Management's Discussion and Analysis

August 2, 2013

This management's discussion and analysis ("MD&A") has been prepared by Hardwoods Distribution Inc. ("HDI" or the "Company") as of August 2, 2013. This MD&A covers our unaudited interim condensed consolidated financial statements as at and for the three and six month periods ended June 30, 2013 ("Interim Financial Statements"). As well, it provides an update to the MD&A section contained in the Company's 2012 Annual Report. The information below should be read in conjunction with the Interim Financial Statements and the audited consolidated financial statements and accompanying notes of the Company for the years ended December 31, 2012 and 2011 ("Audited Financial Statements"). Results are reported in Canadian dollars unless otherwise stated, and have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting." For additional information, readers should also refer to our Annual Information Form and other information filed on www.sedar.com.

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

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

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This MD&A includes the following sections:

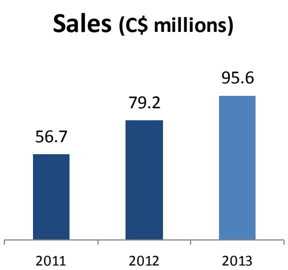
1.0 Executive Summary

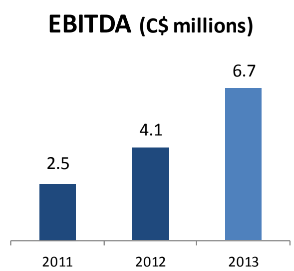
1.1 Overview

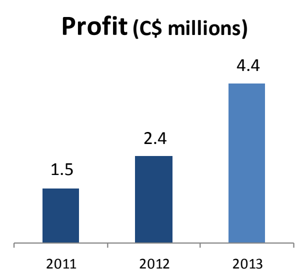
We achieved strong results in the second quarter of 2013 as we responded to growing demand from the US residential construction market. With nearly three quarters of our business in the US, and approximately half of our US sales focused on new residential construction, we are well positioned to benefit from the recovery in this market. Higher sales volumes, together with increased product prices, contributed to our best quarterly sales and EBITDA results in nine years.

For the three months ended June 30, 2013, revenue grew 20.8%, gross profit increased 30.1%, EBITDA was up 65.8%, and profit climbed 85.2% compared to the same period in 2012. For the six months ended June 30, 2013, we grew revenue by 20.1%, gross profit by 25.8%, EBITDA by 79.3% and profit by 110.5% compared to the first half of 2012.

Three Months Ended June 30th:







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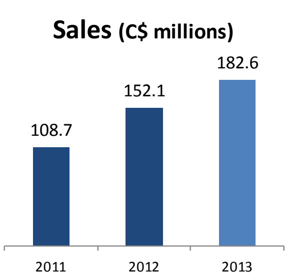

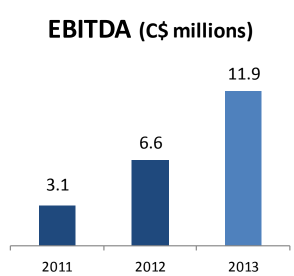

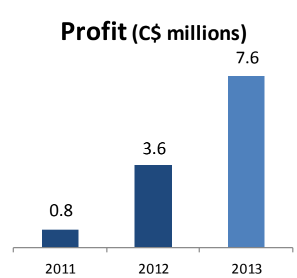

Our US operations successfully capitalized on the improving business conditions, with US sales up 24.9% in the second quarter compared to the second quarter of 2012. Substantially all of this growth was organic, and it is estimated roughly half of the sales increase was driven by higher sales volumes, and the balance attributed to higher product prices.

According to the US Census Bureau, the seasonally adjusted annual rate of US housing averaged 872,000 starts during the second quarter, up 18% from 741,000 during the same period last year. Average prices for hardwood lumber products were up approximately 14% year-over-year according to the Hardwood Lumber Review. Prices for hardwood plywood and other sheet goods vary by product type, but are estimated to have appreciated on average by 10% to 20% during the second quarter, compared to the same period a year ago.

Changes in market prices for the products we sell are generally passed through to our customers, enabling us to achieve a reasonably stable gross profit margin. However certain market conditions, including rapidly changing product prices, can contribute to quarter-to-quarter margin variations. During the second quarter and first half of 2013, prices increased more quickly than normal for our industry. As a result we achieved gross profit margins of 18.9% in the second quarter and 18.6% in the first six months of the year, both of which are at the high end of our historical gross margin range. We view a gross margin percentage around 18% to be a more sustainable level for our business under normal business conditions, and expect gross margin will trend down to more typical levels in the second half of the year.

Strategically, we continued to execute on our market expansion strategy and further strengthened our US branch network with the purchase of a hardwood lumber import business located in Leland, North Carolina (“Leland”). Acquired on May 31, 2013 for $3.0 million, the Leland business builds on our well-established strength as an importer of hardwood products by extending our direct sourcing capabilities to tropical lumber from Africa and South America. The acquisition also expands our US branch network into the US East Coast for the first time. The acquired business contributed 0.3% of our sales growth in the second quarter, reflecting the timing of the transaction and the relatively small size of the business.

Our Canadian operations grew sales revenue despite a slowdown in Canadian residential construction activity. According to the Canada Mortgage and Housing Corporation, the seasonally adjusted rate of housing starts declined 12.5% at the end of the second quarter, compared to the same time a year ago. This slowdown reflects the impact of tighter mortgage rules implemented in 2012 to cool the housing market. Our success in achieving Canadian sales growth of 6.9% in the second quarter and 5.3% during the first half primarily reflects stronger product prices offsetting the impact of lower sales volumes. While demand levels may differ between Canada and the US, product price dynamics are typically similar as the majority of products we sell are purchased from sources outside of Canada.

Commercial/institutional construction markets continued to exhibit modest growth during the second quarter and first half of 2013.

Second quarter and first half operating expenses increased moderately year-over-year as we supported growth in our business. As a percentage of sales, however, expenses were lower than a year ago, reflecting the efficiency of our business model. Our EBITDA as a percentage of sales for the first half of the year climbed to 6.5%, which is the highest EBITDA margin achieved by our business since 2005.

Overall we are encouraged by our second quarter and first half results. On August 2nd our Board of Directors declared a quarterly dividend of $0.035 per share, payable October 31, 2013 to shareholders of record as of October 18, 2013. The Board regularly evaluates the dividend with due regard to desired financial leverage and the outlook for the business. This includes assessing cash needs to finance additional working capital to support growth of the business, the potential utilization of cash to help finance acquisition opportunities, and consideration of uncertainties facing the business such as the trade case against Chinese plywood.

1.2 Outlook

We anticipate that business conditions will remain strong through the balance of 2013 and beyond with forecasters continuing to predict a multi-year strengthening trend for the US residential construction market. Given that hardwood products are typically applied at the final stages of house construction (approximately 9-to-12 months after house construction starts), we expect to see higher demand for our products continuing well into 2014.

The outlook for the US market is tempered by uncertainty over the impact of new antidumping and countervailing duties against imported hardwood plywood panels produced in China. Approximately 14% of our total sales in 2012 were comprised of hardwood plywood manufactured in China and resold to customers in the United States. The next significant development in the trade case is expected in September 2013, when final duty determinations will be announced by the US Department of Commerce. We are watching this case closely and investigating a range of alternative supply solutions. During the first half of 2013, we further improved our import capabilities for panel products from Indonesia, Malaysia, and Russia.

The outlook for the Canadian market is generally neutral with 2013 housing starts expected to remain below 2012 levels following the changes to Canada's mortgage insurance rules. Growth in the Canadian renovation and commercial construction markets is expected to be modest at 3.6% and 3.4% respectively.

Our primary goal in the remainder of 2013 will be to continue capturing the growth potential from a strengthening US housing market, both in terms of sales volumes and product pricing. In the third year of our successful market expansion strategy, we will also continue to:

1. Leverage our ability to source high quality products from a range of international markets.

2. Strengthen our presence in commercial and institutional construction markets.

3. Solidify our presence in large geographic markets, primarily through the introduction of new products, and through the expansion of production capabilities at our Paxton branches.

Overall our outlook for 2013 remains very positive. We are successfully optimizing and growing the business organically, and we will continue to pursue well-priced, strategic acquisition opportunities.

2.0 Background

2.1 Company Overview

Hardwoods is one of North America's largest wholesale distributors of hardwood lumber and related sheet good products, operating a network of 32 distribution centres in the US and Canada. Hardwoods Distribution Inc. is listed on the Toronto Stock Exchange and trades under the symbol HWD.

2.2 Business and Industry Overview

Serving customers for over 50 years, Hardwoods is one of North America's largest distributors of high-grade hardwood lumber and specialty sheet goods to the cabinet, moulding, millwork, furniture and specialty wood products industries. At August 2, 2013 we operated 32 distribution facilities located in 17 states and 5 provinces throughout North America. To maximize inventory management, we utilize a hub and spoke distribution system, with major hub distribution centres holding the bulk of our inventory and making regular truck transfers to replenish stock in satellite distribution centres that are located in smaller markets.

Approximately one third of our product mix is made up of high-grade hardwood lumber. The balance is made up of sheet goods and other specialty products, including hardwood plywood and non-structural sheet goods such as medium-density fiberboard, particleboard and melamine-coated stock. Our sheet goods and lumber are complementary product lines; both are key products used by our customers in the manufacture of their end-use products.

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

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

The majority of the hardwood lumber distributed in North America is harvested from North American hardwood forests, located principally in the Eastern United States, and is milled by hundreds of small mills. Imported hardwood lumber is largely limited to specialty species that generally do not compete with domestic hardwood lumber. Sheet goods are generally produced in North America by large manufacturers using domestic hardwoods and other materials, although imported hardwood plywood volumes have been increasing. Both domestic and imported hardwood lumber and plywood are distributed principally by third parties such as us.

3.0 Results of Operations

3.1Three Months Ended June 30, 2013 and June 30, 2012

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

	For the three months Ended June 30 2013	For the three months Ended June 30 2012	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 95,617	$ 79,153	$ 16,464	20.8%
Sales in the US (US$)	*69,535*	*55,686*	*13,849*	24.9%
Sales in Canada	*24,484*	*22,909*	*1,575*	6.9%
Gross profit	18,081	13,894	4,187	30.1%
Gross profit %	*18.9%*	*17.6%*		
Operating expenses	(11,683)	(10,141)	1,542	15.2%
Profit from operating activities	6,398	3,753	2,645	70.5%
Add: Depreciation and amortization	342	312	30	9.6%
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 6,740	$ 4,065	$ 2,675	65.8%
Add (deduct):				
Depreciation and amortization	(342)	(312)	(30)	-9.6%
Net finance income	102	135	(33)	-24.4%
Income tax expense	(2,097)	(1,511)	(586)	-38.8%
Profit for the period	$ 4,403	$ 2,377	$ 2,026	85.2%
Basic and fully diluted profit per share	$ 0.27	$ 0.15		
Average Canadian dollar exchange rate for one US dollar	1.023	1.010		

Sales

For the three months ended June 30, 2013, total sales increased to $95.6 million, up 20.8% from $79.2 million during the same period in 2012. Organic growth from existing operations accounted for $16.1 million of the sales increase. The remaining $0.4 million in increased sales was contributed by the acquired Leland import lumber business which was purchased on May 31, 2013.

Sales in our US operations were US$69.5 million, an increase of US$13.8 million or 24.9% compared to the same period in the prior year. This growth reflects higher sales volumes related to increased demand from the US residential construction market. Product prices also increased, reflecting the shift to higher market demand, as well as in response to the imposition of duties on hardwood plywood imported from China described in section 8.0 of this report.

Sales in Canada increased by $1.6 million, or 6.9%. This improvement reflects the higher product pricing, partially offset by weaker volume demand in Canada. As the majority of the products we sell originate in the United States, conditions that cause hardwood prices to increase in the US generally also result in higher selling prices in Canada.

Gross Profit

Gross profit for the three months ended June 30, 2013 was $18.1 million, an increase of $4.2 million, or 30.1%, from $13.9 million in the second quarter of 2012. This improvement reflects higher sales together with an increase in gross profit margin. As a percentage of sales, second quarter gross profit was 18.9%, compared to 17.6% in the same period in 2012. The unusually strong gross profit margin reflects the short-term benefit of selling lower-cost inventory into a rising price market. Over the longer term, we view 18% as a sustainable gross margin target for our business, while recognizing that results may fluctuate up or down based upon short-term market conditions.

Operating Expenses

Operating expenses were $11.7 million in the second quarter of 2013, compared to $10.1 million during the second quarter of 2012, an increase of $1.5 million. This increase primarily reflects additional personnel costs incurred to support the significant increase in sales, and an increase in bad debt expense to 0.8% of sales, following an unusually low bad debt result during the same period last year when no bad debt expense was incurred. As a percentage of sales, second quarter 2013 operating expenses improved to 12.2% of sales, from 12.8% in 2012.

EBITDA

For the three months ended June 30, 2013, EBITDA increased to $6.7 million, up $2.7 million from $4.1 million in the second quarter of 2012. The significant improvement reflects the $4.2 million increase in gross profit, partially offset by the $1.5 million increase in operating expenses.

Income Tax Expense

An income tax expense of $2.1 million was recorded in the second quarter of 2013, compared to $1.5 million in the same period in the prior year. The increase in income tax expense reflects higher taxable income generated during the three months ended June 30, 2013 compared to the same period in 2012.

Profit for the Period

Profit for the three months ended June 30, 2013 increased to $4.4 million, from $2.4 million during the same period in 2012. The $2.0 million improvement reflects the $2.7 million increase in EBITDA, partially offset by a $0.6 million increase in income tax expense.

3.2 Six Months Ended June 30, 2013 and June 30, 2012

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

	For the six months Ended June 30 2013	For the six months Ended June 30 2012	$ Increase (Decrease)	% Increase (Decrease)
Total sales	$ 182,600	$ 152,092	$ 30,508	20.1%
Sales in the US (US$)	*133,447*	*106,786*	*26,661*	25.0%
Sales in Canada	*47,044*	*44,697*	*2,347*	5.3%
Gross profit	33,981	27,004	6,977	25.8%
Gross profit %	*18.6%*	*17.8%*		
Operating expenses	(22,769)	(20,991)	1,778	8.5%
Profit from operating activities	11,212	6,013	5,199	86.5%
Add: Depreciation and amortization	671	614	57	9.3%
Earnings before interest, taxes, depreciation and amortization ("EBITDA")	$ 11,883	$ 6,627	$ 5,256	79.3%
Add (deduct):				
Depreciation and amortization	(671)	(614)	(57)	-9.3%
Net finance income (cost)	269	(205)	474	231.2%
Income tax expense	(3,898)	(2,206)	(1,692)	-76.7%
Profit for the period	$ 7,583	$ 3,602	$ 3,981	110.5%
Basic and fully diluted profit per share	$ 0.46	$ 0.22		
Average Canadian dollar exchange rate for one US dollar	1.016	1.006		

Sales

For the six months ended June 30, 2013 total sales increased to $182.6 million, from $152.1 million in the first half of 2012, an increase of $30.5 million or 20.1%.

Our sales growth was predominantly driven by our US operations, where first-half sales activity increased by US$26.7 million or 25.0%. The stronger US sales reflect increased volume demand and stronger product pricing related to improved market conditions, as well as the benefits of strategy implementation as discussed in section 1.0 of this report.

First half sales in Canada increased by $2.3 million, or 5.3% year-over-year, with stronger product pricing helping to offset the impact of flat-to-slightly lower sales volumes.

Gross Profit

First-half gross profit increased to $34.0 million, from $27.0 million in the first six months of 2012. The 25.8% improvement reflects increased sales and a higher gross profit margin. As a percentage of sales, gross profit increased to 18.6% in the first half of 2013, from 17.8% during the same period in 2012 as we capitalized on improving market conditions and rising product prices.

Operating Expenses

Operating expenses increased $1.8 million to $22.8 million in the first six months of 2013, from $21.0 million during the same period in 2012. The increase reflects higher personnel costs incurred to support growth, together with the return to more typical levels of bad debt expense. Bad debt expense in the current year is running at 0.5% of sales (2012 – 0.2% of sales), which is within the normal historical range for our operations. As a percentage of sales, first-half operating expenses improved to 12.5% of sales, compared to 13.8% in 2012.

EBITDA

For the six months ended June 30, 2012, EBITDA increased to $11.9 million, from $6.6 million during the same period in 2012. The $5.3 million, or 79.3%, increase reflects the $7.0 million increase in gross profit, partially offset by the $1.8 million increase in operating expenses.

Net Finance Income (Cost)

(in thousands of Canadian dollars)		Six months ended June 30, 2013		Six months ended June 30, 2012		$ Increase (Decrease)
Finance expense:						
Interest on bank indebtedness	$	(478)	$	(350)	$	128
Accretion of finance lease obligation		(44)		(41)		3
Write-off of uncollectible interest on trade receivables		-		(49)		(49)
Total finance expense		(522)		(440)		82
Finance income:						
Interest on trade receivables						
customer notes, and employee loans		241		200		41
Foreign exchange gain		550		35		515
Total finance income		791		235		556
Net finance income (cost)	$	269	$	(205)	$	(474)

Net finance income during the first half of 2013 was $0.3 million, compared to a net finance cost of $0.2 million during the same period in 2012. As shown in the preceding table, the main factor in this increase was a $0.5 million increase in foreign exchange gain between the periods. This primarily reflects the impact of changes in the Canadian/US dollar exchange rate on translation for reporting purposes of intercompany debt held by or with subsidiaries of the Company. During the six months ended June 30, 2013, a weakening of the Canadian dollar resulted in a foreign exchange gain of $0.6 million on this intercompany debt, compared to just $35,000 in the comparative period in 2012.

Income Tax Expense

Income tax expense increased to $3.9 million in the first six months of 2013, from $2.2 million in the same period in 2012. This increase primarily reflects higher taxable income.

Profit for the Period

Profit for the six months ended June 30, 2013 increased to $7.6 million, from $3.6 million during the same period in 2012. The $4.0 million, or 110.5% improvement primarily reflects the $5.3 million increase in EBITDA and the $0.5 million increase in net finance income, partially offset by a $0.1 million increase in depreciation expense and the $1.7 million increase in income tax expense.

4.0 Quarterly Financial Information and Seasonality

(in thousands of dollars)	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012	Q4 2011	Q3 2011
Total sales	$ 95,617	$ 86,983	$ 74,133	$ 79,862	$ 79,153	$ 72,939	$ 63,899	$ 57,372
Profit (loss)	$ 4,403	$ 3,180	$ 1,313	$ 1,264	$ 2,377	$ 1,225	$ (350)	$ 5,605
Basic profit (loss) per share or unit	$ 0.27	$ 0.19	$ 0.08	$ 0.08	$ 0.15	$ 0.08	$ (0.02)	$ 0.37
Fully diluted profit (loss) per share or unit	$ 0.27	$ 0.19	$ 0.08	$ 0.08	$ 0.15	$ 0.07	$ (0.02)	$ 0.36
EBITDA	$ 6,740	$ 5,143	$ 2,407	$ 3,313	$ 4,065	$ 2,562	$ 941	$ 1,928

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 acquisitions (which occurred with the Paxton acquisition in the three months ended September 30, 2011, and with the import lumber business acquisition in Leland, NC, which occurred in the three months ended June 30, 2013), changes to the foreign exchange rate of the Canadian and US dollar, and changes in the carrying value of deferred income tax assets (which occurred in the three months ended September 30, 2011).

5.0 Liquidity and Capital Resources

5.1 Cash Flows from Operating, Investing and Financing Activities

Selected Unaudited Consolidated Financial Information (in thousands of Canadian dollars)	Three months ended June 30			Six months ended June 30		
	2013	2012	$ Change	2013	2012	$ Change
Cash provided by operating activities before changes in non-cash working capital	$ 5,224	$ 3,919	$ 1,305	$ 9,738	$ 6,501	$ 3,237
Changes in non-cash working capital	(11,005)	(7,765)	(3,240)	(24,942)	(13,231)	(11,711)
Net cash provided by (used in) operating activities	(5,781)	(3,846)	(1,935)	(15,204)	(6,730)	(8,474)
Net cash provided by (used in) investing activities	(3,164)	(106)	(3,058)	(3,084)	72	(3,156)
Net cash provided by financing activities	8,934	3,966	4,968	18,205	6,327	11,878
Increase (decrease) in cash	(11)	14	(25)	(83)	(331)	248
Cash, beginning of period	22	47	(25)	94	392	(298)
Cash, end of period	$ 11	$ 61	$ (50)	$ 11	$ 61	$ (50)

Net cash used in operating activities

In the three months ended June 30, 2013, cash used in operating activities was $5.8 million, compared to $3.8 million in the same period in 2012. Cash provided by operating activities, before changes in non-cash working capital, increased by $1.3 million. This primarily reflects the $2.7 million increase in second quarter EBITDA, partially offset by a $1.3 million increase in income taxes paid. In addition, investment in non-cash working capital was $3.2 million higher in the second quarter of 2013 compared to the same period in the prior year. An analysis of changes in working capital is provided in section 5.2 of this report.

For the six months ended June 30, 2013, cash used in operating activities was $15.2 million, compared to $6.7 million during the same period in the prior year. Cash provided by operating activities, before changes in non-cash working capital, increased by $3.2 million. The increase primarily reflects the $5.3 million increase in EBITDA partially offset by the $1.9 million increase in income taxes paid. Investment made in non-cash working capital increased by $11.7 million in the six months ended June 30, 2013 compared to the prior year period. An analysis of changes in working capital is provided in section 5.2 of this report.

Net cash provided by (used in) investing activities

Net cash used in investing activities increased by $3.1 million and $3.2 million, respectively, in the second quarter and first six months of 2013 compared to the same periods in 2012. The increase in both periods primarily reflects the Leland acquisition of $3.0 million made on May 31, 2013. Net cash provided by (used in) investing activities comprises cash collections on long-term receivables and proceeds from disposal of property, plant and equipment, less expenditures made on business acquisitions as well as capital expenditures made to acquire additional property, plant and equipment.

Other than our five Paxton distribution centres, our capital expenditures are typically low as we lease our buildings and contract out all freight delivery services. Capital expenditures in this part of our business are principally for the replacement of forklifts, furniture and fixtures, leasehold improvements and computer equipment.

Our Paxton business requires some additional ongoing investment in moulders and other light remanufacturing equipment. Paxton also buys trailers and leases tractor units for use in delivery of product to customers, whereas other Hardwoods operations contract out this freight delivery service to third-party carriers.

We believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment. Ongoing maintenance capital expenditures for our operations are anticipated to be approximately $1.0 million annually.

We also lease automobiles for the use of outside sales representatives and certain managers. For the three months ended June 30, 2013, principle payments on automobile finance lease obligation were $0.2 million (2012 - $0.2 million) and for the six months ended June 30, 2013 were $0.4 million (2012 - $0.4 million).

Net cash provided by financing activities

Net cash provided by financing activities increased by $5.0 million and $11.9 million, respectively, in the second quarter and the first six months of 2013 when compared to the same periods in 2012. The year-over-year increases primarily reflect increased bank indebtedness as we supported sales growth with higher working capital investment. In addition, we increased our bank borrowings during the second quarter of 2013 to finance the $3.0 million purchase of import lumber business located in Leland, NC.

5.2 Working Capital

Our business requires an ongoing investment in working capital, which we consider to be comprised of accounts receivable, inventory, and prepaid expenses, partially offset by provisions and short-term credit provided by suppliers in the form of accounts payable and accrued liabilities. We had working capital of $112.0 million at June 30, 2013, compared to $80.8 million at June 30, 2012. Most of this increase is attributable to our increased investment in accounts receivable and inventory to support sales growth of just over 20% in the three and six month periods ended June 30, 2013 compared to the same periods in the prior year, as well as additional working capital acquired as part of the Leland acquisition.

Our investment in working capital fluctuates from quarter-to-quarter based on factors such as seasonal sales demand, strategic purchasing decisions taken by management, and the timing of collections from customers and payments made to our suppliers. Historically the first and fourth quarters are seasonally slower periods for construction activity and therefore demand for hardwood products decreases. As a result, sales and working capital requirements may be lower in these quarters. A summary of changes in our non-cash operating working capital during the three and six months ended June 30, 2013 and 2012 is provided below.

(in thousands of Canadian dollars) Source (use) of funds	**Three months ended June 30, 2013**	**Three months ended June 30, 2012**	**Six months ended June 30, 2013**	**Six months ended June 30, 2012**
Accounts receivable	$ (3,872)	$ (2,478)	$ (13,397)	$ (9,034)
Inventory	(7,328)	(5,755)	(12,444)	(5,905)
Prepaid expenses	(5)	(669)	219	(514)
Provisions	-	14	(7)	5
Accounts payable and accrued liabilities	200	1,123	687	2,217
Increase in non-cash operating working capital	$ (11,005)	$ (7,765)	$ (24,942)	$ (13,231)

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

5.3 Revolving Credit Facilities and Debt Management Strategy

Selected Unaudited Consolidated Financial Information (in thousands of dollars)	**As at June 30, 2013**	**As at December 31, 2012**
Cash	$ (11)	$ (94)
Bank indebtedness	45,909	24,683
Net Debt	45,898	24,589
Shareholders' equity	85,314	76,012
Total Capitalization	$ 131,212	$ 100,601
Net debt to total capitalization	35.0%	24.4%
Previous 12 months EBITDA	$ 17,603	$ 12,347
Net debt to previous 12 months EBITDA	2.6	2.0

We consider our capital to be bank indebtedness (net of cash) and shareholder’s equity. As shown above, our net debt balance increased by $21.3 million to $45.9 million at June 30, 2013, from $24.6 million at December 31, 2012. This increase in net debt primarily reflects the use of our bank lines to finance additional investment in working capital to support our higher sales, and the $3.0 million Leland acquisition completed on May 31, 2013. Overall net debt compared to total capitalization stood at 35.0% as at June 30, 2013, compared to 24.4% at December 31, 2012.

We have independent credit facilities in both Canada and the U.S. Our Canadian credit facility, which has a maturity date of August 7, 2016, provides financing up to $15.0 million. On February 15, 2013, our US credit facility was amended to increase the maximum borrowing available under the credit facility to US$45 million and to extend the maturity date to May 26, 2016. On May 31, 2013, our US credit facility was further amended to increase the maximum borrowing available to US$50 million. This amendment was undertaken concurrently with the completion of the Leland acquisition. Our credit facilities may be drawn down to meet short-term financing requirements such as fluctuations in non-cash working capital, and in the case of the Canadian credit facility, to also make capital contributions to our US operating subsidiary. The amount made available under our Canadian and US revolving credit facilities is limited to the extent of the value of certain accounts receivable and inventories held by subsidiaries of the Company. Credit facilities also require ongoing compliance with certain credit ratios. A summary of our credit facilities at June 30, 2013 is provided in the following table. At June 30, 2013, we had total borrowing capacity available of $22.3 million for future use, as well as to cover checks issued in excess of funds on deposit, which at June 30, 2013, amounted to $0.8 million.

Selected Unaudited Consolidated Financial Information (in thousands of dollars)

	Canadian Credit Facility	**US Credit Facility**
Maximum borrowings under credit facility	$15 million	$ 52.6 million (US$50 million)
Credit facility expiry date	August 7, 2016	May 26, 2016
Available to borrow	$ 15.0 million	$ 52.4 million (US$ 49.8 million)
Credit facility borrowings	$ 10.8 million	$ 34.3 million (US$ 32.6 million)
Unused credit facility available	$ 4.2 million	$ 18.1 million (US$ 17.2 million)
Financial covenants:		
	Covenant does not apply when the unused credit facility available exceeds $2.0 million, which it did at June 30, 2013	Covenant does not apply when the unused credit facility available exceeds US$2.5 million, which it did at June 30, 2013

The terms of the agreements with our lenders provide that dividends cannot be made to our shareholders in the event that our subsidiaries are not compliant with their financial covenants.

As at June 30, 2013, our operating subsidiaries were compliant with all required credit ratios. Accordingly there were no restrictions on dividends arising from non-compliance with financial covenants.

Our debt management strategy is to roll and renew (as opposed to repay and retire) our revolving credit facilities in Canada and the US when they expire in August 2016 and May 2016, respectively. We do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity. The amount of bank debt that will actually be drawn on our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and our cash generating capacity going forward. When making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities. We do not target a specific financial leverage amount. We believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy.

5.4 Contractual Obligations

There were no significant changes in our contractual commitments outside of the normal course of business, compared with those set forth in the Company's 2012 Annual Report, available on SEDAR at www.sedar.com.

5.5 Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements.

5.6 Financial Instruments

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

5.7 Share Data

As at August 2, 2013, the date of this MD&A, we had 16,394,490 common shares issued and outstanding. In addition at August 2, 2013, 55,249 performance shares and 197,327 restricted shares were outstanding under the terms of our long-term incentive plan. The performance and restricted shares can be settled in common shares of the Company issued from treasury, shares purchased by the Company in the market, or in an amount of cash equal to the fair value of our common shares, or any combination of the foregoing. The restricted and performance shares vest over periods of up to three years and we intend to issue common shares from treasury to settle these obligations as they vest.

5.8 Dividends

In the second quarter of 2013, we declared a quarterly dividend of $0.035 per share, which was paid on July 31, 2013 to shareholders of record as at July 19, 2013. On August 2, 2013 we declared a quarterly dividend of $0.035 per share, payable on October 31, 2013 to shareholders of record as at October 18, 2013. The Board regularly assesses our dividend strategy, giving due consideration to anticipated cash needs for additional working capital to support growing the business, appropriate debt levels, acquisition opportunities which may be available, expected market conditions, demand for our products, and other factors.

6.0 Related Party Transactions

There were no material related party transactions in the three and six months ended June 30, 2013 or in the comparative periods in the prior year.

7.0 Critical Accounting Estimates & Adoption of Changes in Accounting Policies

7.1 Critical Accounting Estimates

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

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

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

7.2 Adoption of New Accounting Policies

The significant accounting policies that have been used applied in the preparation of the Interim Financial Statements are summarized in our Audited Financial Statements for the year ended December 31, 2012, except as described below. We adopted the following new IFRS standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions. Several other new standards and amendments came into effect on January 1, 2013; however, they do not impact the Interim Financial Statements and are not anticipated to impact our annual consolidated financial statements.

The nature and impact of each new standard and amendment applicable to the Company are as follows:

IAS 1 Presentation of items of other comprehensive income (Amendment)

The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income (“OCI”). Items that could be reclassified to profit or loss at a future point in time shall be presented separately from items that will never be reclassified. This amendment has no impact on our presentation as the components of OCI pertain only to gains or losses arising on the translation of foreign operations, for which the cumulative exchange differences would be reclassified to profit or loss on disposal of the foreign operation.

IFRS 10 Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements, to replace IAS 27, Consolidated and Separate Financial Statements, and SIC 12, Consolidation – Special Purpose Entities. The new consolidation standard changes the definition of control so that the same criteria apply to all entities, both operating and special purpose entities, to determine control.

The revised definition focuses on the need to have both power and variable returns before control is present. The adoption of IFRS 10 did not result in any change in the consolidation status of any of our subsidiaries or investees.

IFRS 11 Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements, to replace IAS 31, Interests in Joint Ventures. The new standard defines two types of arrangements: Joint Operations and Joint Ventures. The focus of the standard is to reflect the rights and obligations of the parties involved in the joint arrangement, regardless of whether the joint arrangement operates through a separate legal entity. Joint arrangements that are classified as joint ventures are accounted for using the equity method of accounting. Joint arrangements that are classified as joint operations require the venturers to recognize the individual assets, liabilities, revenues and expenses to which they have legal rights or are responsible. The adoption of IFRS 11 did not result in any changes to our Interim Financial Statements as we have no joint arrangements.

IFRS 12 Disclosure of Interests in Other Entities

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities, to create a comprehensive disclosure standard to address the requirements for subsidiaries, joint arrangements and associates including the reporting entity's involvement with other entities. It also includes the disclosure requirements for unconsolidated structured entities (i.e. special purpose entities). We adopted IFRS 12 effective January 1, 2013. The adoption of IFRS 12 may result in incremental disclosures in our annual consolidated financial statements.

IFRS 13 Fair Value Measurement

In May 2011, the IASB issued IFRS 13, Fair Value Measurement, as a single source of guidance for all fair value measurements required by IFRS to reduce the complexity and improve consistency across its application. The standard provides a definition of fair value and guidance on how to measure fair value as well as a requirement for enhanced disclosures. We adopted IFRS 13 on a prospective basis effective January 1, 2013.

We have not undertaken early adoption of any other standard, interpretation or amendment in the Interim Financial Statements that have been issued, but not yet effective.

8.0 Risks and Uncertainties

We are exposed to a number of risks and uncertainties in the normal course of business that could have a negative effect on our financial condition or results of operations. We identify significant risks that we were aware of in our Annual Information Form dated March 19, 2013, and in our Information Circular dated April 2, 2013. Both documents are available to readers at www.sedar.com.

On September 27, 2012 an unfair trade petition was filed in the United States seeking the imposition of countervailing duties ("CVD") and antidumping duties ("AD") against Chinese hardwood plywood. The trade petition was brought by a coalition of U.S. plywood manufacturers, alleging that Chinese imports are sold in the United States at prices below cost and are subsidized by the Government of China. On February 27, 2013 Commerce completed the preliminary stage of its CVD investigation and imposed a preliminary CVD rate of 22.63% against product imported to the U.S. from substantially all Chinese mill producers. On April 30, 2013 Commerce announced it had completed the preliminary stage of its AD duty investigation, imposing a preliminary AD duty rate of 22.14% against most Chinese mill producers. As a result of these announcements, the combined preliminary CVD/AD duty rate on hardwood plywood imported from China into the United States is 44.77%.

We estimate that approximately 14% of our total sales in 2012 were made up of products that would have fallen within the scope of this U.S. trade action. The majority of our U.S. product mix is comprised of products that are not subject to this trade dispute, namely hardwood lumber, specialty wood products, domestically produced plywood products, and plywood imported from counties other than China. In addition, these preliminary duties have no effect upon our Canadian operations.

It cannot be determined to what extent imported Chinese hardwood plywood will be priced out of the U.S. market after bearing a combined 44.77% preliminary CVD/AD duty rate. Although Chinese product becomes immediately more expensive, prices for U.S. produced domestic plywood have also been steadily increasing in the past several months. Current volume demand for hardwood plywood is also strong, reflecting the ongoing recovery in the U.S. housing market. As a result, Hardwoods expects customer demand to continue for some dutiable products from China, whereas some customers will choose to look at alternative product options. Hardwoods strategy includes selling both imported and domestically produced hardwood plywood to satisfy demand and product preferences from Hardwoods' customers. We have active supply lines for hardwood plywood both in the U.S. and in international markets other than China. Although markets are likely to be disrupted in the short-term by the imposition of preliminary CVD/AD duties, we believe that should it become necessary, we are well positioned to respond to customer needs through other sourcing channels that are not dependent upon Chinese production.

The AD and CVD rates that have been announced by Commerce represent their preliminary determinations only, and are subject to further investigation and revision. The final determination regarding both CVD and AD is expected to be issued by Commerce on September 16, 2013. In addition, a separate decision from the US International Trade Commission ("ITC") is expected on the trade case on October 24, 2013. Shortly after that date the ITC will announce whether it finds U.S. plywood manufacturers have been injured, or are threatened to be injured, by hardwood plywood imported from China. An injury finding by the ITC is required to affirm that Commerce can proceed with any CVD and AD duties that Commerce has imposed in the trade case.

Under US CVD and AD legislation, provisions exist for duty rates to be applied retroactively in certain circumstances to imports made 90 days prior to the date at which preliminary CVD and AD duties were imposed. For the possibility of retroactivity to arise, the Petitioners that initiated this trade case would need to file a request that Commerce investigate if there was a surge of imports, known as "Critical Circumstances," in the 90 days prior to the imposition of preliminary duties. The Petitioners have not requested that Commerce investigate Critical Circumstances, but the Petitioners may file such a request prior to the final duty decision date being rendered.

Management has consulted with trade lawyers and received advice that Critical Circumstances is not commonly alleged by Petitioners and affirmed through investigation by Commerce. We believe that certain Petitioners in this case have also themselves imported Chinese products in the Critical Circumstances period, and therefore some Petitioners would themselves be subject to retroactive duties if they alleged Critical Circumstances. For these reasons, we believe the risk of retroactive duties arising prior to the preliminary CVD and AD rates being imposed is remote and we have made no provision for retroactive duties in Interim Financial Statement.

We estimate that during the 90-day period prior to the imposition of the CVD, we directly imported approximately US$5.9 million of products affected by this trade case. Based on the preliminary CVD rate of 22.63%, we estimate our exposure would be US$1.3 million if retroactive CVD duties arise. With respect to the separate AD investigation, we believe that we did not directly import any product subject to this trade case into the US during the 90-day period prior to the decision announcement, and therefore estimate no exposure to retroactive AD duties if they arise.

9.0 Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate disclosure controls and procedures ("DC&P") and internal control over financial reporting ("ICFR"). Any systems of DC&P and ICFR, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to information required to be disclosed and financial statement preparation and presentation. There have been no changes in our ICFR during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our ICFR.

10.0 Note Regarding Forward Looking Information

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

The forward-looking information in this MD&A includes, but is not limited to: we view a gross margin percentage around 18% to be a more sustainable level for our business under normal business conditions, and expect gross margin will trend down to more typical levels in the second half of the year; we anticipate that business conditions will remain strong through the balance of 2013 and beyond with forecasters continuing to predict a multi-year strengthening trend for the US residential construction market; given that hardwood products are typically applied at the final stages of house construction (approximately 9-to-12 months after house construction starts), we expect to see higher demand for our products continuing well into 2014; our belief that the outlook for the US market is tempered by uncertainty over the impact of new antidumping and countervailing duties against imported hardwood plywood panels produced in China; our outlook for the Canadian market is generally neutral with 2013 housing starts expected to remain below 2012 levels following the changes to Canada's mortgage insurance rules; our perspective growth in the Canadian renovation and commercial construction markets is expected to be modest at 3.6% and 3.4% respectively; our primary goal in 2013 will be to continue capturing the growth potential from a strengthening US housing market, both in terms of sales volumes and product pricing; our intent entering year three of our successful market expansion strategy to continue to leverage our ability to source high quality products from a range of international markets, strengthen our presence in commercial and institutional construction markets, and solidify our presence in large geographic markets, primarily through the introduction of new products, and through the expansion of production capabilities at our Paxton branches; that our overall outlook for 2013 remains very positive; our perspective that we are successfully optimizing and growing the business organically, and we will continue to pursue well-priced, strategic acquisition opportunities; we believe we have made sufficient expenditures to sustain productive capacity of our business as it relates to our needs for property, plant and equipment; our expectation that ongoing maintenance capital expenditures for our operations are anticipated to be approximately $1.0 million annually; that our debt management strategy is to roll and renew (as opposed to repay and retire) our revolving credit facilities in Canada and the US when they expire in August 2016 and May 2016, respectively; that we do not intend to restrict future dividends in order to fully extinguish our bank debt obligations upon their maturity; that the amount of bank debt that will actually be drawn on our available revolving credit facilities will depend upon the seasonal and cyclical needs of the business, and our cash generating capacity going forward; that when making future dividend decisions, we will consider the amount of financial leverage, and therefore bank debt, we believe is appropriate given existing and expected market conditions and available business opportunities; that we do not target a specific financial leverage amount; that we believe our current credit facilities are sufficient to finance our working capital needs and market expansion strategy; and that with respect to the trade action against Chinese hardwood plywood imported into the US we believe the risk of retroactive duties arising prior to the preliminary CVD and AD rates being imposed is remote.

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: there are no material exchange rate fluctuations between the Canadian and US dollar that affect our performance; the general state of the economy does not worsen; we do not lose any key personnel; there are no decreases in the supply of, demand for, or market values of hardwood lumber or sheet goods that harm our business; we do not incur material losses related to credit provided to our customers; our products are not subjected to negative trade outcomes; we are able to sustain our level of sales and EBITDA margins; we are able to grow our business long term and to manage our growth;

there is no new competition in our markets that leads to reduced revenues and profitability; we do not become subject to more stringent regulations; importation of products manufactured with hardwood lumber or sheet goods does not increase and replace products manufactured in North America; our management information systems upon which we are dependent are not impaired; our insurance is sufficient to cover losses that may occur as a result of our operations; and, the financial condition and results of operations of our business upon which we are dependent is not impaired.

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

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