

K-Bro Linen Income Fund

Interim Consolidated Financial Statements
March 31, 2010

K-Bro Linen Income Fund

Interim Consolidated Balance Sheets

	March 31, 2010 \$ (Unaudited)	December 31, 2009 \$
Assets		
Current assets		
Accounts receivable	11,912,294	9,450,990
Linen in service	7,589,234	7,304,877
Prepaid expenses and deposits	1,107,875	1,212,988
Future income taxes	252,654	448,920
	<u>20,862,057</u>	<u>18,417,775</u>
Restricted escrow funds (note 4)	250,000	-
Property, plant and equipment	36,917,935	33,583,038
Intangible assets	17,084,471	14,594,973
Goodwill	19,988,242	16,220,250
	<u>95,102,705</u>	<u>82,816,036</u>
Liabilities and Unitholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	10,589,765	9,880,299
Distribution payable to unitholders	642,146	642,146
	<u>11,231,911</u>	<u>10,522,445</u>
Long-term debt	15,912,421	4,043,068
Unamortized lease inducements	596,489	610,547
Future income taxes	3,636,896	3,846,961
	<u>31,377,717</u>	<u>19,023,021</u>
Contingencies and commitments (note 6)		
Unitholders' Equity		
Exchangeable shares (note 7b)	724,110	724,110
Fund units (note 7b)	70,675,516	70,675,516
Fund units held in trust by LTIP	(834,137)	(834,137)
Contributed surplus (note 7c)	634,164	572,376
Deficit	(7,464,506)	(7,309,840)
Accumulated other comprehensive loss (note 7d)	(10,159)	(35,010)
	<u>63,724,988</u>	<u>63,793,015</u>
	<u>95,102,705</u>	<u>82,816,036</u>

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

Approved on behalf of the Fund

(Signed) "Ross Smith"

Trustee

(Signed) "Matthew Hills"

Trustee

K-Bro Linen Income Fund

Interim Consolidated Statements of Earnings and Deficit (Unaudited)

	Three months ended March 31,	
	2010	2009
	\$	\$
Revenue	<u>23,931,610</u>	<u>21,493,461</u>
Expenses		
Wages and benefits	10,773,091	9,757,517
Linen	2,522,836	2,557,502
Utilities	2,010,996	1,700,341
Delivery	943,908	809,202
Occupancy costs	936,824	729,256
Materials and supplies	872,872	755,048
Repairs and maintenance	871,636	768,751
Corporate	1,091,481	923,857
	<u>20,023,644</u>	<u>18,001,474</u>
Earnings before the undernoted	<u>3,907,966</u>	<u>3,491,987</u>
Other expenses		
Amortization of property, plant and equipment	(1,415,379)	(1,352,643)
Amortization of intangible assets	(618,318)	(539,285)
Financial charges	(126,642)	(90,445)
Gain (loss) on disposal of property, plant and equipment	490	(3,317)
	<u>(2,159,849)</u>	<u>(1,985,690)</u>
Earnings before income taxes	1,748,117	1,506,297
Income tax recovery	<u>23,655</u>	<u>85,144</u>
Net earnings for the period	<u>1,771,772</u>	<u>1,591,441</u>
Deficit – beginning of period, as previously stated	(7,309,840)	(7,309,749)
Adjustment due to accounting policy change	-	(96,217)
Deficit – beginning of period, as restated	(7,309,840)	(7,405,966)
Distributions to unitholders (note 8)	<u>(1,926,438)</u>	<u>(1,926,438)</u>
Deficit – end of period	<u>(7,464,506)</u>	<u>(7,740,963)</u>
	\$	\$
Net earnings per unit		
Basic	<u>0.26</u>	<u>0.23</u>
Diluted	<u>0.25</u>	<u>0.23</u>
	#	#
Weighted average number of units outstanding		
Basic	<u>6,935,281</u>	<u>6,969,676</u>
Diluted	<u>6,992,130</u>	<u>6,999,164</u>

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

K-Bro Linen Income Fund

Interim Consolidated Statements of Comprehensive Income (Unaudited)

	Three months ended March 31,	
	2010	2009
	\$	\$
Net earnings for the period	1,771,772	1,591,441
Other comprehensive income for the period		
Gain on derivative instruments designated as cash flow hedges, net of future income taxes of \$9,855 (three months ended March 31, 2009 – \$2,309)	<u>24,851</u>	<u>5,361</u>
Comprehensive income for the period	<u>1,796,623</u>	<u>1,596,802</u>

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

K-Bro Linen Income Fund

Interim Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended March 31,	
	2010	2009
	\$	\$
Cash provided by (used in)		
Operating activities		
Net earnings for the period	1,771,772	1,591,441
Items not affecting cash		
Amortization of property, plant and equipment	1,415,379	1,352,643
Amortization of intangible assets	618,318	539,285
Amortization of lease inducements	(14,058)	(14,058)
(Gain) loss on disposal of property, plant and equipment	(490)	3,317
Future income taxes	(23,655)	(85,144)
	<u>3,767,266</u>	<u>3,387,484</u>
Net change in non-cash working capital items (note 9)	<u>62,653</u>	<u>(4,183,494)</u>
Cash provided (used) by operating activities	<u>3,829,919</u>	<u>(796,010)</u>
Financing activities		
Increase in long-term debt – revolving line of credit	11,869,353	3,149,201
Distributions paid to unitholders	(1,926,438)	(1,926,438)
Cash provided by financing activities	<u>9,942,915</u>	<u>1,222,763</u>
Investing activities		
Purchase of property, plant and equipment	(1,013,756)	(433,253)
Proceeds from disposal of property, plant and equipment	490	6,500
Purchase of software	(207,815)	
Business acquisition (note 4)	(12,301,753)	-
Escrow funds (note 4)	(250,000)	-
Cash used in investing activities	<u>(13,772,834)</u>	<u>(426,753)</u>
Change in cash	-	-
Cash – beginning of period	-	-
Cash – end of period	<u>-</u>	<u>-</u>
Supplementary cash flow information		
Interest paid	<u>101,493</u>	<u>71,217</u>
Non-cash financing and investing activities		
Equipment purchases included in accounts payable and accrued liabilities	<u>416,160</u>	<u>854,716</u>

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

K-Bro Linen Income Fund

Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

1 Business description

K-Bro Linen Income Fund (the “Fund”) is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc. K-Bro Linen Systems Inc. provides a range of services to healthcare institutions, hotels and other commercial accounts that include the processing, management and distribution of general linen and operating room linen.

2 Basis of presentation

These accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”) for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited consolidated financial statements for the fiscal year ended December 31, 2009. However, these interim consolidated financial statements do not include all information and disclosures required under GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009.

3 Adoption of new accounting policies

Credit risk and the fair value of financial assets and financial liabilities

Emerging Issues Committee (“EIC”) EIC 173, *Credit risk and the fair value of financial assets and financial liabilities* concludes that an entity’s own credit risk and the credit risk of the counterparty should be taken into account when determining the fair value of financial assets and financial liabilities including derivative instruments. This Abstract is to apply to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of this Abstract did not have a significant impact to the Fund’s consolidated financial statements.

Financial Instruments - Disclosures

Section 3862, *Financial Instruments – Disclosures* was amended in June 2009 by the CICA to improve fair value and liquidity risk disclosures. Section 3862 now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels, described below, for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair values of assets and liabilities:

- Level 1 – inputs are unadjusted quoted prices of identical instruments in active markets.
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – inputs used in a valuation technique are not based on observable market data in determining fair values of the instruments.

K-Bro Linen Income Fund

Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

Determination of fair value and the resulting hierarchy requires the use of observable market data whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The Fund has also enhanced the liquidity disclosures by including the sources of funding. The additional disclosures required as a result of the adoption of these standards are included in the notes to the annual consolidated financial statements.

4 Business acquisition

On January 29, 2010, the Fund completed the acquisition of the laundry business, linen, certain working capital and equipment of a plant located in Greater Vancouver, British Columbia. The business acquisition has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the net assets acquired at January 29, 2010. The allocation was based on management's best estimate of the fair value of net assets acquired. The purchase price allocations are preliminary and are subject to change once the final valuations are completed and the final determination of the costs related to the acquisition have been made. The acquisition was funded through the Fund's revolving credit facility.

The purchase price allocated to the net assets acquired, based on their estimated fair values, is as follows:

	\$
Consideration	
Purchase price including acquisition costs	12,551,753
Less	
Restricted escrow funds	<u>(250,000)</u>
Net cash consideration	<u>12,301,753</u>
Net assets acquired	
Net working capital	1,227,661
Linen	500,000
Property, plant and equipment	3,906,100
Intangible assets	2,900,000
Goodwill	<u>3,767,992</u>
	<u>12,301,753</u>

Of the cash consideration payable to the vendor, \$250,000 was deposited into escrow with an escrow agent. The full amount of the funds held in escrow will be released to the vendor in 2011 upon the determination that certain representations and warranties are met in the twelve-month period subsequent to the acquisition. Goodwill will be correspondingly increased by the amount released.

K-Bro Linen Income Fund

Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

5 Future income taxes

On June 12, 2007, Bill C-52 Budget Implementation Act 2007, which contains legislation to tax publicly traded trusts in Canada, was substantively enacted by the Canadian Federal Government. As a result, a new 31.5 per cent tax will be applied to distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. There was no additional future income tax expense or recovery that needed to be recorded by the Fund as a result of this legislation as future income taxes are already recorded by the Fund's wholly-owned subsidiary K-Bro Linen Systems Inc.

6 Contingencies and commitments

a) Contingencies

Letters of credit

The Fund has an outstanding letter of credit issued as part of normal business operations in the amount of \$250,000 (2009 – \$250,000) expiring January 24, 2011.

Commitments

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 are as follows:

	\$
Remainder of 2010	4,459,661
2011	4,390,893
2012	3,835,190
2013	1,765,136
2014	1,362,340
Subsequent	2,618,001
	<hr/>
	18,431,221

Linen purchase commitments

At March 31, 2010, the Fund was committed to linen expenditure obligations in the amount of \$1,729,007 (December 31, 2009 – \$1,898,431).

K-Bro Linen Income Fund

Notes to Interim Consolidated Financial Statements

(Unaudited)

March 31, 2010

7 Unitholders' equity

a) Authorized

The declaration of trust provides that an unlimited number of units and an unlimited number of Special Trust Units may be issued.

b) Issued and outstanding

Fund Units	#	\$
Balance at March 31, 2010 and December 31, 2009	6,932,562	<u>70,675,516</u>
Exchangeable shares	#	\$
Balance at March 31, 2010 and December 31, 2009	<u>72,411</u>	<u>724,110</u>
Total Fund Units and Exchangeable shares issued	<u>7,004,973</u>	

The exchangeable shares were issued by the Fund's subsidiary to certain members of management and are exchangeable on a one-to-one basis for Fund Units. The risks and privileges of these shares are the same as for Fund Units. Special Trust Units are attached to and issued in conjunction with Exchangeable Shares for the sole purpose of entitling holders thereof to voting rights at any meeting of holders of Fund Units and Special Trust Units.

c) c) Contributed surplus

	Three months ended March 31, 2010 \$	Year ended December 31, 2009 \$ (Audited)
Balance, beginning of period	572,376	340,728
Net stock based compensation recorded	61,788	650,730
Issuance of vested Units to participants	<u>-</u>	<u>(419,082)</u>
Balance, end of period	<u>634,164</u>	<u>572,376</u>

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d) Accumulated other comprehensive loss

	Three months ended March 31, 2010 \$	Year ended December 31, 2009 \$ (Audited)
Balance, beginning of period	(35,010)	(111,740)
Other comprehensive income during the period	<u>24,851</u>	<u>76,730</u>
Balance, end of period	<u>(10,159)</u>	<u>(35,010)</u>

8 Distributions to unitholders

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practice considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. All such distributions are discretionary. Distributions are declared payable each month to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid by the 15th day of the following month.

Distributions declared during the three months ended March 31, 2010 were at the rate of \$0.09167 per unit per month (\$1.10 per unit annualized) for a total declared distribution of \$1,926,438 (three months ended March 31, 2009 – \$1,926,438).

9 Net change in non-cash working capital items

	Three months ended March 31, 2010 \$	2009 \$
Cash provided (used) by changes in		
Accounts receivable	(997,598)	(1,770,775)
Linen in service	215,643	123,805
Prepaid expenses and deposits	105,113	(618,385)
Accounts payable and accrued liabilities	<u>739,495</u>	<u>(1,918,139)</u>
	<u>62,653</u>	<u>(4,183,494)</u>

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10 Segmented information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through seven operating segments in Vancouver (two locations), Victoria, Calgary, Edmonton, Toronto and Quebec City. The services offered and the economic characteristics associated with these segments are similar, therefore these segments have been aggregated into one reportable segment which operates exclusively in Canada. The results of the second Vancouver operation acquired (see note 4) are reported commencing January 30, 2010.

Total revenue derived from the healthcare and hospitality sectors are as follows:

	Three months ended March 31, 2010	
	\$	%
Healthcare	17,136,767	71.6
Hospitality	6,794,843	28.4
Total	<u>23,931,610</u>	<u>100.0</u>
	Three months ended March 31, 2009	
	\$	%
Healthcare	16,937,314	78.8
Hospitality	4,556,147	21.2
Total	<u>21,493,461</u>	<u>100.0</u>

In Edmonton, the Fund is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region. This contract expires on December 31, 2010. In Calgary, the major customer is contractually committed to February 28, 2018 and in Vancouver the major customer is contractually committed to January 15, 2013.

For the three months ended March 31, 2010, the Fund has recorded revenue of \$13.1 million (three months ended March 31, 2009 – \$12.9 million) from these three major customers, representing 55% (2009 – 60%) of total revenue.

11 Related party transaction

The Fund has incurred expenses in the normal course of business for advisory consulting services provided by a Trustee primarily relating to acquisitions. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the three months ended March 31, 2010, the Fund incurred such fees totalling \$34,500 (three months ended March 31, 2009 – \$34,500).