



K-BRO LINEN INCOME FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND NINE MONTHS ENDED

SEPTEMBER 30, 2009 and 2008

103, 15023 - 123 Avenue, Edmonton, Alberta, Canada T5V 1J7
Phone 780-453-5218 Fax 780-455-6676
www.k-brolinen.com



MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

November 5, 2009

The following Management's Discussion and Analysis ("MD&A") is supplemental to, and should be read in conjunction with, the unaudited consolidated financial statements of K-Bro Linen Income Fund ("the Fund") for the nine months ended September 30, 2009 and the audited consolidated financial statements and MD&A for the year ended December 31, 2008. These financial statements and other documents filed with regulatory authorities can be found on SEDAR at www.sedar.com. The Fund's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Fund's reporting currency is the Canadian dollar. The Fund and its subsidiary K-Bro Linen Systems Inc. will collectively be referred to as "K-Bro" in this MD&A.

Management is responsible for the information contained in this MD&A and its consistency with information presented to the Audit Committee and Board of Trustees. All information in this document has been reviewed and approved by the Audit Committee and Board of Trustees. This review was performed by management with information available as of November 5, 2009.

In the interest of providing unitholders and potential investors of K-Bro with information regarding future plans and operations, this MD&A contains forward-looking information that represents internal expectations, estimates or beliefs concerning, among other things, future activities or future operating results and various components thereof. The use of any of the words "anticipate", "continue", "expect", "may", "will", "project", "should", "believe", and similar expressions suggesting future outcomes or events are intended to identify forward-looking information. Statements regarding such forward-looking information reflect management's current beliefs and are based on information currently available to management.

These statements are not guarantees of future performance and are based on management's estimates and assumptions that are subject to risks and uncertainties, which could cause K-Bro's actual performance and financial results in future periods to differ materially from the forward-looking information contained in this MD&A. These risks and uncertainties include, among other things, (i) risks associated with acquisitions, including the possibility of undisclosed material liabilities; (ii) K-Bro's competitive environment; (iii) utility and labour costs; (iv) K-Bro's dependence on long-term contracts, (v) increased capital expenditure requirements; (vi) reliance on key personnel; and (vii) the availability of future financing. Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking information include: (i) volumes and pricing assumptions; (ii) utility costs; (iii) expected impact of labour cost initiatives; and (iv) the level of capital expenditures. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Certain statements regarding forward-looking information included in this MD&A may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this MD&A.

All forward-looking information in this MD&A is qualified by these cautionary statements. Forward-looking information in this MD&A is presented only as of the date made. Except as required by law, K-Bro does not undertake any obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

This MD&A also makes reference to certain non-GAAP measures to assist in assessing the Fund's financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. Please see "Non-GAAP Measures" for further discussion.

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INTRODUCTION

Core Business

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 is the largest owner and operator of laundry and linen processing facilities in Canada. K-Bro provides a comprehensive range of general linen and operating room linen processing, management and distribution services to healthcare institutions, hotels and other commercial accounts. K-Bro currently has processing facilities in six Canadian cities: Toronto, Edmonton, Calgary, Vancouver, Victoria and Quebec City.

Industry and Market

K-Bro provides laundry and linen services to Canadian healthcare, hospitality and other commercial customers. Typical services offered by K-Bro include the processing, management and distribution of general and operating room linens, including sheets, blankets, towels, surgical gowns and drapes and other linen. Other types of processors in K-Bro's industry in Canada include independent privately-owned facilities (i.e. typically small, single facility companies), public sector central laundries and public and private sector on-premise laundries (known as "OPLs"). Participants in other sectors of the laundry and linen services industry, such as uniform rental companies (which own and launder uniforms worn by their customers' employees) and facilities management companies (which manage public sector central laundries and OPLs), typically do not offer services that significantly overlap with those offered by K-Bro.

Management believes that the healthcare and hospitality sectors of the laundry and linen services industry represent a stable base of annual recurring business with opportunities for growth as additional healthcare beds and funds are made available to meet the needs of an aging demographic.

Industry Characteristics and Trends

Management believes that the industry exhibits the following characteristics and trends:

Stable Industry with Moderate Cyclicity – As evidenced by the stability in the number of approved hospital beds in the healthcare system and hotel rooms in the hospitality industry. Service relationships are typically formalized through contracts in the healthcare sector that are typically long term (from seven to ten years), while contracts in the hospitality sector typically range from two to five years.

Significant Barriers to Entry – Establishing new laundry facilities involves significant up-front investment in equipment, linen, facilities and labour. In addition, customer contracts are typically long-term, making it more difficult for new entrants to access new accounts other than upon the expiry of a contract's term.

Outsourcing and Privatization – There are often advantages to healthcare institutions in outsourcing the processing of healthcare linen to private sector laundry companies such as K-Bro because of the economies of scale and significant management expertise that can be provided on a more comprehensive and cost-effective basis than customers can achieve in operating their own laundry facilities.

Fragmentation – Most Canadian cities have at least one and sometimes several private sector competitors operating in the healthcare and hospitality sectors of the laundry and linen services industry. Management believes that the presence of these operators provides acquisition and consolidation opportunities for larger industry participants with the financial means to complete acquisitions.

Customers and Product Mix

K-Bro's customers include some of the largest healthcare and hospitality institutions in Canada. Healthcare customers include acute care hospitals and long-term care facilities. Most of K-Bro's hospitality customers (typically 250+ rooms) generate between 500,000 and 3,000,000 pounds of linen per year. Most healthcare customers generate between 500,000 pounds of linen per year for a hospital and up to 20,000,000 pounds of linen per year for a healthcare region.

SUMMARY OF RESULTS AND KEY EVENTS FOR THE PERIOD

Sustained Revenue and EBITDA Growth in 2009

Revenue increased in the third quarter of 2009 by 2.7% compared to the third quarter of 2008. For the nine months ended September 30, 2009, revenue increased by 3.7% over the comparable 2008 period. Of this year to date growth, approximately 0.4 percentage points are the result of the acquisition of the assets of Buanderie HMR Inc. (“HMR”) located in Quebec City, Quebec which took place on January 31, 2008, 2.6 percentage points are from the addition of new customers part way through 2008 and in 2009, 3.0 percentage points are from growth in existing customers as a result of growing volumes and price increases, and the loss or termination of customers accounted for a 2.3 percentage point reduction. Of the 3.0 percentage points of organic growth, approximately half is from price increases and half from volume increases.

The weakened economy, stronger Canadian dollar and new US passport requirements had a negative impact on hospitality revenues in the third quarter of 2009. However, with the addition of new hospitality customers in Vancouver and Toronto (see *Market Activities and Opportunities*), revenue for this sector grew by 5.1% in Q3 2009 compared to Q3 2008 and by 0.4% in the first nine months of 2009 compared to the same period in 2008. There can be no assurance that this trend will continue as the general economic conditions may continue to negatively impact K-Bro's hospitality revenues if tourism or business travel decreases further in the future.

EBITDA (see *Non-GAAP Measures*) increased in the third quarter of 2009 to \$4.1 million from \$3.6 million in the third quarter of 2008. This was an increase of 15.0%. For the nine months ended September 30, 2009, EBITDA increased to \$11.7 million from \$9.1 million in the same 2008 period, an increase of 29.4%. The EBITDA margin has increased to 18.3% in Q3 2009 versus 16.3% in Q3 2008. For the nine months ended September 30, the EBITDA margin has increased to 17.8% in 2009 versus 14.3% in 2008. This is primarily the result of:

- the operating efficiencies being achieved in the new Calgary plant that started up in Q2 2008 with increased volumes and price adjustments pursuant to a further 10 year contract with its major healthcare customer;
- contractual price adjustments from customers;
- the positive impact of labour initiatives being realized; and,
- a decrease in the cost of natural gas on the unhedged portion of K-Bro's requirements.

Labour Cost Improvements Achieved

Labour costs for plant staff as a percentage of plant revenue decreased in the third quarter from 45.9% in 2008 to 45.4% in 2009 (and from 47.5% for the first nine months of 2008 to 45.1% for 2009).

This decrease in labour costs is the result of the new, more efficient Calgary plant and the impact of utilizing the federal government's Temporary Foreign Worker Program. Staff hired under the Temporary Foreign Worker Program have been deployed as they arrive between Edmonton, Calgary, Vancouver and Victoria to fill current vacancies, reduce overtime and night shifts, and to fill vacancies due to turnover. This federal program has been in existence since 1996 and the “temporary” nature of it applies to the workers who are granted a 12 – 24 month work permit that can be extended under certain circumstances. K-Bro has been successful in obtaining two new Labour Market Opinions under this program which will

allow further hiring. As well, hiring domestically has seen improvement as a result of a rising unemployment rate.

Market Activities and Opportunities

Activities of significance in K-Bro's markets in the first nine months of 2009 have included:

British Columbia – Processing has commenced for a total of five new hotel accounts. In a September 17, 2009 news release from the Hospital Employees' Union, it was announced that "Vancouver Coastal Health Authority is moving to contract out the remaining laundry services provided by the Tilbury Regional Hospital Laundry to Lower Mainland hospitals." We believe this would be done through a Request for Proposal process to which K-Bro would certainly be a responder.

Alberta – In Edmonton, K-Bro's operating room linen contract was extended for another 21 months to December 31, 2010. Alberta Health Services, in response to a projected budget deficit, announced that it is to present "where applicable, opportunities to improve effectiveness and efficiencies consistent with the Board's goal of accessibility, quality and sustainability in order to achieve further savings in 2010/2011 and beyond." Subsequently, Alberta Health Services announced a planned staged closure of Alberta Hospital, a mental health facility. As this facility has an on-premise laundry, K-Bro would obtain this volume under its current contract when such closure occurs. Additional potential impacts of their initiative on K-Bro are unknown at this stage. In Calgary, the finalized signed contract with the health region (which commenced March 1, 2008) was received.

Ontario – Processing has commenced for four new hotel accounts and the contracts of three other hotel customers were extended for a further three year period. As previously announced, the Halton Healthcare contract was not renewed and service was ended in April. One hospital contract was extended for a further five year period to 2016 pursuant to an extension option exercised by the customer.

Quebec – Processing commenced for two new hotel customers.

The new hotel customers noted above will generate additional annual revenue of approximately \$2.0 million.

K-Bro currently has several proposals out and has entered into discussions with potential new healthcare and hospitality customers. In addition, discussions are at various stages with potential acquisition candidates. Neither the timing nor the degree of likelihood of success of any of these proposals or potential acquisitions can be stated with any degree of accuracy at this time. The current state of the economy and capital markets adds a significant component of uncertainty to this growth process with respect to availability and cost of capital as well as the accretiveness of opportunities.

Effects of Economic Volatility and Uncertainty

K-Bro management feels that it is positioned to withstand the current market volatility and uncertainty given that:

- Approximately 76% of its revenues are from large publicly funded healthcare customers under long-term contract.
- K-Bro's \$30 million line of credit is with a major Canadian bank and has a term to February 28, 2011 with an annual option to renew for an additional year. No events of default have occurred and at September 30, 2009, K-Bro had unutilized borrowing capacity under this line of \$24.6 million or 82% of the line available.
- K-Bro's payout ratio for the quarter was 50.6% and 55.1% for the nine months ended September 30, 2009. The undistributed portion of cashflow provides K-Bro with cashflow from operations to fund growth or cushion it against business downturns.
- K-Bro has fixed a portion of certain potentially volatile components of its cost structure such as natural gas, electricity and interest rates through forward contracts or swaps. With the lowering of commodity prices such as natural gas, K-Bro currently benefits on its approximate 50% unhedged portion as this is a major input cost; however, the hedging of additional quantities is being pursued.

Taxation

On July 14, 2008 the Department of Finance released proposed amendments to the Income Tax Act (Canada) to facilitate the conversion of income trusts into corporations on a tax-deferred basis. These proposed amendments are being evaluated and will be utilized in evaluating the options available to K-Bro in light of the impact of Bill C-52 Budget Implementation Act 2007, which contained legislation creating a new 31.5 per cent tax on distributions from publicly traded income trusts in Canada, was substantively enacted by the Canadian Federal Government. Subsequent substantively enacted tax rate changes have reduced the tax rate applicable to distributions from Canadian public income trusts to 29.5 per cent in 2011 (reducing further to 28.0 per cent in 2012). 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 future income tax expense or recovery that needed to be recorded by the Fund as a result of this legislation as the Fund has no taxable temporary differences that would exist in 2011. Future income taxes are already recorded by the Fund's wholly-owned subsidiary K-Bro Linen Systems Inc.

ACHIEVEMENT OF KEY PERFORMANCE DRIVERS

K-Bro's key performance drivers focus on growth, profitability, stability and cost containment in order to maintain distributions and maximize unitholder value. The following outlines our level of success in each of these areas:

Category	Specific Indicator	Q3 2009	Q3 2008 ²	YTD 2009	YTD 2008 ²
Growth (% change from comparative period)	Distributable cash	13.1%	64.4%	30.2%	30.0%
	EBITDA ¹	15.0%	48.1%	29.4%	24.2%
	Revenue	2.7%	15.8%	3.7%	14.8%
Profitability (actual for the period)	EBITDA	\$4,138	\$3,597	\$11,741	\$9,070
	EBITDA margin	18.3%	16.3%	17.8%	14.3%
	Net income	\$2,096	\$1,610	\$5,855	\$3,337
Stability	Payout ratio	50.6%	57.2%	55.1%	69.9%
	Distributions (annualized rate per Unit)	\$1.10	\$1.10	\$1.10	\$1.10
	Debt to total Capitalization	7.4%	8.8%	7.4%	8.8%
	Unutilized line of credit	\$24,643	\$23,346	\$24,643	\$23,346
Cost containment (as a % of revenue)	Wages and benefits	45.4%	45.9%	45.1%	47.5%
	Utilities	6.7%	7.3%	7.1%	7.9%
	Total operating expenses	81.7%	83.7%	82.2%	85.7%

- Notes:
1. EBITDA is defined as revenue less operating expenses as reflected in the table above (which equates to net earnings before income tax recovery, gain or loss on disposals, financial charges and amortization). See *Non-GAAP Measures*.
 2. Restated for the adoption of CICA accounting standard 3064, which requires the expensing of certain expenditures related to a pre-operating period of a facility rather than recording them as assets (discussed further in *Changes in Accounting Policies Including Initial Adoption – Goodwill and intangible assets*)

OUTLOOK

Management believes that 2009 will end with a continued meaningful increase in EBITDA compared to 2008 and a conservative payout ratio (see *Non-GAAP Measures*). This belief is predicated on:

- The continued success of the new Calgary plant with increased volumes, price adjustments and operating efficiencies for a full year versus ten months in 2008;
- The anticipated continuing organic growth from existing customers;
- The anticipated positive impact of the labour initiatives that is expected to be realized on an ongoing basis; and
- The lower energy costs currently being experienced.

Looking into 2010, there are both new opportunities and risks that will be confronted. We believe that these include:

- A recovering economy that will potentially have positive impacts on our hospitality business.
- Provincial governments in a deficit position that are once again putting healthcare costs under a microscope and potentially seeing the advantage of further outsourcing of non-core activities such as laundry services. This has already been seen in Alberta and British Columbia (see *Market Activities and Opportunities*). Conversely, all healthcare costs and processes are being examined and some changes could negatively impact K-Bro.
- The initiatives in BC and Ontario to implement a harmonized sales tax (“HST”) on July 1, 2010 will lower the input cost of some materials and services to the benefit of K-Bro by an as yet undetermined amount.
- A CPI that remains very low which is potentially positive from a labor, materials and interest rate perspective but which is negative from a revenue perspective for those customer contracts encompassing a price adjustment based on CPI.
- A relatively high unemployment rate which is positive from a labor supply perspective but negative if access to such programs as the Temporary Foreign Worker Program is restricted.
- Natural gas prices that could move higher if current prices prove unsustainable as drilling is curtailed and supplies decrease. Conversely, they could move lower if vast quantities of shale gas glut the market. K-Bro will manage this risk through further hedging of these costs which could be at prices higher than those currently being experienced.
- The potential long-term impact of the Federal Government’s implementation of its income tax changes (see *Taxation*) will continue to unfold as capital markets, investors and the government react to the changes. The Fund, with the assistance of its professional advisers, continues to monitor the possible long-term impact they will have on the Fund and its investors, and what, if any, steps to take in respect of the Fund. However, this legislation is not expected to have an immediate impact on the Fund's tax treatment or distribution policy or the tax treatment of distributions to investors. There can be no assurance that the Fund will be able to undertake any measures to minimize the long-term impact; however, based on current knowledge and belief, it appears that conversion to a dividend paying corporation on or before December 31, 2010 may be a suitable alternative structure. The cost of such a conversion may range from \$0.5 million to \$1.0 million.

Given this outlook, combined with an expected continuance of a conservative payout ratio, management believes that the current level of cash distributions is sustainable for the Fund in its current structure.

RESULTS OF OPERATIONS

(all amounts in this section in \$000’s except per unit amounts and percentages)

Overall Performance

The third quarter of 2009 saw revenue increase by \$596 or 2.7% over the third quarter of 2008 (increases of \$2,332 and 3.7% for the first nine months of 2009 compared to 2008). See the previous discussion under *Summary of Results and Key Events for the Period* and the *Revenues* section below for an analysis of this change. Operating costs decreased to 81.7% of revenue in the current quarter compared to 83.7% in 2008 (82.2% of revenue for the nine months of 2009 compared to 85.7% in 2008). The causes of this are discussed later under *Operating Expenses*.

As a result, EBITDA increased in the current quarter by \$541 (15.0%) over the third quarter of 2008 (\$2,670 or 29.4% for the first nine months of 2009 compared to 2008).

Selected Annual and Quarterly (Unaudited) Financial Information

The following table provides certain selected consolidated financial and operating data prepared by K-Bro management for the periods indicated:

Fiscal year	2009			Total	2008 ²				2007
	Q3	Q2	Q1		Q4	Q3	Q2	Q1	
Revenue	22,659	21,746	21,493	85,113	21,547	22,063	21,840	19,663	18,725
Operating expenses	18,521	17,635	18,001	72,718	18,223	18,466	18,539	17,490	16,842
EBITDA ¹	4,138	4,111	3,492	12,395	3,324	3,597	3,301	2,173	1,883
EBITDA as a % of revenue	18.3%	18.9%	16.2%	14.6%	15.4%	16.3%	15.1%	11.1%	10.1%
Amortization	1,885	1,871	1,892	7,203	1,950	1,903	1,896	1,454	1,408
Financial charges	60	64	91	687	142	148	140	257	318
Loss (gain) on disposal of equipment	1	-	3	507	49	-	458	-	(28)
Write-off of new plant start-up costs	-	-	-	132	-	-	27	105	-
Earnings before income taxes	2,192	2,176	1,506	3,866	1,183	1,546	780	357	185
Income tax (expense) recovery	(97)	(8)	85	856	202	64	231	359	859
Net earnings	2,095	2,168	1,591	4,722	1,385	1,610	1,011	716	1,044
Net earnings as a % of revenue	9.2%	10.0%	7.4%	5.5%	6.4%	7.3%	4.6%	3.6%	5.6%
Diluted earnings per Unit	0.30	0.31	0.23	0.70	0.21	0.23	0.14	0.12	0.19
Total assets	83,565	84,639	86,344	85,793	85,793	88,241	89,398	89,463	83,342
Total long-term financial liabilities	9,676	11,263	11,536	8,501	8,501	10,825	13,718	8,872	21,948
Funds provided by (used in) operations	5,568	3,539	(796)	15,322	5,594	5,570	470	3,688	2,966
Long-term debt, end of period	5,107	6,735	7,210	4,061	4,061	6,219	9,010	4,000	16,627
Distributions declared per unit	0.28	0.27	0.28	1.10	0.27	0.28	0.28	0.27	0.27

- Notes:
1. EBITDA is defined as revenue less operating expenses as reflected in the table above (which equates to net earnings before income tax recovery, gain or loss on disposals, financial charges and amortization). See *Non-GAAP Measures*.
 2. Restated for the adoption of CICA accounting standard 3064, which requires the expensing of certain expenditures related to a pre-operating period of a facility rather than recording them as assets (discussed further in *Changes in Accounting Policies Including Initial Adoption – Goodwill and intangible assets*)

Revenues

See previous discussion under *Summary of Results and Key Events for the Period and Overall Performance*. Revenues by sector consist of:

Fiscal year	2009			Total	2008				2007
	Q3	Q2	Q1		Q4	Q3	Q2	Q1	
Sector									
Healthcare	16,524	16,723	16,937	64,698	16,782	16,226	16,448	15,242	14,806
Hospitality	6,135	5,023	4,556	20,415	4,765	5,837	5,392	4,421	3,919
Total	22,659	21,746	21,493	85,113	21,547	22,063	21,840	19,663	18,725

Operating Expenses

Wages and benefits - The major cause of the quarterly and annual improvement in labour costs as a percentage of revenue is the performance of the Alberta plants as outlined under *Labour Cost Improvements Achieved in Summary of Results and Key Events for the Period*.

Linen - Costs as a percentage of revenue have decreased for both the three and nine months ended September 30, 2009 compared to the same periods in 2008, as the costs of standard and operating room linen items have remained flat in a competitive global market.

Utilities - Reductions in natural gas and electricity rates occurred in the last half of 2008 and the first nine months of 2009, resulting in a decrease in utility costs as a percentage of revenue from 7.3% in the third quarter of 2008 to 6.7% in the third quarter of 2009. This decreased expense for the first nine months was somewhat offset by a decline in the amount of the rebate received through the Alberta Natural Gas Rebate Program as a result of the lower market rates. This program ended on March 31, 2009. K-Bro continues to evaluate expanding its natural gas and electricity hedges to take advantage of the current low prices as a continuance of its strategy of locking in future variable costs where feasible.

Delivery - The decrease in delivery costs for both the three and nine months is primarily the result of lower fuel costs.

Repairs and maintenance – As a percentage of revenue, there was an increase of 0.1 percentage points for the quarter and 0.2 percentage points for the nine months in repairs and maintenance costs. The \$45 increase in repairs and maintenance in the third quarter of 2009 (\$220 for the nine months of 2009) is the result of increased repairs and maintenance on certain equipment ages.

Materials and supplies – This includes many different categories, including administrative expenses at the plant level. The quarterly and nine month increases are in large part due to the 2008 one-time recovery of costs related to the new Calgary plant and worker's compensation expense rebates and special dividends received in 2008.

Occupancy - Of the \$165 decrease in quarterly occupancy costs and \$250 decrease in occupancy costs for the nine months, substantially all of the decrease is related to the one-time costs of vacating the former Calgary plant recorded in 2008, net of additional expenses related to the new and larger Calgary facility which was occupied at the end of Q1 2008.

Corporate - Costs increased by \$68 over the third quarter of 2008 and \$442 over the first nine months of 2008 which is primarily attributable to an increase in the accrual for the Long Term Incentive Plan (see below) as a result of exceeding performance targets for the period.

Long Term Incentive Plan

In April 2006, a trust (the "LTIP Trust") was formed to hold Units of the Fund on behalf of the participants of K-Bro's long-term incentive plan (the "LTIP"). K-Bro is neither a trustee nor a direct participant of the LTIP; however, under certain circumstances K-Bro may be the beneficiary of forfeited Units held by the LTIP Trust. Consequently, the LTIP Trust is considered a variable interest entity for accounting purposes and K-Bro has consolidated the LTIP Trust in accordance with the Canadian Institute of Chartered Accountants ("CICA") issued Accounting Guideline AcG-15. For a specific performance year, one-quarter of the Units held by the LTIP Trust vest to the participants of the LTIP thirty days after approval of the audited financial statements by the Trustees upon the participant signing a Participation Agreement and Confirmation and three-quarters will vest on the second anniversary of that date upon continued employment, except in limited circumstances. Compensation expense is recorded by K-Bro in the period earned. Distributions made by the Fund with respect to unvested Units held by the LTIP Trust are paid to LTIP participants. Unvested units held by the LTIP Trust are shown as a reduction of unitholders' equity. At September 30, 2009 a total of 69,692 units were unvested.

Effects of Inflation

The majority of K-Bro's customer contracts have an annual price adjustment mechanism based on a published price index such as the Consumer Price Index. To the extent that such indices are impacted by inflation, this would be reflected in K-Bro's revenues and net income. K-Bro's operating costs may be affected by general inflation but to a much greater extent are impacted by labour market conditions, textile costs in a global environment and commodity prices impacting the cost of energy.

Amortization of Property and Equipment

Amortization of property and equipment represents the expense related to the appropriate matching of certain of K-Bro's long-term assets to the estimated useful life and period of economic benefit to K-Bro of those assets. Amortization of plant and equipment for the quarter and first nine months of 2009 has increased from the comparable period in 2008 primarily due to the capital expense of the new Calgary plant.

Amortization of Intangible Assets

Amortization of intangible assets represents the expense related with matching K-Bro's finite life intangible assets to the estimated useful life and period of economic benefit to K-Bro of those assets. Amortization expense in the first nine months of 2009 increased compared to 2008 as a result of the HMR acquisition on January 31, 2008.

Financial Charges

Financial charges in the current quarter decreased by \$87 over 2008 (and decreased by \$330 for the first nine months of 2009 compared to 2008) as a result of a reduced long-term debt balance and lower market interest rates (see *Liquidity and Capital Resources – Financing Activities*).

Income Tax Recovery

Income tax recovery includes current and future income taxes based on taxable income and the temporary timing differences between the tax and accounting bases of assets and liabilities. Income tax recovery reflects the structure as an income trust whereby the Fund's unitholders bear the tax obligations with respect to distributions.

On June 12, 2007, Bill C-52 Budget Implementation Act 2007, which contained legislation creating a new 31.5 per cent tax on distributions from publicly traded income trusts in Canada, was substantively enacted by the Canadian Federal Government. Subsequent substantively enacted tax rate changes have reduced the tax rate applicable to distributions from Canadian public income trusts to 29.5 per cent in 2011 (reducing further to 28.0 per cent in 2012). 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 future income tax expense or recovery that needed to be recorded by the Fund as a result of this legislation as the Fund has no taxable temporary differences that would exist in 2011. Future income taxes are already recorded by the Fund's wholly-owned subsidiary K-Bro Linen Systems Inc.

Currently, the Fund is only taxable on amounts that are not distributed to Unitholders. Once the Fund is subject to the new rules (which is not expected to be until 2011), the Fund will be subject to income tax on its earnings regardless of whether amounts are distributed to the Unitholders or not.

LIQUIDITY AND CAPITAL RESOURCES

(all amounts in this section in \$000's except per unit amounts and percentages)

Cash Provided by Operating Activities

Cash provided by operating activities was \$5,568 in the third quarter of 2009, a decrease of \$2 from the funds provided by operating activities in the third quarter of 2008. This \$2 decrease is attributable to an increase in cashflow from operations of \$628 offset by an increased working capital requirement of \$630 in the quarter compared to the corresponding period in 2008. For the nine months, cash provided by operating activities was \$8,311 in 2009, a decrease of \$1,417 from the funds provided by operating activities in 2008. This \$1,417 decrease is attributable to an increase in cashflow from operations of \$3,119 offset by an increased working capital requirement of \$4,536 compared to the corresponding period in 2008.

The changes in working capital requirements are the result of: changes in accounts receivable resulting from the timing of receipts from major customers and growth in revenues; and, changes in accounts payable and prepaid expenses and deposits as the result of timing differences in payments (primarily associated with the payment of accrued volume rebates in Q1 2009 and reduced construction expenditure accruals in 2009 vs. 2008).

Financing Activities

In the first quarter of 2008, the Fund raised proceeds (net of offering costs before tax) of \$18,252 from the issuance of 1,362,000 units on a bought deal basis and 146,700 additional units when a portion of the related over-allotment option was exercised. As planned, these funds financed the acquisition of HMR (\$3,852 including the escrowed funds) and were used for the retrofit and equipping of the new Calgary plant and for general corporate purposes. No equity issuances occurred in the first nine months of 2009.

During the quarter ended September 30, 2009, the Fund declared distributions to unitholders at an annualized rate of \$1.10 per unit for a total amount of \$1,927 (\$1,926 for the third quarter of 2008). For the nine months ended September 30, 2009, the Fund declared distributions to unitholders at an annualized rate of \$1.10 per unit for a total amount of \$5,779 (\$5,628 for 2008.) The increase in 2009 is reflective of the increased number of units outstanding as a result of the equity offering on February 27, 2008 and the related over-allotment option exercised on March 28, 2008.

Long-term debt at September 30, 2009 was \$5,107 compared with \$4,061 at December 31, 2008 and \$6,219 at September 30, 2008. The increase from the fourth quarter of 2008 is primarily the result of the increase in working capital requirements and the purchase of property, plant and equipment.

The existing long-term debt of \$5,107 consists of draw downs on a secured revolving, interest only, credit facility (the "Credit Facility") of up to \$30,000. The Credit Facility is a two-year committed facility maturing February 28, 2011 and is extendable annually for an additional year at the lender's option. It is subject to customary terms and conditions and is also subject to the maintenance of a maximum ratio of funded debt to EBITDA of 2.75 (increased to 3.25 for the two fiscal quarters immediately following an acquisition), and minimum ratios of 1.50 for the defined current ratio and 1.00 for fixed charge coverage. K-Bro has incurred no events of default under the terms of its credit facility agreement.

On June 24, 2005, K-Bro entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of \$4,000 of this debt has been fixed at 5.95% for a period of five years. The floating rate of interest that was swapped for this fixed rate is currently at 2.90%.

In the second quarter of 2009, the Fund entered into a foreign exchange forward contract at an exchange rate of 1.0865 Canadian per US dollar to cover its foreign exchange exposure with respect to its liability for certain equipment purchases. This foreign exchange forward contract was exercised in the third quarter of 2009.

Investing Activities

During the current quarter, K-Bro used \$256 (2008 – \$68) of funds for maintenance capital expenditures and \$1,758 (2008 – \$787) of funds for strategic capital expenditures for a total cash investment of \$2,014 (2008 – \$855) for the quarter. For the nine months, K-Bro used \$997 of funds for maintenance capital expenditures in 2009 (2008 – \$310) and \$2,587 of funds for strategic capital expenditures (2008 – \$7,929) for a total cash investment of \$3,584 (2008 – \$8,239). Management defines maintenance capital expenditures as additions to, or replacements of, property and equipment to maintain K-Bro's current business operations. K-Bro has embarked on a computer software upgrade that commenced in the first quarter of 2009. Total costs of phase one of this two phase project, including software and hardware, are estimated to be \$1,000, of which \$526 was incurred in the first nine months of 2009 as a maintenance capital expenditure. Management estimates that ongoing annual average maintenance capital expenditures are approximately \$850. The modest level of maintenance capital expenditures is due to the long life of the majority of the processing equipment. The high level of strategic capital expenditures in 2008 is related to the new Calgary plant.

Expenditures on parts such as motors, belts and ironer pads are expensed as incurred. These expenditures and an extensive preventative maintenance program performed at each plant by a full complement of qualified maintenance engineers has resulted in a repairs and maintenance expense (including personnel costs) totaling \$1,356 in the third quarter of 2009 (\$1,233 in 2008) which are included in the calculation of EBITDA. This amount as a percentage of revenue is up 0.4 percentage points for the current quarter over the third quarter of 2008.

Strategic capital expenditures are defined by management as those expenditures utilized for improvements to, and expansion of, K-Bro's property and equipment to enhance efficiencies and capacity to process incremental volumes. The strategic capital expenditures in 2009 are primarily related to the requirements of handling additional volume and gaining efficiencies.

No disposals of equipment were recorded in the third quarter of 2009.

Contractual Obligations

At September 30, 2009, payments due under contractual obligations for the next five years and thereafter are as follows:

	Payments Due by Period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Long-term debt	5,107	–	5,107	–	–
Operating leases and utility commitments	14,508	1,352	5,396	3,786	3,974
Linen purchase obligations	1,310	1,310	–	–	–

The source of funds for these commitments will be from operating cash flow and the undrawn portion of the Credit Facility.

Financial Position

Capital Structure at September 30		
	2009	2008
Long-term debt	\$5,107	\$6,219
Unitholders' equity	63,685	64,357
Total capitalization	68,792	70,576
Debt to total capitalization	7.4%	8.8%

For the three months ended September 30, 2009, the Fund had a payout ratio (see *Non-GAAP Measures*) of 50.6%, a debt to total capitalization of 7.4%, an unused line of credit of \$24,643 and has not incurred any events of default under the terms of its credit facility agreement. Based on this, management believes that K-Bro has sufficient liquidity and is able to generate sufficient amounts of cash to meet its planned growth and has access to the equity market, if available and cost effective, to fund additional growth as acquisition opportunities arise.

DISTRIBUTIONS FOR THE PERIOD

Fiscal year		2009		2008	
Period	Payment Date	Per Unit Distribution	Distribution Amount (\$)	Per Unit Distribution	Distribution Amount (\$)
Fund Units					
First quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,754,774
Second quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
July	August 14	\$0.09167	\$635,508	\$0.09167	\$635,508
August	September 15	\$0.09167	\$635,508	\$0.09167	\$635,508
September	October 15	\$0.09167	\$635,508	\$0.09167	\$635,508
Third quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
Year to date		\$0.82503	\$5,719,572	\$0.82503	\$5,567,822
Exchangeable Shares					
First quarter		\$0.27501	\$19,914	\$0.27501	\$19,913
Second quarter		\$0.27501	\$19,913	\$0.27501	\$19,914
July	August 14	\$0.09167	\$6,638	\$0.09167	\$6,638
August	September 15	\$0.09167	\$6,638	\$0.09167	\$6,638
September	October 15	\$0.09167	\$6,638	\$0.09167	\$6,637
Third quarter		\$0.27501	\$19,914	\$0.27501	\$19,913
Year to date		\$0.82503	\$59,741	\$0.82503	\$59,740
Total Distributions		\$0.82503	\$5,779,313	\$0.82503	\$5,627,562

For the nine months ended September 30, 2009, the Fund distributed \$0.82503 per unit compared with Distributable Cash (see *Non-GAAP Measures*) per unit of \$1.49. The actual payout ratio was 55.1%.

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practices 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 in equal amounts to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid by the 15th of the following month.

DISTRIBUTABLE CASH (see *Non-GAAP Measures*)

(all amounts in this section in \$000's except per unit amounts and percentages)

The Fund's source of cash for distributions is cash provided by operating activities. Distributable cash, reconciled to cash provided by operating activities as calculated under GAAP, is presented as follows:

Fiscal year ¹	2009			2008 ²					2007
	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1	Q4
Per consolidated financial statements:									
Cash provided by (used in) operating activities	\$5,568	\$3,539	\$(796)	\$15,322	\$5,594	\$5,570	\$470	\$3,688	\$2,966
Add (deduct):									
Net changes in non-cash working capital items ³	(1,505)	494	4,183	(3,788)	(2,424)	(2,135)	2,649	(1,878)	(1,398)
Maintenance capital expenditures ⁴	(256)	(608)	(133)	(490)	(180)	(68)	(172)	(70)	(58)
Distributable cash	\$3,807	\$3,425	\$3,254	\$11,044	\$2,990	\$3,367	\$2,947	\$1,740	\$1,510
Distributable cash per weighted average diluted Units outstanding	\$0.54	\$0.49	\$0.46	\$1.63	\$0.44	\$0.48	\$0.42	\$0.29	\$0.26
Distributions declared ⁵	\$1,927	\$1,926	\$1,926	\$7,554	\$1,927	\$1,926	\$1,926	\$1,775	\$1,511
Distributions declared per unit (see "Non-GAAP Measures")	\$0.28	\$0.27	\$0.28	\$1.10	\$0.27	\$0.28	\$0.28	\$0.27	\$0.27
Payout ratio (see "Non-GAAP Measures")⁵	50.6%	56.2%	59.2%	68.4%	64.4%	57.2%	65.4%	102.0%	100.0%
Weighted average units outstanding during the period — Basic	6,930	6,946	6,970	6,719	6,969	6,969	6,961	5,972	5,459
Weighted average units outstanding during the period — Diluted	6,994	7,010	6,999	6,747	6,998	6,996	6,985	5,997	5,493
12-month trailing									
Distributable cash	13,476	13,036	12,558		11,044	9,564	8,245	7,483	7,704
Distributions	7,706	7,705	7,705		7,554	7,138	6,724	6,309	6,046
Payout ratio	57.2%	59.1%	61.4%		68.4%	74.6%	81.6%	84.3%	78.5%
Cumulative since IPO February 3, 2005									
Distributable cash	42,641	38,834	35,409		32,155	29,165	25,798	22,851	21,111
Distributions	29,351	27,424	25,498		23,572	21,645	19,719	17,793	16,018
Payout ratio	68.8%	70.7%	72.0%		73.3%	74.2%	76.4%	77.9%	75.9%

- Following the revised Staff Notice 52-306 issued by the Canadian Securities Administrators on distributable cash presentation, we adopted their recommendations retroactive to February 3, 2005 in order to disclose comparable results.
- Restated for the adoption of CICA accounting standard 3064, which requires the expensing of certain expenditures related to a pre-operating period of a facility rather than recording them as assets (discussed further in *Changes in Accounting Policies Including Initial Adoption – Goodwill and intangible assets*).
- Net changes in non-cash working capital is excluded from the calculation as management believes it would introduce significant cash flow variability and affect underlying cash flow from operating activities. Significant variability can be caused by such things as the timing of receipts (which individually are large because of the nature of K-Bro's customer base and timing may vary due to the timing of customer approval, vacations of customer personnel, etc.) and the timing of disbursements (such as the payment of large volume rebates done once annually). As well, large increases in working capital are generally required when contracts with new customers are signed as linen is purchased and accounts receivable increase. Management feels that this amount should be excluded from the distributable cash figure which is used as the basis for determining the distributions to be paid.
- Maintenance capital expenditure is discussed under *Investing Activities*.
- The level of distributions paid compared to distributable cash is reviewed periodically to take into account the current and prospective performance of the business and other items considered to be prudent.

OUTSTANDING UNITS

At September 30, 2009, the Fund had 6,932,562 Fund Units outstanding and 72,411 Special Trust Units outstanding (unchanged from June 30, 2009 and December 31, 2008). The basic and the diluted weighted average number of units outstanding for the first nine months of 2009 were 6,950,274 and 7,014,454 respectively (6,951,816 and 6,978,573 respectively for the first nine months of 2008).

In accordance with the LTIP agreement and in conjunction with the performance of the Fund in the prior fiscal year, the Compensation, Nominating and Corporate Governance Committee of the Trustees of the Fund in 2009 approved LTIP compensation of \$0.8 million (2008 – \$0.3 million) and approved the funding and transfer of \$0.8 million (2008 – \$0.3 million) of cash to the LTIP Trust in April 2009 and March 2008 respectively in order to fund the purchase of Units by the LTIP Trust. In April 2009, the LTIP Trust purchased 68,171 Units of the Fund (2008 – 24,751). As at September 30, 2009, 72,739 Units held by the LTIP Trust have vested (December 31, 2008 – 38,961). The basic net earnings per unit calculation exclude the unvested units held by the LTIP Trust.

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 September 30, 2009, the Fund incurred such fees totaling \$34,500 (three months ended September 30, 2008 – \$11,500). For the nine months ended September 30, 2009, the Fund incurred such fees totalling \$103,500 (nine months ended September 30, 2008 – \$39,500).

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements, in conformity with GAAP, requires management of K-Bro to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Management regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances. This involves varying degrees of judgment and uncertainty and, therefore, amounts currently reported in the financial statements could differ in the future. There have been no changes in these accounting estimates from those reported at December 31, 2008.

NON-GAAP MEASURES

EBITDA

We report on our EBITDA (Earnings before interest, taxes, depreciation and amortization) because it is a key measure used by management to evaluate performance. EBITDA is utilized in measuring compliance with debt covenants and in making decisions relating to distributions to unitholders. We believe EBITDA assists investors in assessing our performance on a consistent basis as it is an indication of our capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their vintage, technological currency and management's estimate their useful life. Accordingly, EBITDA comprises revenues less operating costs before: financing costs, capital asset amortization, disposal and impairment charges, and income taxes.

EBITDA is not a calculation based on GAAP and is not considered an alternative to net earnings in measuring K-Bro's performance. EBITDA does not have a standardized meaning and is therefore not likely to be comparable with similar measures used by other issuers. For reconciliation with GAAP, please refer to "Selected Annual and Quarterly Information". EBITDA should not be used as an exclusive measure of cash flow since it does not account for the impact of working capital changes, capital expenditures, debt changes and other sources and uses of cash, which are disclosed in the consolidated statements of cash flows.

Distributable Cash

Distributable cash is a non-GAAP measure generally used by Canadian income trusts as an indicator of financial performance but it should not be seen as a measurement of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. Management believes that this measure is commonly used by investors, management and other stakeholders to evaluate the ongoing performance of K-Bro. For reconciliation with GAAP, please refer to the *Distributable Cash* section.

Cash Distributions per Unit and Payout Ratios

We report on cash distributions per unit and payout ratios (actual cash distribution divided by distributable cash) because they are believed to be key measures used by investors to value K-Bro, assess its performance and provide an indication of the sustainability of distributions. Cash distributions per unit and the payout ratio depend on the amount of distributable cash generated and the Fund's distribution policy.

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practices considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. 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 of the following month. All distributions are discretionary. We periodically review cash distributions taking into account our current and prospective performance.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

The Fund has adopted one new accounting standard:

Goodwill and intangible assets

In February 2008, the CICA issued a new accounting standard – Section 3064 “Goodwill and intangible assets” replacing accounting standards Section 3062 “Goodwill and other intangible assets” and Section 3450 “Research and development costs.” Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. The new Section is applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Fund adopted the new standard for its fiscal year beginning January 1, 2009. The provisions of Section 3064 were adopted retrospectively, with restatement of prior periods.

As a result of this adoption, the Fund has retroactively expensed certain expenditures related to the pre-operating period of the new Calgary plant, rather than recording them as assets in “Deferred charges.” The adoption of Section 3064 resulted in an increase to opening deficit of \$nil at January 1, 2008 and \$96,217 at January 1, 2009. For the three months ended September 30, 2008, the adoption of this standard resulted in no change to the statement of earnings or the earnings per unit. For the nine months ended September 30, 2008, the adoption of this standard resulted in an increase of \$132,631 in the “Write-off of new plant start-up costs” expense and an increase in the “Future income tax recovery” of \$36,414, and reduced both basic and diluted earnings per unit by \$0.01.

International Financial Reporting Standards

The Accounting Standards Board of Canada has announced that accounting standards in Canada, as used by public companies, will be converged to International Financial Reporting Standards (“IFRS”) effective January 1, 2011. The changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

IFRS uses a conceptual framework similar to Canadian GAAP but there are significant differences in recognition, measurement and disclosure requirements. As a result, the Fund has established a changeover plan to convert to these new standards according to the timetable set with these new rules. An implementation plan has been created and will be executed with internal and external resources. The Fund has completed the scoping and diagnostic phase and has moved to the impact analysis and design phase. The Fund’s preliminary analysis of IFRS in comparison to Canadian GAAP has identified a number of differences. At this time, the impact on our future financial position and results of operations is not reasonably determinable or estimable. The Fund will continually review and adjust the changeover plan to ensure the implementation process properly addresses the key elements of the plan.

Key activities, milestones/deadlines and status are as follows:

Key Activity	Milestones/Deadlines	Status
Financial Statement Preparation: <ul style="list-style-type: none"> ▪ Identify differences between IFRS and Canadian GAAP accounting policies ▪ Selection of IFRS policies ▪ Select choices under IFRS 1 ▪ Develop financial statement format ▪ Quantify effects of change in initial IFRS1 disclosures and 2010 financial statements 	Senior Management sign-off and audit committee review for all items by end of fourth quarter, 2009.	Most of the differences have been identified and documented. Recommendation regarding IFRS policies and selection of choices under IFRS 1 being drafted.
Staffing: Define and introduce appropriate level of IFRS expertise for each of the following: <ul style="list-style-type: none"> ▪ Accounting staff ▪ Senior executives and Board, including Audit Committee 	Appropriate level of expertise to be in place by second quarter 2009.	Experienced consultant contracted in July for duration of project. Internal resource assessment ongoing.
Infrastructure: Ensure information technology is fully compliant for IFRS as follows: <ul style="list-style-type: none"> ▪ Capability of system to produce dual financial statements (Canadian GAAP and IFRS) during the transition years ▪ Programs upgrades/changes ▪ Gathering disclosure data ▪ Budget/forecast monitoring process 	Ready for parallel processing of 2010 general ledgers and for planning/monitoring process.	Process currently underway in conjunction with financial systems software upgrade.
Business Policy Assessment: Financial Covenants <ul style="list-style-type: none"> ▪ Identify impact of IFRS on financial covenants ▪ Complete any required renegotiations/changes 	Renegotiations to be completed by third quarter 2010.	Process of identifying metrics affected by conversion to IFRS currently underway. Preliminary discussions with bank held.
Business Policy Assessment: Compensation Arrangements <ul style="list-style-type: none"> ▪ Identify impact on compensation arrangements ▪ Make any required changes 	Fourth quarter 2010.	Process of identifying metrics affected by conversion to IFRS currently underway.
Business Policy Assessment: Customer and Supplier Contracts <ul style="list-style-type: none"> ▪ Evaluate impact of IFRS on current customer or supplier contracts. 	Complete review by first quarter 2010.	Process of identifying IFRS consequences in process.

<p>Control Environment: ICFR</p> <ul style="list-style-type: none"> ▪ For all accounting policy changes identified, assess ICFR design and effectiveness implications. ▪ Implement changes where appropriate. 	<p>Fourth quarter 2009.</p>	<p>To be reviewed in conjunction with accounting policies.</p>
<p>Control Environment: DC&P</p> <ul style="list-style-type: none"> ▪ For all accounting policy changes identified, assess DC&P design and effectiveness implications. ▪ Implement changes where appropriate. 	<p>See ICFR deadlines above.</p> <p>Publish impact of conversion on Key Performance Indicators in third quarter, 2010 MD&A.</p> <p>Publish material changes in policies and expectations by January 10, 2011.</p> <p>Publish revised 2010 results and MD&A by March 31, 2011.</p>	<p>To be reviewed in conjunction with accounting policies.</p>

FINANCIAL INSTRUMENTS

K-Bro's financial instruments at September 30, 2009 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders, long-term debt and an interest rate swap agreement. The Fund does not enter into financial instruments for trading or speculative purposes. Financial assets are either classified as available for sale, held to maturity, trading or loans and receivables. Financial liabilities are recorded at amortized cost. Initially, all financial assets and financial liabilities must be recorded on the balance sheet at fair value. Subsequent measurement is determined by the classification of each financial asset and liability. Unrealized gains and losses on financial assets that are held as available for sale are recorded in other comprehensive income until realized, at which time they are recorded in the consolidated statement of earnings. All derivatives, including embedded derivatives that must be separately accounted for, are recorded at fair value in the consolidated balance sheet. Transaction costs related to financial instruments are generally capitalized and then amortized over the expected life of the financial instrument using the effective yield method.

Derivative financial instruments are utilized by K-Bro to manage cashflow risk against the volatility in interest rates on its long-term debt and foreign exchange rates on its equipment purchase commitments. K-Bro does not utilize derivative financial instruments for trading or speculative purposes. K-Bro has floating interest rate debt that gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in interest rates. In order to manage these risks, K-Bro may enter into interest rate swaps, forward contracts or option contracts. K-Bro has entered into an interest rate swap arrangement as described under "Financing Activities".

It is K-Bro's policy to document all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. K-Bro also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair value or cash flows of hedged items. K-Bro's interest rate swaps, forward contracts or option contracts are designated as hedges when the underlying risks of the hedged and hedging instruments offset to manage K-Bro's exposure. Gains or losses relating to such contracts are accounted for as discussed above.

CRITICAL RISKS AND UNCERTAINTIES

As at September 30, 2009, there are no material changes in the Fund's risks or risk management activities since December 31, 2008. The Fund's results of operations, business prospects, financial condition, cash distributions to Unitholders and the trading price of the Fund's units are subject to a number of risks. These risk factors include: the effects of market volatility and uncertainty; potential future tax changes; the competitive environment; our ability to acquire and successfully integrate and operate additional businesses; utility costs; the labour markets; the fact that our credit facility imposes numerous covenants and encumbers assets; and, environmental matters.

For a discussion of these risks and other risks associated with an investment in Fund Units, see *Risk Factors – Risks Related to K-Bro and the Laundry and Linen Industry* detailed in the Fund's Annual Information Form that is available at www.sedar.com.

In July, a new sixty-six month agreement was ratified by the labor union in K-Bro's Quebec City plant with market based adjustments to wages and benefits.

CONTROLS AND PROCEDURES

In order to ensure that information with regard to reports filed or submitted under securities legislation present fairly in all material respects the financial information of K-Bro, management including the President and Chief Executive Officer and the Vice-President and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures, as well as internal control over financial reporting.

Disclosure Controls and Procedures

As of December 31, 2008, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Multilateral Instrument 52-109 was performed under the supervision of the President and Chief Executive Officer and the Vice-President and Chief Financial Officer who attested that the design and operation of these disclosure controls and procedures were effective, as at December 31, 2008. K-Bro's management can therefore provide reasonable assurance that material information relating to the Fund is reported to it in a timely manner so that it can provide investors with complete and reliable information.

Management also concluded that during the three and nine months ended September 30, 2009, no changes were made to internal controls over financial reporting that would have materially affected, or would be reasonably considered to materially affect, these controls.

Internal Controls over Financial Reporting

K-Bro undertook the documentation and assessment of the design of internal controls over financial reporting for its operating and accounting processes. Similar to the evaluation of disclosure controls and procedures referred to above, the design of internal controls over financial reporting was evaluated as defined in Multilateral Instrument 52-109. Based on the results of this evaluation, the President and Chief Executive Officer and the Vice President and Chief Financial Officer attested that the internal controls over financial reporting are designed to provide reasonable assurance that its financial reporting is reliable and that K-Bro's consolidated financial statements were prepared in accordance with Canadian GAAP.

Management also concluded that during the three and nine months ended September 30, 2009, no changes were made to internal controls over financial reporting that would have materially affected, or would be reasonably considered to materially affect, these controls.

STRATEGY

K-Bro maintains the following three-part strategic focus:

Secure and Maintain Long-Term Contracts with Large Healthcare and Hospitality Customers – K-Bro's core service is providing high quality laundry and linen services at competitive prices to large healthcare and hospitality customers under long-term contracts. K-Bro's contracts in the healthcare sector typically range from seven to ten years in length. Contracts in the hospitality sector typically range from two to five years.

Extend Core Services To New Markets – Management has demonstrated its ability to successfully expand K-Bro's business into new markets from its established base in Edmonton and Toronto. K-Bro entered the Calgary market in 1998, the Vancouver market in 2003, the Victoria market in 2006 and the Quebec market in 2008. These new markets have contributed significantly to K-Bro's growth. Management believes that new outsourcing opportunities will continue to arise in the near to medium-term and that K-Bro is well-positioned for continued growth, particularly as healthcare and hospitality institutions continue to increase their focus on core services and confront pressures for capital and cost savings.

Management may in the future expand its core services to new markets either through acquisitions or by establishing new facilities. Its choice of areas for expansion will depend on the availability of suitable acquisition candidates, the volume of healthcare linen to be processed and the policies of applicable governments.

Introduce Related Services – In addition to focusing on its core services, K-Bro also attempts to capitalize on attractive business opportunities by introducing closely-related services that enable it to provide more complete solutions to the K-Bro's healthcare customers. These related service offerings include K-Bro Operating Room Services ("KOR") and on-site services. For three major hospitals in Toronto, K-Bro has introduced the sterilization of operating room linen packs to its menu of services.