telephone: 604-881-1988
Facsimile: 604-881-1995

Auditors

KPMG LLP
Vancouver, British Columbia

Investor Relations

Rob Brown
Chief Financial Officer
Telephone: 604-881-1990
Email: robbrown@hardwoods-inc.com

Listings

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

Transfer Agent

Computershare Trust
Company of Canada

