K·BRO

# Q1, 2017

# CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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# Interim Condensed Consolidated Statements of Financial Position

(unaudited, thousands of Canadian dollars)

| | March 31, 2017 | December 31, 2016 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Accounts receivable | $ 17,944 | $ 18,451 |
| Income tax receivable | 141 | - |
| Prepaid expenses and deposits | 1,540 | 1,472 |
| Linen in service | 12,474 | 11,511 |
| | 32,099 | 31,434 |
| **Property, plant and equipment (note 4)** | 125,315 | 113,258 |
| **Intangible assets** | 2,713 | 3,141 |
| **Goodwill** | 20,456 | 20,456 |
| | $ 180,583 | $ 168,289 |
| **LIABILITIES** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | $ 22,727 | $ 16,270 |
| Income taxes payable | - | 596 |
| Dividends payable to shareholders | 802 | 802 |
| | 23,529 | 17,668 |
| **Long-term debt (note 5)** | 32,363 | 25,800 |
| **Unamortized lease inducements** | 2,173 | 1,863 |
| **Deferred income taxes** | 6,598 | 6,286 |
| | $ 64,663 | $ 51,617 |
| **SHAREHOLDERS' EQUITY** | | |
| **Share capital** | 109,390 | 109,390 |
| **Contributed surplus** | 2,349 | 1,944 |
| **Retained earnings** | 4,181 | 5,338 |
| | $ 115,920 | $ 116,672 |
| **Contingencies and commitments (note 6)** | | |
| | $ 180,583 | $ 168,289 |

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

# Interim Condensed Consolidated Statements of Earnings & Comprehensive Income

(unaudited, thousands of Canadian dollars, except share and per share amounts)

| | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| **Revenue** | $ 38,958 | $ 38,812 |
| **Expenses** | | |
| Wages and benefits | 17,962 | 17,537 |
| Linen | 4,440 | 4,353 |
| Utilities | 2,723 | 2,380 |
| Delivery | 2,579 | 2,081 |
| Occupancy costs | 1,457 | 1,266 |
| Materials and supplies | 1,503 | 1,272 |
| Repairs and maintenance | 1,374 | 1,215 |
| Corporate | 2,156 | 1,932 |
| | 34,194 | 32,036 |
| **EBITDA** | 4,764 | 6,776 |
| **Other expenses** | | |
| Depreciation of property, plant and equipment (note 4) | 2,381 | 2,231 |
| Amortization of intangible assets | 428 | 506 |
| Finance expense | 185 | 393 |
| | 2,994 | 3,130 |
| **Earnings before income taxes** | 1,770 | 3,646 |
| Current income tax expense | 208 | 938 |
| Deferred income tax expense | 312 | 176 |
| **Income tax expense** | 520 | 1,114 |
| **Net earnings and Comprehensive income** | 1,250 | 2,532 |
| **Net earnings per share:** | | |
| Basic | $ 0.16 | $ 0.32 |
| Diluted | $ 0.16 | $ 0.32 |
| **Weighted average number of shares outstanding**: | | |
| Basic | 7,978,846 | 7,945,997 |
| Diluted | 7,999,181 | 7,964,604 |

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

# Interim Condensed Consolidated Statements of Changes in Equity

(unaudited, thousands of Canadian dollars)

| | | Total Share Capital | | Contributed surplus | | Retained earnings | | Total equity |
|---|---|---|---|---|---|---|---|---|
| **As at January 1, 2017** | $ | 109,390 | $ | 1,944 | $ | 5,338 | $ | 116,672 |
| Net earnings | | - | | - | | 1,250 | | 1,250 |
| Dividends declared (note 7) | | - | | - | | (2,407) | | (2,407) |
| Employee share based compensation expense | | - | | 405 | | - | | 405 |
| **As at March 31, 2017** | $ | 109,390 | $ | 2,349 | $ | 4,181 | $ | 115,920 |

| | | Total Share Capital | | Contributed surplus | | Retained earnings | | Total equity |
|---|---|---|---|---|---|---|---|---|
| **As at January 1, 2016** | $ | 108,079 | | 1,737 | | 3,424 | $ | 113,240 |
| Net earnings | | - | | - | | 2,532 | | 2,532 |
| Dividends declared (note 7) | | - | | - | | (2,396) | | (2,396) |
| Employee share based compensation expense | | - | | 483 | | - | | 483 |
| **As at March 31, 2016** | $ | 108,079 | $ | 2,220 | $ | 3,560 | $ | 113,859 |

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

# Interim Condensed Consolidated Statements of Cash Flow

(unaudited, thousands of Canadian dollars)

| | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| **Net earnings** | $ 1,250 | $ 2,532 |
| Depreciation of property, plant and equipment (note 4) | 2,381 | 2,231 |
| Amortization of intangible assets | 428 | 506 |
| Lease inducements, net of amortization | 310 | (38) |
| Fair value loss on derivative instrument | - | 171 |
| Employee share based compensation expense | 405 | 483 |
| Deferred income taxes | 312 | 176 |
| | 5,086 | 6,061 |
| Change in non-cash working capital items (note 8) | 1,214 | 665 |
| Cash provided by operating activities | 6,300 | 6,726 |
| **FINANCING ACTIVITIES** | | |
| Net proceeds of revolving credit facility | 6,563 | 3,621 |
| Dividends paid to shareholders (note 7) | (2,407) | (2,396) |
| Cash provided by financing activities | 4,156 | 1,225 |
| **INVESTING ACTIVITIES** | | |
| Purchase of property, plant and equipment (note 4) | (10,456) | (7,951) |
| Cash used in investing activities | (10,456) | (7,951) |
| Change in cash and cash equivalents during the period | - | - |
| Cash and cash equivalents, beginning of period | - | - |
| Cash and cash equivalents, end of period | $ - | $ - |
| **Supplementary cash flow information** | | |
| Interest paid | $ 263 | $ 68 |
| Income taxes paid | $ 946 | $ 1,022 |

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

K-Bro Linen Inc. (the "Corporation" or "K-Bro") is incorporated in Canada under the Business Corporations Act (Alberta). The Corporation and its wholly owned subsidiaries provide a range of linen services to healthcare institutions, hotels and other commercial accounts that include the processing, management and distribution of general linen and operating room linen. The Corporation provides services from nine processing facilities in eight major cities across Canada from Victoria, British Columbia to Québec City, Québec and two distribution centres in Saskatchewan.

The Corporation's common shares are traded on the Toronto Stock Exchange under the symbol "KBL". The address of the Corporation's registered head office is 14903 – 137 Avenue, Edmonton, Alberta, Canada.

These unaudited interim condensed consolidated financial statements were approved and authorized for issuance by the Board of Directors ("the Board") on May 12, 2017.

## 1 Basis of Presentation

These unaudited interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and Canadian Generally Accepted Accounting Principles ("GAAP"), as applicable to interim financial reports including IAS 34, *Interim Financial Reporting*, and should be read in conjunction with the annual consolidated audited financial statements for the year ended December 31, 2016 which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board, and GAAP as issued by CPA Canada. The accounting policies followed in these unaudited interim condensed consolidated financial statements are consistent with those of the previous year, except as described below.

## 2 Significant accounting policies adopted January 1, 2017

On January 1, 2017 the Corporation adopted the amendments to IAS 7, Statement of Cash Flows, and amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses. IAS 7 was amended to improve information provided to users of financial statements about an entity's financing activities. IAS 12 was amended to provide further clarity and examples in the practice around the recognition of a deferred tax asset that is related to a debt instrument measured at fair value. Adoption of the amendments did not result in any changes to the presentation or disclosures in the financial statements.

## 3 New Standards and interpretations not yet adopted

The following standards have been issued but have not yet been applied in preparing the interim condensed consolidated financial statements.

- IFRS 15, Revenue from Contracts with Customers, was issued in May 2014 by the IASB and supersedes IAS 18, "Revenue", IAS 11 "Construction Contracts" and other interpretive guidance associated with revenue recognition. IFRS 15 provides a single model to determine how and when an entity should recognize revenue, as well as requiring entities to provide more informative, relevant disclosures in respect of its revenue recognition criteria. IFRS 15 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Corporation is in the process of evaluating the impact that IFRS 15 may have on the financial statements.

- IFRS 9, Financial Instruments, was issued in July 2014 by the IASB and supersedes IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through OCI and fair value through P&L. IFRS 9 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Corporation is in the process of evaluating the impact that IFRS 9 may have on the financial statements.

(unaudited, thousands of Canadian dollars except share and per share amounts,
three months ended March 31, 2017 and 2016)

- IFRS 16, Leases, was issued in January 2016 and applies to annual reporting periods beginning on or after January 1, 2019. IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The Corporation is in the process of evaluating the impact that IFRS 16 may have on the financial statements.

- On June 20, 2016 the IASB issued an amendment to IFRS 2 "Share based Payment" addressing three classification and measurement issues. The amendment clarifies the measurement basis for cash-settled, share based payments and the accounting for modifications that change an award from cash-settled to equity settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly-equity settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share based payment and pay that amount to the tax authority. The Corporation is in the process of evaluating the impact that the amendment may have on the financial statements. The amendments are effective for periods beginning on or after January 1, 2018.

## 4 Property, plant and equipment

| | Land | Buildings | Laundry Equipment(1) | Office Equipment | Delivery Equipment | Computer Equipment | Leasehold Improvements(2) | Spare Parts | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Year ended, December 31, 2016** | | | | | | | | | |
| Opening net book amount | $ 2,454 | $ 17,964 | $ 54,316 | $ 341 | $ 266 | $ 539 | $ 11,834 | $ 427 | $ 88,141 |
| Additions | - | 281 | 21,464 | 71 | 60 | 208 | 12,242 | 136 | 34,462 |
| Disposals | - | - | (107) | - | (3) | - | - | - | (110) |
| Transfers | - | - | - | - | - | - | - | - | - |
| Depreciation charge | - | (980) | (6,056) | (108) | (73) | (370) | (1,648) | - | (9,235) |
| **Closing net book amount** | $ 2,454 | $ 17,265 | $ 69,617 | $ 304 | $ 250 | $ 377 | $ 22,428 | $ 563 | $ 113,258 |
| **At December 31, 2016** | | | | | | | | | |
| Cost | $ 2,454 | $ 19,012 | $ 110,175 | $ 710 | $ 683 | $ 1,279 | $ 32,065 | $ 563 | $ 166,941 |
| Accumulated depreciation | - | (1,747) | (40,558) | (406) | (433) | (902) | (9,637) | - | (53,683) |
| **Net book amount** | $ 2,454 | $ 17,265 | $ 69,617 | $ 304 | $ 250 | $ 377 | $ 22,428 | $ 563 | $ 113,258 |
| **Period ended, March 31, 2017** | | | | | | | | | |
| Opening net book amount | $ 2,454 | $ 17,265 | $ 69,617 | $ 304 | $ 250 | $ 377 | $ 22,428 | $ 563 | $ 113,258 |
| Additions | - | 1 | 12,690 | 41 | - | 208 | 1,481 | 17 | 14,438 |
| Disposals | - | - | - | - | - | - | - | - | - |
| Depreciation charge | - | (242) | (1,552) | (27) | (14) | (103) | (443) | - | (2,381) |
| **Closing net book amount** | $ 2,454 | $ 17,024 | $ 80,755 | $ 318 | $ 236 | $ 482 | $ 23,466 | $ 580 | $ 125,315 |
| **At March 31, 2017** | | | | | | | | | |
| Cost | $ 2,454 | $ 19,013 | $ 122,199 | $ 751 | $ 683 | $ 1,488 | $ 33,546 | $ 580 | $ 180,714 |
| Accumulated depreciation | - | (1,989) | (41,444) | (433) | (447) | (1,006) | (10,080) | - | (55,399) |
| **Net book amount** | $ 2,454 | $ 17,024 | $ 80,755 | $ 318 | $ 236 | $ 482 | $ 23,466 | $ 580 | $ 125,315 |

(1) Included in laundry equipment are assets under development in the amount of $7,131 (2016 - $16,536). These assets are not available for service and accordingly are not presently being depreciated.

(2) Included in leasehold improvements are assets under development in the amount of $0 (2016 - $11,547). These assets are not available for service and accordingly are not presently being depreciated.

(3) Total property, plant and equipment additions include amounts in accounts payable of $5,703 (2016 - $1,721).

(unaudited, thousands of Canadian dollars except share and per share amounts,
three months ended March 31, 2017 and 2016)

## 5 Long-term debt

| | | Prime Rate Loan[1] |
|---|---|---|
| At January 1, 2016 | $ | 2,349 |
| Net proceeds from debt | | 23,451 |
| Closing balance at December 31, 2016 | $ | 25,800 |
| | | |
| At January 1, 2017 | **$** | **25,800** |
| Net proceeds from debt | | **6,563** |
| Closing balance at March 31, 2017 | **$** | **32,363** |

(1) Prime rate loan, collateralized by a general security agreement, bear interest at prime plus an interest margin dependent on certain financial ratios, with a monthly repayment of interest only, maturing on July 31, 2020 (December 31, 2016 – July 31, 2020). The additional interest margin can range between 0.0% to 1.25% dependent upon the calculated Debt/EBITDA financial ratio, with a range between 0 to 3.5x. As at March 31, 2017, the combined interest rate was 2.95% (December 31, 2016 – 2.7%).

The Corporation has a revolving credit facility of up to $85,000 of which $34,013 is utilized (including letters of credit totaling $1,650 as at March 31, 2017). Interest payments only are due during the term of the facility.

Drawings under the revolving credit facility are available by way of Bankers' Acceptances, Canadian prime rate loans, letters of credit or standby letters of guarantee. Drawings under the revolving credit facility bear interest at a floating rate, plus an applicable margin based on certain financial performance ratios.

A general security agreement over all assets, a mortgage against all leasehold interests and real property, insurance policies and an assignment of material agreements have been pledged as collateral.

The carrying value of borrowings approximate their fair value as the debt is based on a floating rate, the interest rate risk has not changed, and the impact of discounting is not significant.

The Corporation has incurred no events of default under the terms of its credit facility agreement.

## 6 Contingencies and commitments

### a) Contingencies – Letters of credit

The Corporation has standby letters of credit issued as part of normal business operations in the amount of $1,650 (December 31, 2016 – $1,650) which will remain outstanding for an indefinite period of time.

### b) Commitments

#### (i) Operating leases and utility commitments

Minimum lease payments for operating leases on buildings and equipment and estimated natural gas and electricity commitments for the next five calendar years and thereafter are as follows:

(unaudited, thousands of Canadian dollars except share and per share amounts,
three months ended March 31, 2017 and 2016)

**Operating lease commitments**

| | | |
|---|---|---|
| Remainder of 2017 | $ | 3,875 |
| 2018 | | 5,672 |
| 2019 | | 5,189 |
| 2020 | | 4,825 |
| 2021 | | 4,177 |
| Subsequent | | 31,176 |
| | $ | 54,914 |

**Utility commitments**

| | | |
|---|---|---|
| Remainder of 2017 | $ | 1,560 |
| 2018 | | 1,794 |
| 2019 | | 1,287 |
| 2020 | | 1,288 |
| 2021 | | 1,274 |
| Subsequent | | - |
| | $ | 7,203 |

**(ii) Linen purchase commitments**

At March 31, 2017, the Corporation was committed to linen expenditure obligations in the amount of $7,201 (December 31, 2016 – $6,926) to be incurred within the next year.

**(iii) Property, plant and equipment commitments**

At March 31, 2017, the Corporation was committed to capital expenditure obligations in the amount of $21,489 (December 31, 2016 – $28,897) to be incurred within the next year and $2,465 (December 31, 2016 – $8,628) to be incurred in the next two years.

## 7 Dividends to shareholders

During the three months ended March 31, 2017, the Corporation declared total dividends to shareholders of $2,407 or $0.300 per share (March 31, 2016 - $2,396 or $0.300 per share).

(unaudited, thousands of Canadian dollars except share and per share amounts,
three months ended March 31, 2017 and 2016)

## 8 Net change in non-cash working capital items

| | Three Months Ended March 31, 2017 | 2016 |
|---|---|---|
| Accounts receivable | $ 507 | $ 101 |
| Linen in service | (963) | (283) |
| Prepaid expenses and deposits | (68) | (829) |
| Accounts payable and accrued liabilities | 2,475 | 1,760 |
| Income taxes payable / Receivable | (737) | (84) |
| | $ 1,214 | $ 665 |

## 9 Fair value of financial instruments

The Corporation's financial instruments at March 31, 2017 consist of accounts receivable, accounts payable and accrued liabilities, dividends payable to shareholders, and long term debt. The carrying value of accounts receivable, accounts payable and accrued liabilities, and dividends payable to shareholders approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Corporation's interest-bearing debt approximates the respective carrying amount due to the floating rate nature of the debt.

## 10 Related party transactions

The Corporation incurred expenses in the normal course of business for advisory consulting services provided by a Director. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the three months ended March 31, 2017, the Corporation incurred such fees totaling $35 (2016– $35).

## 11 Segmented information

The Corporation provides laundry and linen services to the healthcare and hospitality sectors through nine operating divisions located in Vancouver, Victoria, Calgary, Edmonton, Regina, Toronto, Montréal, and Québec City. Management has assessed that the services offered and the economic characteristics associated with these divisions are similar, and therefore they have been aggregated into one reportable segment which operates exclusively in Canada.

The aggregation assessment requires significant judgment by management. Economic indicators used by management to assess the economic characteristics are the gross margin and the growth rate of each division.

In Edmonton, the Corporation is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region and this contract expires on March 31, 2023. In Calgary, the major customer is contractually committed to February 28, 2018, in Vancouver the major customer is contractually committed to March 1, 2027, and in Saskatchewan the major customer is contractually committed to June 1, 2025. For the three months ended March 31, 2017, from these four major customers the Corporation has recorded revenue of $22,075 (2016 – $22,148), representing 56.7% (2016 – 57.1%) of total revenue.

(unaudited, thousands of Canadian dollars except share and per share amounts,
three months ended March 31, 2017 and 2016)

| | Three Months Ended March 31, 2017 | | | Three Months Ended March 31, 2016 | | |
|---|---|---|---|---|---|---|
| Healthcare | $ | 28,053 | 72.0% | $ | 28,124 | 72.5% |
| Hospitality | | 10,905 | 28.0% | | 10,688 | 27.5% |
| | $ | 38,958 | 100.0% | $ | 38,812 | 100.0% |

## 12 Subsequent events

### a) Dividends

On April 13, 2017, the Board declared an eligible dividend of $0.1000 per common share of the Corporation payable on May 15, 2017 to shareholders of record April 30, 2017.

On May 12, 2017, the Board declared an eligible dividend of $0.1000 per common share of the Corporation payable on June 15, 2017 to shareholders of record May 31, 2017.

### b) Approval of Long-term Incentive Compensation

On April 21, 2017, the Board of Directors approved the recommendations of the Compensation, Nominating and Governance Committee with respect to long-term incentive compensation for the senior management of the Corporation. Total compensation to be awarded to employees is $1,489 which will be satisfied through the issuance of treasury shares based on the five-day volume weighted average price for the period ending May 15, 2017.

### c) Equity Offering

On April 25, 2017 the Corporation closed a bought deal offering of 1,518,000 common shares at $38.00/share. The net proceeds of the offering after deducting estimated expenses of the offering and the underwriter's fee are anticipated to be $55,006. The net proceeds of the offering will be used to fund the build out of the Corporation's state-of-the-art facilities in Toronto and Vancouver, to pay down the indebtedness and for general corporate purposes.