



K-Bro Linen Income Fund

**Unaudited Interim Consolidated
Financial Statements**

June 30, 2010 and 2009

K-Bro Linen Income Fund

Consolidated Balance Sheets

	June 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets		
Accounts receivable	\$11,207,995	\$9,450,990
Linen in service	7,944,117	7,304,877
Prepaid expenses and deposits	1,153,946	1,212,988
Future income taxes	252,654	448,920
	<u>20,558,712</u>	<u>18,417,775</u>
Restricted escrow funds (Note 4)	250,000	-
Property, plant and equipment	35,948,975	33,583,038
Intangible assets	16,473,003	14,594,973
Goodwill	20,048,628	16,220,250
	<u>\$93,279,318</u>	<u>\$82,816,036</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$11,257,041	\$9,880,299
Distribution payable to unitholders	642,146	642,146
	<u>11,899,187</u>	<u>10,522,445</u>
Long-term debt (Note 5)	13,836,122	4,043,068
Unamortized lease inducements	582,431	610,547
Future income taxes	3,675,523	3,846,961
	<u>29,993,263</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	(1,600,938)	(834,137)
Contributed surplus (Note 7c)	898,811	572,376
Deficit	(7,426,040)	(7,309,840)
Accumulated other comprehensive income (loss) (Note 7d)	14,596	(35,010)
	<u>63,286,055</u>	<u>63,793,015</u>
	<u>\$93,279,318</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

Consolidated Statements of Earnings and Deficit (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Revenue	<u>\$25,901,664</u>	<u>\$21,745,884</u>	<u>\$49,833,274</u>	<u>\$43,239,345</u>
Expenses				
Wages and benefits	11,996,900	9,664,406	22,769,991	19,421,923
Linen	2,596,107	2,560,334	5,118,943	5,117,836
Utilities	2,024,052	1,427,283	4,035,048	3,127,624
Delivery	957,404	768,342	1,901,312	1,577,544
Occupancy costs	943,242	719,740	1,880,067	1,448,996
Materials and supplies	996,842	827,163	1,869,713	1,582,211
Repairs and maintenance	802,388	769,913	1,674,024	1,538,664
Corporate	1,260,927	897,891	2,352,408	1,821,748
	<u>21,577,862</u>	<u>17,635,072</u>	<u>41,601,506</u>	<u>35,636,546</u>
Earnings before the undernoted	<u>4,323,802</u>	<u>4,110,812</u>	<u>8,231,768</u>	<u>7,602,799</u>
Other expenses				
Amortization of property, plant and equipment	(1,443,593)	(1,331,174)	(2,858,972)	(2,683,817)
Amortization of intangible assets	(640,133)	(539,285)	(1,258,451)	(1,078,570)
Financial charges	(188,895)	(64,119)	(315,537)	(154,564)
Loss on disposal of property, plant and equipment	(57,111)	-	(56,621)	(3,317)
	<u>(2,329,732)</u>	<u>(1,934,578)</u>	<u>(4,489,581)</u>	<u>(3,920,268)</u>
Earnings before income taxes	1,994,070	2,176,234	3,742,187	3,682,531
Income tax recovery (expense)	<u>(29,167)</u>	<u>(8,106)</u>	<u>(5,512)</u>	<u>77,038</u>
Net earnings for the period	<u>1,964,903</u>	<u>2,168,128</u>	<u>3,736,675</u>	<u>3,759,569</u>
Deficit - beginning of period	(7,464,506)	(7,740,963)	(7,309,840)	(7,405,966)
Distributions to unitholders (Note 8)	<u>(1,926,437)</u>	<u>(1,926,437)</u>	<u>(3,852,875)</u>	<u>(3,852,875)</u>
Deficit - end of period	<u>\$(7,426,040)</u>	<u>\$(7,499,272)</u>	<u>\$(7,426,040)</u>	<u>\$(7,499,272)</u>
Net earnings per unit:				
Basic	<u>\$0.29</u>	<u>\$0.31</u>	<u>\$0.54</u>	<u>\$0.54</u>
Diluted	<u>\$0.28</u>	<u>\$0.31</u>	<u>\$0.54</u>	<u>\$0.54</u>
Weighted average number of units outstanding:				
Basic	<u>6,877,948</u>	<u>6,946,242</u>	<u>6,862,601</u>	<u>6,957,894</u>
Diluted	<u>6,951,198</u>	<u>7,010,423</u>	<u>6,936,239</u>	<u>7,022,075</u>

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

K-Bro Linen Income Fund

Consolidated Statements of Comprehensive Income (Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net earnings for the period	\$1,964,903	\$2,168,128	\$3,736,675	\$3,759,569
Other comprehensive income				
Gain (loss) on derivative instruments designated as cash flow hedges, net of future income taxes of (\$9,460) (six months ended June 30, 2010 - (\$19,316); three months ended June 30, 2009 - (\$19,997); six months ended June 30, 2009 - \$22,306)	<u>24,754</u>	<u>52,325</u>	<u>49,606</u>	<u>57,686</u>
Other comprehensive income for the period	<u>24,754</u>	<u>52,325</u>	<u>49,606</u>	<u>57,686</u>
Comprehensive income for the period	<u>\$1,989,657</u>	<u>\$2,220,453</u>	<u>\$3,786,281</u>	<u>\$3,817,255</u>

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

K-Bro Linen Income Fund

Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Cash provided by (used in)				
Operating activities				
Net earnings for the period	\$1,964,903	\$2,168,128	\$3,736,675	\$3,759,569
Items not affecting cash				
Amortization of property, plant and equipment	1,443,593	1,331,174	2,858,972	2,683,817
Amortization of intangible assets	640,133	539,285	1,258,451	1,078,570
Amortization of lease inducements	(14,058)	(14,058)	(28,116)	(28,116)
Loss on disposal of property, plant and equipment	57,111	-	56,621	3,317
Future income taxes	29,167	8,106	5,512	(77,038)
	<u>4,120,849</u>	<u>4,032,635</u>	<u>7,888,115</u>	<u>7,420,119</u>
Net change in non-cash working capital items (Note 9)	<u>417,383</u>	<u>(493,656)</u>	<u>480,036</u>	<u>(4,677,150)</u>
Cash provided by operating activities	<u>4,538,232</u>	<u>3,538,979</u>	<u>8,368,151</u>	<u>2,742,969</u>
Financing activities				
(Decrease) increase in long-term debt - revolving line of credit	(2,076,299)	(475,935)	9,793,054	2,673,266
Distributions paid to unitholders	<u>(1,926,437)</u>	<u>(1,926,437)</u>	<u>(3,852,875)</u>	<u>(3,852,875)</u>
Cash provided by (used in) financing activities	<u>(4,002,736)</u>	<u>(2,402,372)</u>	<u>5,940,179</u>	<u>(1,179,609)</u>
Investing activities				
Purchase of property, plant and equipment	(450,274)	(1,136,607)	(1,464,030)	(1,569,860)
Proceeds from disposal of property, plant and equipment	3,830	-	4,320	6,500
Purchase of intangibles	(28,666)	-	(236,481)	-
Business acquisition	(60,386)	-	(12,362,139)	-
Escrow funds	<u>-</u>	<u>-</u>	<u>(250,000)</u>	<u>-</u>
Cash used in investing activities	<u>(535,496)</u>	<u>(1,136,607)</u>	<u>(14,308,330)</u>	<u>(1,563,360)</u>
Change in cash	-	-	-	-
Cash - beginning of period	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Cash - end of period	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>
Supplementary cash flow information				
Interest paid	<u>\$148,028</u>	<u>\$87,417</u>	<u>\$249,522</u>	<u>\$158,634</u>
Non-cash financing and investing activities				
Equipment purchases included in accounts payable and accrued liabilities	<u>\$501,459</u>	<u>\$1,416,542</u>	<u>\$501,459</u>	<u>\$1,416,542</u>

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

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

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. These services include the processing, management and distribution of 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

Business combinations

CICA Handbook Section 1582, *Business Combinations* replaces Section 1581. This new standard aligns accounting for business combinations under Canadian GAAP and International Financial Reporting Standards ("IFRS"). The standard requires assets and liabilities acquired in a business combination to be measured at fair value at the acquisition date. The standard also requires acquisition-related costs, such as advisory or legal fees, incurred to effect a business combination to be expensed in the period in which they are incurred. This Section shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted.

The Fund has not early adopted the above accounting standard and is assessing the impact of the above standards in conjunction with the transition to IFRS effective January 1, 2011.

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

3 Adoption of new accounting policies (continued)

Consolidated Financial Statements and Non-controlling Interests

CICA Handbook Sections 1601, *Consolidated Financial Statements* and 1602, *Non-controlling Interests* replace the former consolidated financial statements standard. Section 1602 introduces the following changes:

- In the consolidated balance sheets and consolidated statements of unitholders' equity, non-controlling interest is now presented as a separate component of unitholders' equity, rather than as a liability;
- Non-controlling interest is no longer recorded as a deduction from net earnings;
- Net earnings and other comprehensive income are attributed to the Unitholders of the Fund and non-controlling interest based on their respective ownership interests.

The Fund has not early adopted the above accounting standard and is assessing the impact of the above standards in conjunction with the transition to IFRS effective January 1, 2011.

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	\$12,612,139
Less	
Restricted escrow funds	<u>(250,000)</u>
Net cash consideration	<u>\$12,362,139</u>
Net assets acquired	
Net working capital	\$1,227,661
Linen in service	500,000
Property, plant and equipment	3,906,100
Intangible assets	2,900,000
Goodwill	<u>3,828,378</u>
	<u>\$12,362,139</u>

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

4 Business acquisition (continued)

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.

During the second quarter of 2010, the Fund incurred additional acquisition related costs in the amount of \$60,386 which have been recorded to Goodwill. All of the goodwill acquired in the transaction is deductible for tax purposes.

Intangible assets acquired are made up of customer contracts and customer lists.

5 Long-term debt

	June 30, 2010	Dec 31, 2009
Bankers' Acceptance, interest at BA 30 day rates plus 2.5% depending on certain financial ratios, due July 20, 2010	\$4,000,000	\$4,000,000
Prime rate loan, secured with a general security agreement, interest at prime plus 1.0% depending on certain financial ratios, monthly repayment of interest only, maturing on June 30, 2012	<u>9,836,122</u>	<u>43,068</u>
	<u>\$13,836,122</u>	<u>\$4,043,068</u>

Interest expense of \$248,996 (June 30, 2009 - \$158,634) on the Bankers' Acceptance and prime rate loan are included in finance costs.

The Bankers' Acceptance which expired on July 20, 2010 was renewed to August 20, 2010 on the same terms under the provisions of the revolving credit facility which expires in fiscal 2012.

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

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.

b) 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	\$2,828,188
2011	4,809,082
2012	4,087,477
2013	1,884,582
2014	1,362,340
Subsequent	2,618,001
	<u>\$17,589,670</u>

Linen purchase commitments

At June 30, 2010, the Fund was committed to linen expenditure obligations in the amount of \$1,718,120 (December 31, 2009 – \$1,898,431).

Capital equipment commitments

At June 30, 2010, the Fund was committed to capital expenditure obligations in the amount of \$243,353 (December 31, 2009 – \$nil).

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

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	Units	\$
Balance at June 30, 2010 and December 31, 2009	<u>6,932,562</u>	<u>\$70,675,516</u>
Exchangeable shares		
Balance at June 30, 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) Contributed surplus

	June 30, 2010	Dec 31, 2009
Balance, beginning of period	\$572,376	\$340,728
Net stock based compensation recorded	953,847	650,730
Issuance of vested Units to participants	<u>(627,412)</u>	<u>(419,082)</u>
Balance, end of period	<u>\$898,811</u>	<u>\$572,376</u>

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

7 Unitholders' equity (continued)

d) Accumulated other comprehensive income (loss)

	June 30, 2010	Dec 31, 2009
Balance, beginning of period	\$(35,010)	\$(111,740)
Other comprehensive income during the period	<u>49,606</u>	<u>76,730</u>
Balance, end of period	<u>\$14,596</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 six months ended June 30, 2010 were at the rate of \$0.09167 per unit per month (\$1.10 per unit annualized) for a total declared distribution of \$3,852,875 (six months ended June 30, 2009 - \$3,852,875).

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

9 Net change in non-cash working capital items

	Three months ended June 30,	
	2010	2009
Cash provided (used) by changes in		
Accounts receivable	\$704,300	\$1,000,697
Linen in service	(354,883)	302,884
Prepaid expenses and deposits	(46,071)	461,149
Accounts payable and accrued liabilities	114,037	(2,258,386)
	<u>\$417,383</u>	<u>\$(493,656)</u>
	Six months ended June 30,	
	2010	2009
Cash provided (used) by changes in		
Accounts receivable	\$(293,298)	\$(770,078)
Linen in service	(139,240)	426,689
Prepaid expenses and deposits	59,042	(157,236)
Accounts payable and accrued liabilities	853,532	(4,176,525)
	<u>\$480,036</u>	<u>\$(4,677,150)</u>

K-Bro Linen Income Fund

Notes to the Interim Consolidated Financial Statements (Unaudited)

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 29, 2010.

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

	Three months ended June 30,	
	2010	2009
Healthcare	\$17,645,506	\$16,723,346
Hospitality	8,256,158	5,022,538
Total	<u>\$25,901,664</u>	<u>\$21,745,884</u>
	Six months ended June 30,	
	2010	2009
Healthcare	\$34,782,273	\$33,660,660
Hospitality	15,051,001	9,578,685
Total	<u>\$49,833,274</u>	<u>\$43,239,345</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 November 12, 2015.

For the six months ended June 30, 2010, the Fund has recorded revenue of \$26.3 million (six months ended June 30, 2009 - \$26.1 million) from these three major customers, representing 53% (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 June 30, 2010, the Fund incurred such fees totalling \$34,500 (three months ended June 30, 2009 - \$34,500). For the six months ended June 30, 2010, the Fund incurred such fees totalling \$69,000 (six months ended June 30, 2009 - \$69,000).