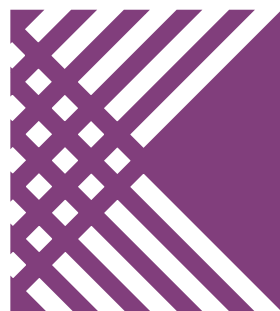


# 2009 Annual Report

**K-BRO LINEN INCOME FUND**



**K·BRO**

**(TSX: KBL.UN)**

# **K-BRO LINEN INCOME FUND**

**K-Bro Linen Income Fund, through its wholly-owned subsidiary K-Bro Linen Systems Inc., is Canada's largest healthcare and hospitality laundry and linen processor. Our name is known and respected in our industry. With seven large processing facilities in Toronto, Edmonton, Calgary, Vancouver, Victoria and Québec City, we employ over 1,500 people.**

**K-Bro provides an extensive value added menu of services that go beyond basic laundry services. These include reusable operating room pack services (KOR Services), resident personal clothing programs, specialty linen purchasing, various textile testing and extensive customer site-based services, including floor-to-floor distribution and linen room management.**

**We continued to successfully execute our three-part strategic focus in 2009 to:**

- **Secure and maintain long-term contracts with large healthcare and hospitality customers**
- **Extend core services to new markets**
- **Introduce related services.**

## **2 FINANCIAL HIGHLIGHTS**

## **3 PRESIDENT'S MESSAGE**

## **5 MANAGEMENT'S DISCUSSION AND ANALYSIS**

## **37 FINANCIAL STATEMENTS**

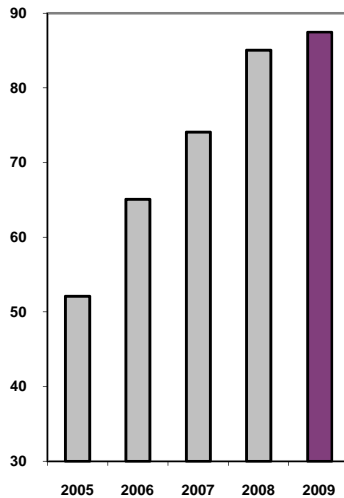
## **62 CORPORATE INFORMATION**

# FINANCIAL HIGHLIGHTS

- EBITDA <sup>(1)</sup> increased by 25.4% and revenues increased by 2.8% in 2009 from 2008.
- Net earnings increased by 65.2% to \$7.8 million in 2009 from \$4.7 million in 2008.
- Distributions of \$1.10 per unit were paid in 2009 consistent with the previous three years.
- Distributable cash <sup>(1)</sup> was \$14.0 million or \$1.99/unit, an increase of \$3.0 million over 2008.
- K-Bro had a conservative payout ratio <sup>(1)</sup> of 55.1% for 2009 and 68.4% for 2008.
- The company had a conservative debt to EBITDA <sup>(1)</sup> ratio of 0.26 at December 31, 2009.

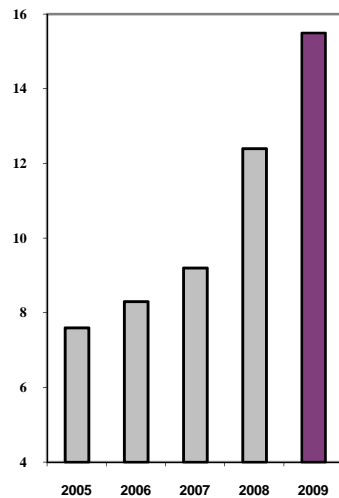
## REVENUE

(in millions of Canadian dollars)



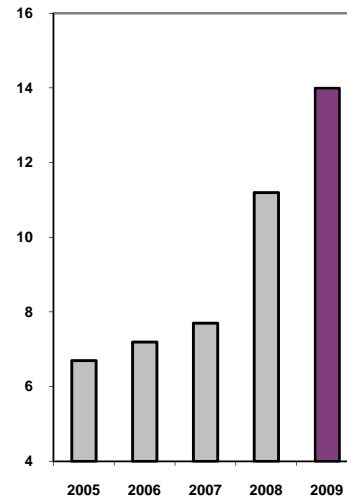
## EBITDA <sup>(1)</sup>

(in millions of Canadian dollars)

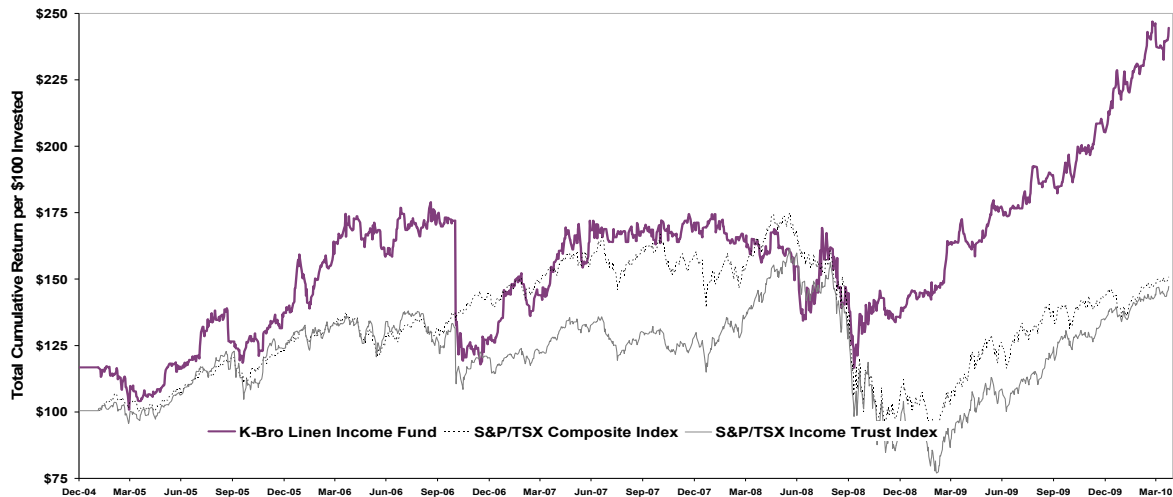


## DISTRIBUTABLE CASH <sup>(1)</sup>

(in millions of Canadian dollars)



## TOTAL CUMULATIVE RETURN (February 3, 2005 to April 30, 2010) K-BRO LINEN INCOME FUND V.S. S&P/TSX COMPOSITE



## INDEX VS. S&P/TSX INCOME TRUST INDEX

<sup>(1)</sup> Please refer to page 21 of Management's Discussion and Analysis for a discussion of this non-GAAP measure.

## PRESIDENT'S MESSAGE

I am pleased to report that the results of our growth initiatives, the progress made on labour costs and the positive impact of a full year in our new Calgary plant are all reflected in our strong 2009 results. We enter 2010 with the successful acquisition in January, 2010 of a second plant in Vancouver, the anticipated continuance of a low payout ratio, a strong balance sheet, low debt levels and effective control over our costs. However, our view of future organic growth is tempered by a low inflation rate negatively impacting price adjustments, provincial deficits potentially impacting hospital funding, changes in linen usage patterns as customers seek savings and an economy still in recovery mode. I feel that we are positioned to deal with these issues and pursue growth opportunities as they arise but are cautiously optimistic about 2010.

Our revenue for the year ended December 31, 2009 was \$87.5 million, a modest increase of 2.8% over 2008. However, EBITDA for the 2009 year increased by a gratifying 25.4% to \$15.5 million compared to the 2008 fiscal year. The EBITDA margin also increased significantly to 17.8% in 2009 from 14.6% in 2008, primarily as a result of an improvement in labour and energy costs. For the year, K-Bro made distributions of \$1.10 per unit and distributable cash was \$1.99 per unit. This amounted to annual distributions of \$7.7 million compared to distributable cash of \$14.0 million for a conservative payout ratio of 55.1%. Net earnings after taxes increased in 2009 by 65.2% to \$7.8 million as a result of the increased EBITDA. Despite the flat revenue, we are pleased to be able to deliver these improved returns to our Unitholders.

In concluding, I reiterate that my outlook for 2010 continues to remain positive but somewhat tempered by the risks and uncertainties of today's realities. However, the strategies, prospects, people, and financial capacity all remain in place and we have a solid foundation to meet the challenges of 2010.

I would like to thank our Unitholders, our employees, our customers and our Board for the continued support.



Linda McCurdy  
President and Chief Executive Officer

## A FIVE YEAR REVIEW OF ACHIEVEMENTS

Since our IPO on February 3, 2005 K-Bro has achieved the following significant milestones and accomplishments:

<b>Significant revenue growth has been achieved.</b>	Revenues have increased from \$48.1 million in 2005 to \$87.5 million in 2009. This is a compounded annual growth rate (“CAGR”) of 16.1%.
<b>Growth by acquisition has been achieved.</b>	From four plants in 2005, K-Bro has grown to include seven processing plants. Acquisitions were completed in Victoria (2006), Quebec City (2008) and a second plant in Vancouver (2010).
<b>Significant EBITDA growth has been achieved.</b>	EBITDA has increased from \$7.1 million in 2005 to \$15.5 million in 2009, a CAGR of 21.6%.
<b>Significant growth in distributable cash has been achieved.</b>	Distributable cash has increased from \$6.2 million in 2005 to \$14.0 million in 2009, a CAGR of 18.5%.
<b>Market capitalization has increased significantly.</b>	From a market capitalization of \$43.4 million at IPO to a market capitalization of \$93.5 million at December 31, 2009, this is a CAGR of 16.6%
<b>The level of distributions to Unitholders was increased in 2006 and has been maintained since then.</b>	The \$1.05 per Unit distribution was increased in 2006 to \$1.10 per Unit and has been consistently paid at that rate since then. The payout ratio for 2009 was a conservative 55.1%.

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

March 10, 2010

*The following Management's Discussion and Analysis ("MD&A") is supplemental to, and should be read in conjunction with, the audited consolidated financial statements of K-Bro Linen Income Fund (the "Fund") for the years ended December 31, 2009 and 2008. These financial statements and other documents filed with regulatory authorities can be found on SEDAR at [www.sedar.com](http://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 March 10, 2010.*

*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 with the associated renewal risk, (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.*

Introduction	6	Distributions for the Year	17	Changes in Accounting Policies	22
Summary of Results and Key Events	7	Distributable Cash	18	Financial Instruments	28
Key Performance Drivers	10	Outstanding Units	19	Critical Risks and Uncertainties	31
Outlook	11	Related Party Transaction	19	Controls and Procedures	34
Results of Operations	12	Critical Accounting Estimates	19	Vision	35
Liquidity and Capital Resources	15	Non-GAAP Measures	21	Strategy	36

## **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 seven 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.

*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**

### **Acquisition of Business and Assets of Second Plant in Greater Vancouver**

On January 29, 2010, the Fund completed the acquisition of the laundry business, linen, certain working capital and equipment of a plant located in Burnaby, British Columbia. The business acquisition will be accounted for using the purchase method, whereby the purchase consideration will be allocated to the fair values of the net assets acquired at January 29, 2010. The purchase price to be allocated to the net assets acquired is approximately \$12.6 million including estimated acquisition costs. The acquisition was funded through the Fund's revolving credit facility.

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.

The acquired business consists of Vancouver healthcare institutions and hospitality customers in both the greater Vancouver area and Whistler, British Columbia. K-Bro acquired all assets of the owner's Vancouver linen business including the processing plant that operates from a leased facility.

Annual revenues from the acquired business were \$14.4 million in its most recent fiscal year ended June 30, 2009. Management estimates that adjusted EBITDA was approximately \$1.7 million for that fiscal year. These operating results, combined with potential synergies, results in an acquisition that management believes will be immediately accretive to the Fund.

### **Revolving Credit Facility Increased**

In March, 2010, K-Bro Linen Systems Inc. secured an additional \$10,000,000 of credit under its revolving credit facility that will now have a limit of \$40,000,000. The term of the agreement was extended to June 30, 2012 and the working capital covenant was removed.



## **Sustained Revenue and EBITDA Growth in 2009**

Revenue increased in the fourth quarter of 2009 to \$21.6 million or by 0.4% compared to the fourth quarter of 2008. For the year ended December 31, 2009, revenue increased to \$87.5 million or by 2.8% over 2008. This growth was achieved despite the overall economic recession experienced. However, it is reflective of a lower inflation rate that impacts price adjustments, negligible growth in the hospitality sector as volume from new accounts secured was offset by reductions experienced by other customers, as well as cost cutting initiatives by hospitals as they face budget pressures from deficit strapped provincial governments. See further discussion below under *Market Activities and Opportunities*.

EBITDA (see *Non-GAAP Measures*) increased in the fourth quarter of 2009 to \$3.8 million from \$3.3 million in the fourth quarter of 2008. This was an increase of 14.4%. For the year ended December 31, 2009, EBITDA increased to \$15.5 million from \$12.4 million in 2008, an increase of 25.4%. The EBITDA margin has increased to 17.6% in Q4 2009 versus 15.4% in Q4 2008. For the year ended December 31, the EBITDA margin has increased to 17.8% in 2009 versus 14.6% 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 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
- more favorable natural gas and electricity rates on the unhedged portion of K-Bro's requirements.

## **Labour Cost Improvements Achieved**

Labour costs for plant staff as a percentage of revenue decreased in the fourth quarter from 46.1% in 2008 to 44.9% in 2009 (and from 47.2% for 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 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 as obtaining extensions for workers who wish to stay an additional year. Hiring domestically has also seen improvement as a result of an increasing unemployment rate in Canada.

## **Market Activities and Opportunities**

Activities of significance in K-Bro's markets in 2009 have included:

*British Columbia* – Processing commenced for a total of seven new hotel accounts during the year. In December, 2009 a Request for Proposal was issued by the hospital authority with respect to the laundry services provided by the Tilbury Regional Hospital Laundry to Lower Mainland hospitals. K-Bro responded to this request and is awaiting the outcome. Given the competitive nature of the RFP process, there can be no assurance that K-Bro's bid will be successful for this volume.

*Alberta* – Processing commenced in Q4 for Alberta Hospital in Edmonton which is part of Alberta Health Services. This volume was previously processed by the hospital using an on premise laundry. In the February provincial budget, Alberta Health Services received a 6% increase in its operating grant, a one time provision to eliminate its accumulated deficit and a budget of \$2.5 billion over three years to support capital projects. It remains to be seen as to how this may impact a previous announcement that Alberta Health Services is seeking "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." K-Bro's Edmonton contracts with Alberta Health Services expire December 31, 2010 and discussions have commenced with Alberta Health Services regarding this situation.

*Ontario* – In 2009, processing 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.

### **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 \$40 million line of credit is with a major Canadian bank and has a term to June 30, 2012 with an annual option to renew for an additional year. No events of default have occurred and at December 31, 2009, under its previous limit of \$30 million, K-Bro had unutilized borrowing capacity of \$25.7 million or 86% of the line available.
- K-Bro's payout ratio for the quarter was 54.9% and for the year ended December 31, 2009 was 55.1%. 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 variable cost components such as natural gas, electricity and interest rates through forward contracts or swaps. In Q4, 2009, K-Bro entered into natural gas and electricity hedges for a three year term commencing once the existing hedges expire in February, 2010.

### **Taxation**

On March 12, 2009, Bill C-10, Budget Implementation Act, 2009, which further modifies the rules applicable to certain publicly traded income trusts in Canada, received Royal Assent. In particular, Bill C-10 provides rules to facilitate the conversion of income trusts into corporations on a tax-deferred basis. These rules 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 tax on distributions from publicly traded income trusts in Canada that was enacted by the Canadian Federal Government. Subsequent enacted tax rate changes have reduced the tax rate applicable 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 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	Q4 2009	Q4 2008 <sup>2</sup>	YTD 2009	YTD 2008 <sup>2</sup>
Growth (% change from comparative period)	Distributable cash	17.3%	98.0%	26.7%	43.4%
	EBITDA <sup>1</sup>	14.4%	76.5%	25.4%	34.9%
	Revenue	0.4%	15.1%	2.8%	14.9%
Profitability (actual for the period)	EBITDA	\$3,805	\$3,325	\$15,546	\$12,395
	EBITDA margin	17.6%	15.4%	17.8%	14.6%
	Net income	\$1,947	\$1,384	\$7,802	\$4,722
Stability	Payout ratio	54.9%	64.4%	55.1%	68.4%
	Distributions (annualized rate per Unit)	\$0.27	\$0.28	\$1.10	\$1.10
	Debt to total Capitalization	6.0%	6.0%	6.0%	6.0%
	Unutilized line of credit	\$25,707	\$25,504	\$25,707	\$25,504
Cost containment (as a % of revenue)	Wages and benefits	44.9%	46.1%	45.1%	47.2%
	Utilities	7.5%	7.3%	7.2%	7.8%
	Total operating expenses	82.4%	84.6%	82.2%	85.4%

- 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 2010 will show an increase in revenue and EBITDA compared to 2009 but with a moderation of historical “same plant” growth. This belief is predicated on:

- The acquisition completed in January, 2010 (see *Summary of Results and Key Events*);
- The improved results from the new Calgary plant, which opened in 2008 with increased volumes and operating efficiencies, are fully reflected in the 2009 results, thereby tempering future gains;
- The organic growth from existing customers may moderate as cost savings initiatives are implemented by them;
- The positive impact of the labour initiatives over the last two years will continue but further margin improvements will be minimal; and
- The low rate of inflation will be of some benefit in moderating certain expenses but will also result in lower price adjustments for customers with contracts subject to an annual consumer price index “CPI” adjustment factor.

In 2010 there will be both opportunities and risks that will be confronted. Management believes that these include:

- A recovering economy that will potentially have positive impacts on our hospitality business.
- Provincial governments in a deficit position are once again putting healthcare costs under a microscope and are 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 reduced.
- 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 has managed 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 steps to take in respect of the Fund. 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 in 2010. 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. The post conversion dividend policy will be determined by the Board giving full consideration to K-Bro’s business outlook, payout ratio, capital requirements and market conditions.

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 for 2010.

## RESULTS OF OPERATIONS

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

### Overall Performance

The fourth quarter of 2009 saw revenue increase by \$87 or 0.4% over the fourth quarter of 2008 (increases of \$2,419 and 2.8% for 2009 compared to 2008). See the previous discussion under *Summary of Results and Key Events* and the *Revenues* section below for an analysis of this change. Operating costs decreased to 82.4% of revenue in the current quarter compared to 84.6% in 2008 (82.2% of revenue for 2009 compared to 85.4% in 2008). The causes of this are discussed later under *Operating Expenses*. As a result, EBITDA increased in the current quarter by \$480 (14.4%) over the fourth quarter of 2008 (\$3,151 or 25.4% for 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					2008 <sup>2</sup>					2007
	Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1	Total
Revenue	87,533	21,635	22,659	21,746	21,493	85,113	21,547	22,063	21,840	19,663	74,101
Operating expenses	71,987	17,830	18,521	17,635	18,001	72,718	18,223	18,466	18,539	17,490	64,913
EBITDA <sup>1</sup>	15,546	3,805	4,138	4,111	3,492	12,395	3,324	3,597	3,301	2,173	9,188
EBITDA as a % of revenue	17.8%	17.6%	18.3%	18.9%	16.2%	14.6%	15.4%	16.3%	15.1%	11.1%	12.4%
Amortization	7,504	1,856	1,885	1,871	1,892	7,203	1,950	1,903	1,896	1,454	5,755
Financial charges	311	96	60	64	91	687	142	148	140	257	880
Loss (gain) on disposal of equipment	54	50	1	-	3	507	49	-	458	-	(3)
Write-off of new plant start-up costs	-	-	-	-	-	132	-	-	27	105	-
Earnings before income taxes	7,677	1,803	2,192	2,176	1,506	3,866	1,183	1,546	780	357	2,556
Income tax (expense) recovery	125	145	(97)	(8)	85	856	202	64	231	359	1,558
Net earnings	7,802	1,948	2,095	2,168	1,591	4,722	1,385	1,610	1,011	716	4,114
Net earnings as a % of revenue	8.9%	9.0%	9.2%	10.0%	7.4%	5.5%	6.4%	7.3%	4.6%	3.6%	5.6%
Basic Earnings per Unit	1.12	0.28	0.30	0.31	0.23	0.70	0.21	0.23	0.14	0.12	0.75
Diluted earnings per Unit	1.11	0.27	0.30	0.31	0.23	0.70	0.21	0.23	0.14	0.12	0.75
Total assets	82,816	82,816	83,565	84,639	86,344	85,793	85,793	88,241	89,398	89,463	83,342
Total long-term financial liabilities	8,500	8,500	9,676	11,263	11,536	8,636	8,636	10,825	13,718	8,872	21,948
Funds provided by (used in) operations	11,860	3,549	5,568	3,539	(796)	15,322	5,594	5,570	470	3,688	6,942
Long-term debt, end of period	4,043	4,043	5,107	6,735	7,210	4,061	4,061	6,219	9,010	4,000	16,627
Distributions declared per unit	1.10	0.27	0.28	0.27	0.28	1.10	0.27	0.28	0.28	0.27	1.10

- 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 Event* and *Overall Performance*. Revenues by sector consist of:

Fiscal year	2009					2008				
	Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1
Sector										
Healthcare	66,846	16,662	16,524	16,723	16,937	64,698	16,782	16,226	16,448	15,242
Hospitality	20,687	4,973	6,135	5,023	4,556	20,415	4,765	5,837	5,392	4,421
Total	87,533	21,635	22,659	21,746	21,493	85,113	21,547	22,063	21,840	19,663

## Operating Expenses

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

*Linens* - Costs as a percentage of revenue have decreased for both the quarter and year ended December 31, 2009 compared to the same periods in 2008, as the costs of standard linen items have decreased somewhat in a competitive global market and operating room linen purchases have been somewhat less.

*Utilities* - Reductions in natural gas and electricity rates occurred in the last half of 2008 and for most of 2009, resulting in a decrease in utility costs as a percentage of revenue from 7.8% in 2008 to 7.2% in 2009. The somewhat increased expense in Q4 2009 vs. Q4 2008 (7.5% of revenue vs. 7.3%) is primarily the result of a decline in the amount of the rebate received through the Alberta Natural Gas Rebate Program. This program ended on March 31, 2009. K-Bro has executed its strategy to utilize natural gas and electricity hedges to take advantage of the current low prices in order to lock in future variable costs where feasible.

*Delivery* - The decrease in delivery costs for both the quarter and year is primarily the result of lower fuel costs.

*Repairs and maintenance* – As a percentage of revenue, repairs and maintenance costs were relatively stable with a decrease of 0.2 percentage points for the quarter and an increase of 0.1 percentage points for the year.

*Materials and supplies* – This includes many different categories, including administrative expenses at the plant level. Year over year, total expenditures in this category were flat. The decrease for Q4 2009 of 1.5 percentage points compared to Q4 2008 was in large part due to the 2008 one-time recovery of costs related to the new Calgary plant and foreign worker recruitment costs expensed in Q4 2008.

*Occupancy* – Year over year total expenditures in this category were flat. Quarter over quarter variances can occur as a result of accrual adjustments for such things as property taxes and operating costs.

*Corporate* - Costs increased in Q4 2009 by \$72 over Q4 2008 and \$514 in 2009 compared to 2008. This 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 year.

### *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 December 31, 2009 a total of 69,692 units were unvested. LTIP expense for the 2009 year, included in Corporate expenses, was \$915 (2008 - \$463).

### *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 the 2009 year has increased from the comparable period in 2008 primarily due to the capital expense of the new Calgary plant and other capital additions.

### *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 2009 increased modestly compared to 2008 as the Quebec City acquisition was completed on January 31, 2008.

### *Financial Charges*

Financial charges in the current quarter decreased by \$46 over 2008 (and decreased by \$376 for the 2009 year 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. 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 \$3,549 in the fourth quarter of 2009, a decrease of \$2,045 from the funds provided by operating activities in the fourth quarter of 2008. This \$2,045 decrease is attributable to an increase in cashflow from operations of \$525 offset by an increased working capital requirement of \$2,570 in the quarter compared to the corresponding period in 2008. For the year, cash provided by operating activities was \$11,860 in 2009, a decrease of \$3,462 from the funds provided by operating activities in 2008. This \$3,462 decrease is attributable to an increase in cashflow from operations of \$3,644 offset by an increased working capital requirement of \$7,106 compared to the corresponding period in 2008.

The changes in working capital requirements are the result of: an increase in accounts receivable resulting from the timing of receipts from major customers, a reduction in accounts payable and accrued liabilities (primarily the payment of accrued volume rebates) and an increase in prepaid expenses (primarily acquisition costs related to the 2010 Vancouver plant acquisition).

### **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 in Quebec City and were used for the retrofit and equipping of the new Calgary plant and for general corporate purposes. No equity issuances occurred in 2009.

During the quarter ended December 31, 2009, the Fund declared distributions to unitholders at an annualized rate of \$1.10 per unit for a total amount of \$1,927 (\$1,927 for the fourth quarter of 2008). For the year ended December 31, 2009, the Fund declared distributions to unitholders at an annualized rate of \$1.10 per unit for a total amount of \$7,706 (\$7,554 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 December 31, 2009 was \$4,043 compared with \$4,061 at December 31, 2008.

The existing long-term debt of \$4,043 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.



In March, 2010 K-Bro Linen Systems Inc. secured an additional \$10,000,000 of credit under its revolving credit facility that will now have a limit of \$40,000,000. The term of the agreement was extended to June 30, 2012 and the working capital covenant was removed.

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 was 2.90% as of December 31, 2009.

### Investing Activities

During the current quarter, K-Bro used \$34 (2008 – \$180) of funds for maintenance capital expenditures and \$597 (2008 – \$1,325) of funds for strategic capital expenditures for a total cash investment of \$631 (2008 – \$1,505) for the quarter. For the year, K-Bro used \$505 of funds for maintenance capital expenditures in 2009 (2008 – \$490) and \$2,974 of funds for strategic capital expenditures (2008 – \$9,255) for a total cash investment of \$3,479 (2008 – \$9,745). Management defines maintenance capital expenditures as additions to, or replacements of, property and equipment to maintain K-Bro's current business operations. K-Bro is progressing with its computer software upgrade that commenced in the first quarter of 2009. Total cost of software for phase one of this two phase project is estimated to be \$800, of which \$679 was incurred in 2009 (\$153 in Q4). This investment is recorded in intangible assets but treated as a maintenance capital expenditure for purposes of calculating Distributable Cash (see *Non- GAAP Measures*).

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.

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 significant disposals of equipment were recorded in the fourth quarter or for the 2009 year as a whole.

### Contractual Obligations

At December 31, 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	4,043	–	4,043	–	–
Operating leases and utility commitments	18,915	5,113	7,959	3,228	2,615
Linen purchase obligations	1,898	1,898	–	–	–

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 December 31		
	2009	2008
Long-term debt	\$4,043	4,061
Unitholders' equity	63,793	63,766
Total capitalization	67,836	67,827
Debt to total capitalization	6.0%	6.0%

For the year ended December 31, 2009, the Fund had a payout ratio (see *Non-GAAP Measures*) of 55.1%, a debt to total capitalization of 6.0%, an unused line of credit of \$25,707 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 YEAR

Fiscal year		2009		2008	
Period	Payment Date	Per Unit Distribution	Distribution Amount (\$)	Per Unit Distribution	Distribution Amount (\$)
<b>Fund Units</b>					
First quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,754,774
Second quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
Fourth quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
October	November 13	\$0.09167	\$635,508	\$0.09167	\$635,508
November	December 15	\$0.09167	\$635,508	\$0.09167	\$635,508
December	January 15	\$0.09167	\$635,508	\$0.09167	\$635,508
Fourth quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
Year to date		\$1.10000	\$7,626,096	\$1.10000	\$7,474,346
<b>Exchangeable Shares</b>					
First quarter		\$0.27501	\$19,914	\$0.27501	\$19,913
Second quarter		\$0.27501	\$19,913	\$0.27501	\$19,914
Fourth Quarter		\$0.27501	\$19,914	\$0.27501	\$19,913
October	November 13	\$0.09167	\$6,638	\$0.09167	\$6,638
November	December 15	\$0.09167	\$6,638	\$0.09167	\$6,638
December	January 15	\$0.09167	\$6,637	\$0.09167	\$6,638
Fourth quarter		\$0.27501	\$19,913	\$0.27501	\$19,914
Year to date		\$1.10000	\$79,654	\$1.10000	\$79,654
<b>Total Distributions</b>		<b>\$1.10000</b>	<b>\$7,705,750</b>	<b>\$1.10000</b>	<b>\$7,554,000</b>

For the year ended December 31, 2009, the Fund distributed \$1.10 per unit compared with Distributable Cash (see *Non-GAAP Measures*) per unit of \$1.99. 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 15<sup>th</sup> 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 <sup>1</sup>	2009					2008 <sup>2</sup>				
	Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1
<b>Per consolidated financial statements:</b>										
Cash provided by (used in) operating activities	\$11,860	\$3,549	\$5,568	\$3,539	\$(796)	15,322	\$5,594	\$5,570	\$470	\$3,688
Add (deduct):										
Net changes in non-cash working capital items <sup>3</sup>	3,318	146	(1,505)	494	4,183	(3,788)	(2,424)	(2,135)	2,649	(1,878)
Maintenance capital expenditures <sup>4</sup>	(1,184)	(187)	(256)	(608)	(133)	(490)	(180)	(68)	(172)	(70)
<b>Distributable cash</b>	<b>\$13,994</b>	<b>\$3,508</b>	<b>\$3,807</b>	<b>\$3,425</b>	<b>\$3,254</b>	<b>11,044</b>	<b>\$2,990</b>	<b>\$3,367</b>	<b>\$2,947</b>	<b>\$1,740</b>
<b>Distributable cash per weighted average diluted Units outstanding</b>	<b>\$1.99</b>	<b>\$0.50</b>	<b>\$0.54</b>	<b>\$0.49</b>	<b>\$0.46</b>	<b>\$1.63</b>	<b>\$0.44</b>	<b>\$0.48</b>	<b>\$0.42</b>	<b>\$0.29</b>
Distributions declared <sup>5</sup>	\$7,706	\$1,927	\$1,927	\$1,926	\$1,926	\$7,554	\$1,927	\$1,926	\$1,926	\$1,775
<b>Distributions declared per unit (see "Non-GAAP Measures")</b>	<b>\$1.10</b>	<b>\$0.27</b>	<b>\$0.28</b>	<b>\$0.27</b>	<b>\$0.28</b>	<b>\$1.10</b>	<b>\$0.27</b>	<b>\$0.28</b>	<b>\$0.28</b>	<b>\$0.27</b>
<b>Payout ratio (see "Non-GAAP Measures")<sup>5</sup></b>	<b>55.1%</b>	<b>54.9%</b>	<b>50.6%</b>	<b>56.2%</b>	<b>59.2%</b>	<b>68.4%</b>	<b>64.4%</b>	<b>57.2%</b>	<b>65.4%</b>	<b>102%</b>
Weighted average units outstanding during the period – Basic	6,946	6,935	6,930	6,946	6,970	6,719	6,969	6,969	6,961	5,972
Weighted average units outstanding during the period – Diluted	7,000	6,989	6,994	7,010	6,999	6,747	6,998	6,996	6,985	5,997
<b>12-month trailing</b>										
Distributable cash		13,994	13,476	13,036	12,558		11,044	9,564	8,245	7,483
Distributions		7,706	7,706	7,705	7,705		7,554	7,138	6,724	6,309
Payout ratio		55.1%	57.2%	59.1%	61.4%		68.4%	74.6%	81.6%	84.3%
<b>Cumulative since IPO February 3, 2005</b>										
Distributable cash		46,149	42,641	38,834	35,409		32,155	29,165	25,798	22,851
Distributions		31,278	29,351	27,424	25,498		23,572	21,645	19,719	17,793
Payout ratio		67.8%	68.8%	70.7%	72.0%		73.3%	74.2%	76.4%	77.9%

- 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**

The Fund has 6,932,562 Fund Units outstanding and 72,411 Special Trust Units outstanding (unchanged from September 30, 2009 and December 31, 2009 and 2008). The basic and the diluted weighted average number of units outstanding for 2009 were 6,946,495 and 6,999,719 respectively (6,719,305 and 6,747,522 respectively for 2008). The Fund's subsidiary issued 72,411 Exchangeable Shares to certain members of management that 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.

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 68,173 Units of the Fund (2008 – 24,751). As at December 31, 2009, 72,739 Units held by the LTIP Trust have vested (December 31, 2008 – 38,961). The cost of the 69,692 unvested units held in trust by the LTIP at December 31, 2009 (December 31, 2008 – 35,297) was \$834,137 (December 31, 2008 - \$457, 079). 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 Matthew Hills, 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 December 31, 2009, the Fund incurred such fees totaling \$34,500 (three months ended December 31, 2008 – \$34,500). For the year ended December 31, 2009, the Fund incurred such fees totaling \$138,000 (year ended December 31, 2008 – \$74,000).

## **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.

### **Linen in Service**

Linen in service is recorded at cost. Operating room linen is amortized on a straight-line method over an estimated service life of 24 months. General linen is amortized based on usage which results in an estimated service life of the linen equal to 24 months. Based on past experience, management believes that a service life of 24 months is representative of the average service life of linen and would not expect a material deviation to the balance of linen in service or linen expense.

## Revenue and Volume Rebates

Revenue from linen management and laundry services is largely based on written service agreements whereby K-Bro has agreed to collect, launder, deliver and replenish linens. K-Bro recognizes revenue in the period in which the services are provided. Volume rebates, where applicable, are recorded based on annualized expected volumes when it is determined that they are likely to be met. Based on past experience, management believes that volumes utilized for any estimates are reasonable and would not expect a material deviation to the balance of accrued liabilities or revenue.

## Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Amortization is provided over the estimated useful lives of the assets, based on past experience, on a declining basis using the following annual rates:

Building.....	5%
Laundry equipment .....	15%
Office and delivery equipment .....	20%
Computers and software .....	30%
Leasehold improvements.....	straight line over the initial lease period

The carrying value of property, plant and equipment is evaluated whenever significant circumstances indicate impairment in value is likely. The carrying value of property, plant and equipment and amortization expense is affected by these estimates.

## Goodwill

Goodwill is not amortized and K-Bro assesses goodwill for impairment on an annual basis, or more frequently if changes in circumstances indicate a potential impairment. Any potential impairment is identified by comparing the fair value of the business to its carrying value. If the fair value exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds its fair value, a more detailed goodwill impairment assessment would have to be undertaken. Any resulting impairment would be charged to earnings in the period in which the impairment is identified and would affect the carrying value of goodwill but such charges do not result in a cash outflow and would not affect K-Bro's liquidity. No impairment was incurred upon completion of management's 2009 and 2008 assessments. The possible impact of the Bill C-52 tax changes has been taken into account in K-Bro's review for impairment of goodwill.

## Intangible Assets

Intangible assets with a finite life which relate to contracts K-Bro has with certain customers are recorded at cost and are amortized over the remaining life of the contract plus one renewal period. Those which relate to computer software will be amortized using the straight-line method over sixty months when put into service. Impairment is evaluated if there are significant changes in circumstances affecting the carrying value of intangible assets by comparing the fair value of the finite life intangible asset with its carrying value. Management has determined that no such significant change has occurred in 2009 or 2008 that would impact the carrying value of intangible assets.

## **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 15<sup>th</sup> 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 the following new standards:

### **Goodwill and intangible assets**

In February 2008, the CICA issued a new accounting standard – Section 3064 “*Goodwill and intangible assets*” which replaced the existing standard for goodwill and other intangible assets in Section 3062 and research and development costs in Section 3450. The new Section was adopted by the Fund beginning January 1, 2009. It established standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. In accordance with this new policy, deferred charges at December 31, 2008 of \$132,631 were written off retrospectively against equity in 2009 with restatement of comparative amounts. The adoption of this standard resulted in an increase of \$132,631 in the “Write-off of new plant start-up costs” expense, an increase in the “Future income tax recovery” of \$36,414, and reduced basic earnings per unit by \$0.02 and diluted earnings per unit by \$0.01 for the year ended December 31, 2008. Also as required by this standard, certain computer software costs have been recorded in 2009 as a finite life intangible asset.

### **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.

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 consolidated financial statements.

Future changes in accounting policies are:

### **Business combinations**

Section 1582 “Business combinations” will be applicable to business combinations for which the acquisition date is on or after January 1, 2011. Early adoption is permitted. The section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements

### **Consolidated financial statements**

Section 1601 “Consolidated financial statements” will be applicable to financial statements beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for the preparation of consolidated financial statements. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

### **Non-controlling interests**

Section 1602 “Non-controlling interests” will be applicable to financial statements beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

### **International Financial Reporting Standards (“IFRS”)**

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian publicly accountable enterprises will be required to adopt IFRS in place of Canadian Generally Accepted Accounting Principles (Canadian GAAP) for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. Accordingly, the Fund will issue its last financial statements prepared in accordance with Canadian GAAP in 2010. Starting from the first quarter of 2011, the Fund’s financial statements will be prepared in accordance with IFRS in effect in 2011, with 2010 comparative figures and January 1, 2010 (“date of transition”) opening balance sheet restated to conform to IFRS.

Financial reporting under IFRS differs from Canadian GAAP in a number of respects, some of which are significant. IFRS on the date of adoption also is expected to differ from current IFRS due to new IFRS standards and pronouncements that are expected to be issued before the changeover date.

The Fund has established a changeover plan in order to transition its financial statement reporting, presentation and disclosure under IFRS to meet the January 1, 2011 deadline. An implementation team, which is led by finance management, has been created and third party advisors have been utilized to plan for and achieve a smooth transition to IFRS.



The implementation project consists of three primary phases, which in certain cases will be in process concurrently as IFRS is applied to specific areas from start to finish:

### ***Phase 1: Scoping and Diagnostic Phase***

This phase involved performing a detailed diagnostic comparing Canadian GAAP to IFRS and identifying key areas that may be impacted by the transition to IFRS. Phase 1 included:

- Performing a detailed analysis of our actual accounting policies and practices with all relevant IFRS standards and applicable interpretations;
- Identifying the different options available to the Fund at the date of transition as well as the ongoing IFRS policy choices that could be applied to prepare subsequent IFRS financial statements; and
- Classifying the differences identified by work streams to analyze and resolve the differences.

### ***Phase 2: Impact Analysis and Design Phase***

In this phase, each area identified from the scoping and diagnostic phase were addressed. Phase 2 included:

- Making accounting policy choices, including those under IFRS 1 choices;
- Determining the changes required to existing accounting policies;
- Determining the changes or additions required to information technology and data systems, internal controls over financial reporting and disclosure controls; and
- Developing draft IFRS financial statements.

### ***Phase 3: Implementation and Review Phase***

In this last phase, we will implement changes in accounting policies and practices to the different business processes, information systems and internal controls. These changes will be adequately tested before the changeover date to ensure all significant differences have been successfully resolved by the first quarter of 2011.

#### *Current status of our IFRS changeover plan*

We have completed Phase 1 and Phase 2 of our conversion project. As a result of this work, we have identified a number of differences and policy alternatives between Canadian GAAP and IFRS that will modify our financial statements at the date of conversion.

The following describes the major identified differences that could be presented in our reconciliation of net earnings and unitholders' equity upon transition if the conversion was done as of December 31, 2009 with currently applicable standards. Key IFRS exemption options are subsequently presented.

Notwithstanding the above, the current International Accounting Standards Board (IASB) and International Financial Reporting Interpretations Committee (IFRIC) projects are likely to significantly modify some of the actual IFRS requirements which might therefore ultimately impact the following identified major differences.

### **Income Taxes – Temporary differences on intangible assets**

**Canadian GAAP** – Future income taxes are calculated from temporary differences that are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. Under the current Canadian Income Tax Act, "eligible capital expenditures" are deductible for tax purposes to the extent of 75 percent of the cost incurred; Section 3465 – *Income taxes* addresses this specific situation and specifies that for these assets, at any point in time, the tax basis represents the balance in the cumulative eligible capital pool plus 25 percent of the carrying amount.

**IFRS** – The definition of temporary differences under IFRS is generally consistent with Canadian GAAP. However, IFRS does not provide specific guidance in relation to the determination of the tax basis of eligible capital expenditures such as the one described above. As such, the tax basis of these assets, without taking into consideration the 25 percent adjustment of the carrying amount as allowed under Canadian GAAP, should be compared with the carrying amount in the balance sheet to determine the temporary difference relating to these assets.

### **Business Combinations**

**Canadian GAAP** – Business combinations are currently accounted for using Section 1581 – *Business combinations*. The recognition and measurement requirements applicable under this Section differ in a number of ways from the IFRS standards applicable to business combinations.

**IFRS** – Business combinations will be accounted for in accordance with IFRS 3 – *Business Combinations*. Under IFRS 3, acquisition costs such as legal and consulting fees that the acquirer incurs to effect a business combination are recognized as expenses then they are incurred. They are not included as part of the purchase consideration as they are under GAAP. The allocation of the purchase consideration to assets and liabilities will be in accordance with other IFRS provisions that may differ from GAAP. Contingent consideration is included in the fair value of consideration where it is probable that the outflow will occur. In addition, an entity making the transition to IFRS will be required to show comparative information for any business combinations completed during the preceding fiscal year measured and presented in accordance with IFRS 3. This will impact the accounting for the recent acquisition in Vancouver (see *Summary of Results and Key Events*).

### **Consolidation and non-controlling interests**

**Canadian GAAP** – Section 1600 – *Consolidated financial statements* currently establishes standards for the preparation of consolidated financial statements. This section differs in a number of ways from the IFRS standards applicable for consolidation and non-controlling interests. However, none of these differences are expected to impact the Fund.

### **Grouping of assets for impairment purposes**

**Canadian GAAP** – When a long-lived asset does not have identifiable cash flows that are largely independent of those from other assets, that asset must be grouped with other related assets for impairment. This is referred to as the asset group.

**IFRS** – Asset grouping should be done when an asset does not have identifiable cash inflows, as opposed to net cash flows, that are independent of those from other assets. The Fund's individual operations have identifiable cash inflows and will therefore be evaluated individually for impairment purposes.

## Key IFRS 1 Exemption Options

**1. Business combinations** – IFRS 3, *Business Combinations*, may be applied retrospectively or prospectively. The retrospective basis would require restatement of all business combinations that occurred prior to the transition date. We will not elect to retrospectively apply IFRS 3 to business combinations that occurred prior to the Transition Date and such business combinations will not be restated. Any goodwill arising on such business combinations before the Transition Date will not be adjusted from the carrying value previously determined under Canadian GAAP as a result of applying these exemptions except as required under IFRS 1, unless warranted by an impairment test.

**2. Fair value as deemed cost** – IFRS 1 provides a choice between measuring property, plant and equipment at its fair value at the date of transition and using those amounts as deemed cost or using the historical valuation under the prior GAAP. We will continue to apply the cost model for property, plant and equipment and will not restate property, plant and equipment to fair value under IFRS. We will use the historical bases under Canadian GAAP as deemed cost under IFRS at Transition Date.

At this time, the quantitative impact on these differences and elections on our future financial position and results of operations is not reasonably determinable or estimable. However, they should not impact distributable cash given that the majority of these adjustments are not cash related.

The following table summarizes the status of our changeover plan based on the recommendations published in October 2008 by the Canadian Performance Reporting Board with regards to the Pre-2011 communications about IFRS conversion. Given the progress of the project and outcomes identified, we could change our intentions between the time of communicating these key milestones below and the changeover date. Further, changes in regulation or economic conditions at the date of the changeover or through the project could result in change of the project activities communicated in the following chart.

Key Activity	Milestones/Deadlines	Status
<b>Financial Statement Preparation:</b> <ul style="list-style-type: none"> <li>▪ Identify differences between IFRS and Canadian GAAP accounting policies</li> <li>▪ Selection of IFRS policies</li> <li>▪ Select choices under IFRS 1</li> <li>▪ Develop financial statement format</li> <li>▪ Quantify effects of change in initial IFRS1 disclosures and 2010 financial statements</li> </ul>	Senior Management sign-off and audit committee review for all items by end of fourth quarter, 2009.	Differences have been identified and documented. Recommendation regarding IFRS policies and selection of choices under IFRS 1 have been finalized.
<b>Staffing:</b> Define and introduce appropriate level of IFRS expertise for each of the following: <ul style="list-style-type: none"> <li>▪ Accounting staff</li> <li>▪ Senior executives and Board, including Audit Committee</li> </ul>	Appropriate level of expertise to be in place by second quarter 2009.	Experienced consultant contracted in July, 2009 and work was completed in December, 2009. Review of work by external accounting advisors was completed. Internal resource assessment ongoing.
<b>Infrastructure:</b> Ensure information technology is fully compliant for IFRS as follows: <ul style="list-style-type: none"> <li>▪ Capability of system to produce dual financial statements (Canadian GAAP and IFRS) during the transition years</li> <li>▪ Programs upgrades/changes</li> <li>▪ Gathering disclosure data</li> <li>▪ Budget/forecast monitoring process</li> </ul>	Ready for parallel processing of 2010 general ledgers and for planning/monitoring process.	Process currently underway in conjunction with financial systems software upgrade.

<b>Business Policy Assessment: Financial Covenants</b> <ul style="list-style-type: none"> <li>▪ Identify impact of IFRS on financial covenants</li> <li>▪ Complete any required renegotiations/changes</li> </ul>	Renegotiations to be completed by third quarter 2010.	Process of identifying metrics affected by conversion to IFRS currently underway. Preliminary discussions with bank held.
<b>Business Policy Assessment: Compensation Arrangements</b> <ul style="list-style-type: none"> <li>▪ Identify impact on compensation arrangements</li> <li>▪ Make any required changes</li> </ul>	Fourth quarter 2010.	Process of identifying metrics affected by conversion to IFRS currently underway.
<b>Business Policy Assessment: Customer and Supplier Contracts</b> <ul style="list-style-type: none"> <li>▪ Evaluate impact of IFRS on current customer or supplier contracts.</li> </ul>	Complete review by first quarter 2010.	Process of identifying IFRS consequences in process.
<b>Control Environment: ICFR</b> <ul style="list-style-type: none"> <li>▪ For all accounting policy changes identified, assess ICFR design and effectiveness implications.</li> <li>▪ Implement changes where appropriate.</li> </ul>	Fourth quarter 2009.	Reviewed in conjunction with accounting policies. No substantive changes identified as being required.
<b>Control Environment: DC&amp;P</b> <ul style="list-style-type: none"> <li>▪ For all accounting policy changes identified, assess DC&amp;P design and effectiveness implications.</li> <li>▪ Implement changes where appropriate.</li> </ul>	See ICFR deadlines above.  Publish impact of conversion on Key Performance Indicators in third quarter, 2010 MD&A.  Publish material changes in policies and expectations by January 10, 2011.  Publish revised 2010 results and MD&A by March 31, 2011.	To be reviewed in conjunction with accounting policies.

## FINANCIAL INSTRUMENTS

K-Bro's financial instruments at December 31, 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 capitalized and then amortized over the expected life of the financial instrument using the effective interest 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.

Section 3862 of the Handbook, *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.

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.

## Fair value

The Fund's financial instruments at December 31, 2009 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders, long-term debt, and an interest rate swap agreement. The carrying value of accounts receivable, accounts payable and accrued liabilities, and distribution payable to unitholders approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Fund's long-term debt is estimated based on market prices for same or similar instruments and approximates carrying value. The interest rate swap agreement is a derivative designated as an effective hedge and is measured at fair value with subsequent changes in fair value being charged to other comprehensive income. All of the Fund's financial instruments are classified as Level 2 using the fair value hierarchy described above.

## Financial risk management

The Fund's activities are exposed to a variety of financial risks: price risk, credit risk and liquidity risk. The Fund's overall risk management program focuses on the unpredictability of financial and economic markets and seeks to minimize potential adverse effects on the Fund's financial performance. Risk management is carried out by financial management in conjunction with overall Fund governance.

## Price risk

### (i) Currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar. The Fund is not significantly exposed to foreign currency risk as all revenues are received in Canadian dollars and minimal expenses are incurred in foreign currencies. For large capital expenditure commitments denominated in a foreign currency, the Fund will enter into foreign exchange forward contracts if considered prudent to mitigate this risk. At December 31, 2009, no foreign exchange forward option contracts were outstanding. Based on the Fund's US dollar liability for equipment purchases at December 31, 2009, a 1% change in the Canadian-US dollar foreign exchange rate would result in a \$2,300 change in the amount recorded in property, plant and equipment.

### (ii) Interest rate risk

The Fund is subject to interest rate risk as its credit facility bears interest at rates that depend on certain financial ratios of the Fund and vary in accordance with market interest rates. On June 24, 2005, the Fund entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of \$4 million 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 was 2.90% at December 31, 2009. Based on the outstanding balance on the Fund's revolving credit facility for which the interest rate has not been fixed at December 31, 2009, a 1% fluctuation in the Canadian prime rate would result in a negligible change in annual interest expense. Management does not believe that the impact of interest rate fluctuations will be significant.

### (iii) Other price risk

The Fund's exposure to other price risk is limited since there are no significant financial instruments which fluctuate as a result of changes in market prices.

## Credit risk

The Fund's financial assets that are exposed to credit risk consist primarily of accounts receivable and an interest rate swap agreement. The Fund, in the normal course of business, is exposed to credit risk from its customers. The allowance for doubtful accounts and past due receivables are reviewed by management at each balance sheet reporting date. The Fund updates its estimate of the allowance for doubtful accounts based on the evaluation of the recoverability of accounts receivable balances of each customer taking into account historic collection trends, the contractual relationship with the customer and the nature of the customer which in many cases is a publicly funded health care entity. The Fund is exposed to credit loss in the event of non-performance by counterparties to the interest rate swap. Management believes that the risks associated with concentrations of credit risk with respect to accounts receivable and the interest rate swap are limited due to the nature of the customers and the swap counterparty serviced by the Fund and the generally short payment terms and frequent settlement of swap differences.

The aging of the Fund's receivables and related allowance for doubtful accounts are:

	<b>2009</b>	<b>2008</b>
	\$	\$
<b>Current</b>	6,223,678	6,701,444
<u>Past due amounts:</u>		
1 – 30 days	2,698,973	1,851,171
Greater than 30 days	570,626	160,028
Less: allowance for doubtful accounts	<u>(42,287)</u>	<u>(42,704)</u>
Accounts receivable, net	<u>9,450,990</u>	<u>8,669,939</u>

## Liquidity risk

The Fund's accounts payable and distribution payable are due within one year.

The Fund has long-term debt with a maturity date of February 28, 2011 (subsequently extended to June 30, 2012 – see *Summary of Results and Key Events*). The degree to which the Fund is leveraged may reduce its ability to obtain additional financing for working capital and to finance investments to maintain and grow the current levels of cash flows from operations. The Fund may be unable to extend the maturity date of the credit facility.

Management, to reduce liquidity risk, has historically renewed the terms of the credit facility in advance of its maturity dates and the Fund has maintained financial ratios that management believes are conservative compared to financial covenants applicable to the credit facility. A significant portion of the available facility remains undrawn.

Management measures liquidity risk through comparisons of current financial ratios with financial covenants contained in the credit facility.

## Hedge accounting

Where derivatives are held for risk management purposes or when transactions meet the criteria, including documentation requirements, specified in the CICA Handbook Section 3865, hedge accounting is applied to the risks being hedged. When hedge accounting is not applied, the change in the fair value of the derivative is recognized in earnings. The Fund applied hedge accounting on the interest rate swap agreement outstanding at December 31, 2009.

## **CRITICAL RISKS AND UNCERTAINTIES**

### **Effects of Market Volatility and Uncertainty**

See “*Summary of Results and Key Events – Effects of Economic Volatility and Uncertainty*”, “*Market Activities and Opportunities*” and “*Outlook*”. Risks and uncertainties in this area include those associated with contract renewals, customer volumes, price adjustments and customer cost cutting initiatives.

### **Alberta Labour Market**

Despite an increased unemployment rate in Alberta, K-Bro continues to be faced with a competitive market for workers and the inability to recruit and retain sufficient workers to process increasing volumes of business could have an adverse impact on the operations. K-Bro has taken steps on many fronts including utilizing the Temporary Foreign Worker program, adjusting wage levels, reviewing benefits and working conditions to address this situation but there can be no assurance that these will be successful. Continuance of the federally legislated Temporary Foreign Worker program in its current form is an important factor in this process but there can be no assurance of this continuance given the national unemployment rate.

### **Competitive Environment**

K-Bro experiences competition in its markets from its public and private sector competitors, especially so when a contract is due to expire and the Fund may be subjected to a competitive Request for Proposal process. The principal elements of competition include quality, service and price. While many competitors are independent and privately-owned, certain of K-Bro's competitors are public sector entities and may have greater financial and other resources. There can be no assurance that these competitors will not substantially increase the resources devoted to the development and marketing, including discounting, of products and services that compete with those offered by K-Bro.

In addition to competition provided by its laundry processor competitors, K-Bro also competes against suppliers of single-use disposable linens, particularly in its K-Bro Operating Room (“KOR”) business of providing reusable surgical packs. Management estimates that suppliers of disposable packs currently control 80% of the overall operating room linen market in Canada.

It is believed that these risks are managed primarily by entering into long-term contracts where possible, providing a comprehensive program of services, adhering to the highest possible quality and service standards and providing a cost effective service through the economies of large scale processing plants and purchasing. However, there can be no assurance that contract renewals will be achieved given the competitive environment faced by the Fund.

### **Utility Costs**

K-Bro's operations utilize natural gas, electricity and water that comprise approximately 9% of its operating expenses. K-Bro's energy costs are affected by various market factors including the availability of supplies of particular forms of energy, energy prices and local and national regulatory decisions. There can be no assurance that K-Bro will be protected against substantial changes in the price or availability of energy sources. K-Bro has entered into fixed price natural gas and electricity contracts with remaining terms of up to 3 years to fix the price on a significant portion of its natural gas and electricity requirements over this time period. Upon expiration of the contracts, K-Bro will be subject to prevailing market rates. K-Bro reviews its requirements and the forward pricing regularly to determine if it's feasible and desirable to lock in additional volumes or years.

K-Bro's Calgary and Edmonton facilities have in the past benefited from a natural gas rebate program sponsored by the Alberta provincial government. The program was terminated by the Alberta government effective March 31, 2009. There can be no assurance that the program will be renewed in the future.



## **Credit Facility Imposes Numerous Covenants and Encumbers Assets**

Covenants in the Credit Facility include, among others, ones that limit the ability of K-Bro to incur additional debt, make liens, dispose of assets, consolidate, merge or acquire other businesses, pay dividends or make other distributions (including on the common shares of K-Bro Linen Systems Inc. and the promissory notes of K-Bro Linen Systems Inc. held by the Fund), and amend material contracts. These covenants restrict numerous aspects of the business of K-Bro. Moreover, financial performance covenants require K-Bro, among other things, to maintain up to a maximum total debt-to-EBITDA ratio, no less than a minimum ratio of current assets to current liabilities and up to a maximum total fixed charge coverage ratio. The failure to comply with the terms of the Credit Facility would, after the expiration of available cure periods, entitle the bank to accelerate all amounts outstanding under the Credit Facility, and upon such acceleration, the bank would be entitled to begin enforcement procedures against the assets of K-Bro Linen Systems Inc. or the Fund, including accounts receivable, inventory and equipment. The bank would then be repaid from the proceeds of such enforcement proceedings, using all available assets. Only after such repayment and the payment of any other secured and unsecured creditors would the holders of Units receive any proceeds from the liquidation of K-Bro's assets. K-Bro's ability to satisfy the restrictive covenants may be affected by events beyond its control. K-Bro monitors its compliance on an ongoing basis, including prospectively. K-Bro has incurred no events of default under the terms of its credit facility agreement.

## **Income Tax Matters**

On June 12, 2007, Bill C-52, which significantly modifies the income tax rules applicable to certain publicly traded or listed trusts and partnerships, was substantively enacted by the Canadian Federal Government. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These rules will be effective with respect to trusts which commence public trading after October 31, 2006. For trusts which were publicly traded or listed prior to November 1, 2006, the application of the rules will be delayed to the earlier of (i) the trust's 2011 taxation year, and (ii) a taxation year of the trust in which the trust exceeds normal growth as determined by reference to the normal growth guidelines, as amended from time to time, unless that excess arose as a result of a prescribed transaction.

On December 15, 2006, the Department of Finance (Canada) released the normal growth guidelines for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance, as amended from time to time, establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. If the limits described in the normal growth guidelines are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the new rules.

The conversion rules, as enacted by Bill C-10, provide income trusts with tax efficient structuring options to convert to corporate form in advance of their 2011 taxation year at which time most income trusts would become subject to a new entity level tax based on corporate income tax rates. Management is reviewing the conversion rules to assess their implication to the Fund.

The Fund is considering these legislative changes and their possible impact to the Fund. The new rules (including the normal growth guidelines) may adversely affect the marketability of the Fund's units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the new rules apply to the Fund, the distributable cash of the Fund may be materially reduced.

## **Capital Investment**

Laundry equipment can, with proper ongoing maintenance, remain useful for long periods of time. For example, the useful life of a tunnel washer can extend beyond 20 years. K-Bro's maintenance capital expenditures have historically been modest. Management currently expects that for the foreseeable future, the normalized level of capital expenditures required to maintain K-Bro's laundry processing operations will be approximately \$850,000 per year. In 2009, K-Bro commenced a project to upgrade its management information systems which will increase this anticipated annual amount for 2010 and possibly 2011.

K-Bro also funds capital expenditures necessary for growth or that result in efficiencies that provide high returns in terms of anticipated increased revenues or lower costs. The amount of these strategic capital expenditures have fluctuated over the past several years as K-Bro has selectively pursued growth opportunities through the purchase of (i) new equipment to increase capacity; (ii) equipment with an anticipated high payback from a reduction in labour and utility costs; and (iii) the purchase or construction of new laundry facilities.

The timing and amount of capital expenditures by K-Bro will indirectly affect the amount of cash available for distribution to Unitholders. Distributions may be reduced, or even eliminated, at times when K-Bro deems it necessary to make significant capital or other expenditures.

## **Acquisitions and Integration of Acquired Businesses**

K-Bro's long-term growth strategy depends, in part, on its ability to acquire and successfully integrate and operate additional businesses. There can be no assurances that K-Bro can successfully integrate this new volume or successfully identify, negotiate, complete and integrate any future acquisitions. However, the size and scope of K-Bro's operations, the experience and reputation of its management team and its financial capacity may alleviate this risk.

## **Environmental Matters**

K-Bro's facilities are subject to federal, provincial and municipal laws and regulations relating to the protection of the environment and worker health and safety including those governing water waste discharges, management, recycling and disposal of hazardous materials and waste, cleanup of contamination, and worker exposure to hazardous materials. K-Bro is attentive to the environmental concerns surrounding and the environmental laws regulating the disposal of its waste materials and has through the years continued to make significant investments in properly handling and disposing of these materials. K-Bro does not use toxic materials or produce hazardous waste in its laundry facilities. All waste water is discharged through the municipal sewer system in compliance with applicable regulations. Each plant's waste water is regularly tested by the relevant municipal authorities to ensure compliance with local by-laws. Compliance with environmental laws and regulations has not and is not expected to give rise, in the aggregate, to any material adverse financial or operational effects upon K-Bro's business. Environmental laws and regulations and their interpretation, however, have changed rapidly over the years and may continue to do so in the future.

## **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**

The Fund's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Fund is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the President and Chief Executive Officer and the Vice-President and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As of December 31, 2009, 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, 2009. 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 twelve months ended December 31, 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**

Management is responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The President and Chief Executive Officer and the Chief Financial Officer assessed, or caused an assessment under their direct supervision of the design and operating effectiveness of K-Bro's internal controls over financial reporting as at December 31, 2009, and based on that assessment determined that K-Bro's internal controls over financial reporting were appropriately designed and were operating effectively in accordance with the COSO framework, published by the Committee of Sponsoring Organizations of the Treadway Commission.

No changes were made in the Fund's design of internal controls over financial reporting during the three and twelve months ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, K-Bro's internal controls over financial reporting.

A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instance of fraud, if any, have been detected. These inherent limitations include, amongst other items: (i) that managements' assumptions and judgments could ultimately prove to be incorrect under varying conditions and circumstances; or, (ii) the impact of isolated errors.

Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override. The design of any system of controls is also based, in part, upon certain

assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential (future) conditions.

## VISION

Management believes that K-Bro has the capability to deliver results and can achieve its vision of continuing to grow profitably in existing and new markets by capitalizing on its strengths and competitive advantages which include:

**Long-Term Contracts** – K-Bro's contracts with its healthcare customers typically range from seven to ten years. Contracts in the hospitality sector typically range from two to five years. K-Bro is the exclusive provider of laundry and linen services to most of its customers. Management believes that these long standing relationships, customer knowledge, quality services and value added services may bode well when contract renewals are due such as the contract with Alberta Health Services in Edmonton due to expire December 31, 2010.

**Strong Institutional Customer Base** – K-Bro's customers include a number of leading hospitals, health authorities, continuing care facilities and hotels in Canada. Healthcare customers include: Alberta Health Services (which encompasses the Calgary Health Region and Capital Health in Edmonton); The Hospital For Sick Children, Mount Sinai Hospital and St. Michael's Hospital in Toronto; and, Vancouver Coastal Health and Fraser Health (the central healthcare organizations for the greater Vancouver region). K-Bro's hospitality customers include major hotels from such well known groups as Fairmont, Westin, Delta, Four Seasons and Hyatt. This customer base provides a strong reference list for entry into new markets or expanding services in existing markets.

**Modest Maintenance Capital Expenditure Requirements** – Laundry equipment can, with proper ongoing maintenance, remain operative for long periods of time. For example, the useful life of a high capacity, energy efficient tunnel washer can extend beyond 20 years. This allows for competitive pricing for existing and new customers, as well as margin improvement as additional volumes are processed without additional capital expenditure. The longevity of equipment is enhanced by having a full complement of qualified maintenance engineers at each plant performing a comprehensive on-going preventative maintenance program.

**National Brand-Name Recognition and Strong Reputation** – K-Bro is the largest owner and operator of laundry and linen processing plants in Canada and the only service provider with a large operation in several of Canada's largest cities. Management believes that K-Bro's size and presence in multiple markets provide it with enhanced credibility when competing for new accounts in existing markets. As well, opportunity for growth in new markets through acquisitions or new builds is also enhanced. Management believes that this reputation is also enhanced through well established “green programs” including: an extensive reusable operating room linen program (K-Bro's “KOR” program); effective energy use and re-use through direct fired water heaters, heat exchangers and efficient tunnel washer systems; plastic recycling programs; and, replacement of chlorine bleach with more environmentally friendly hydrogen peroxide where feasible.

**Experienced Management Team and Effective Organizational Structure** – The general managers at K-Bro's six laundry facilities have each been in the industry from 15 to 21 years, and four began their careers at K-Bro in other positions before being promoted to their current positions. When combined with the CEO and the CFO, the group of eight senior managers has an average of 18 years of industry experience and an average age of 47. This provides an effective combination of youth and experience which bodes well for the future success of K-Bro in achieving its vision.

K-Bro's organizational structure has been developed to enable the general managers of its plants to focus on growth and operations in their individual markets, while enabling aggressive business development and tight management controls through K-Bro's separate corporate team.

**Scalable Business Model** – Each of K-Bro's plants is highly automated and has a cost structure with a significant fixed cost component. This allows the Company to generate economies of scale as volumes increase. Maintenance capital expenditures are incurred as necessary to maintain productive capacity in each plant. Strategic capital expenditures are incurred as necessary to enhance productive capacity as dictated by growth from existing or new customers. See Liquidity and Capital Resources—*Investing Activities*. Productive capacity can also be increased in each plant through longer operating hours; however, adequate consideration must be given to downtime for preventative maintenance as well as the availability of productive labor to perform efficiently in an expanded day.

**Effective Financing Strategy** – K-Bro maintains a conservative financing strategy to ensure the availability of lines of credit to fund growth as necessary. For major acquisitions or strategic capital expenditures, the equity markets will be accessed when available and it is prudent to do so. Payout ratios are kept at a prudent level giving consideration to business conditions and maintenance capital expenditures.

## 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. A second plant in Vancouver was acquired in January, 2010. 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.

# FINANCIAL STATEMENTS

## MANAGEMENT'S REPORT

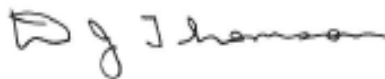
Management is responsible for the integrity and objectivity of the financial information presented in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in this annual report is consistent with that shown in the accompanying consolidated financial statements.

Management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets. The consolidated financial statements include amounts that are based on the best estimates of management.

The Board of trustees is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee, which consists solely of non-management trustees, reviews the consolidated financial statements and recommends them to the Board for approval. The fund's auditors PricewaterhouseCoopers LLP have full and unrestricted access to the Audit Committee and meet periodically with them (and separately, in the absence of management) to discuss audit, financial reporting and related matters.



Linda McCurdy  
President and Chief Executive Officer



Doug Thomson, FCA  
Vice President and Chief Financial Officer

## AUDITORS' REPORT


March 10, 2010

### To the Unitholders of K-Bro Linen Income Fund

We have audited the consolidated balance sheets of **K-Bro Linen Income Fund** as at December 31, 2009 and 2008 and the consolidated statements of earnings and deficit, comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



**Chartered Accountants**

Edmonton, Canada

# K-Bro Linen Income Fund

## Consolidated Balance Sheets

	As at December 31,	
	2009	2008
	\$	\$
		Restated (see note 2k)
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable	9,450,990	8,669,939
Linen in service	7,304,877	7,755,839
Prepaid expenses and deposits	1,212,988	623,953
Future income taxes (note 9)	448,920	426,032
	18,417,775	17,475,763
<b>Restricted escrow funds (note 3)</b>	-	540,500
<b>Property, plant and equipment (note 4)</b>	33,583,038	36,024,039
<b>Intangible assets (note 5)</b>	14,594,973	16,073,218
<b>Goodwill (note 3)</b>	16,220,250	15,679,750
	82,816,036	85,793,270
<b>Liabilities and Unitholders' Equity</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	9,880,299	12,749,682
Distribution payable to unitholders	642,146	642,146
	10,522,445	13,391,828
<b>Long-term debt (note 6)</b>	4,043,068	4,061,285
<b>Unamortized lease inducements (note 8)</b>	610,547	655,357
<b>Future income taxes (note 9)</b>	3,846,961	3,919,231
	19,023,021	22,027,701
<b>Contingencies and commitments (note 10)</b>		
<b>Unitholders' Equity</b>		
Exchangeable shares (note 11b)	724,110	724,110
Fund units (note 11b)	70,675,516	70,675,516
Fund units held in trust by LTIP (note 12)	(834,137)	(457,079)
Contributed surplus (note 11c)	572,376	340,728
Deficit	(7,309,840)	(7,405,966)
Accumulated other comprehensive loss (note 11d)	(35,010)	(111,740)
	63,793,015	63,765,569
	82,816,036	85,793,270

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

Approved on behalf of the Fund

(Signed) "Ross Smith"

(Signed) "Matthew Hills"

Trustee

Trustee

38

# K-Bro Linen Income Fund

## Consolidated Statements of Earnings and Deficit

	Year ended December 31,	
	2009 \$	2008 \$ Restated (see note 2k)
<b>Revenue</b>	<u>87,532,626</u>	<u>85,113,294</u>
<b>Expenses</b>		
Wages and benefits	39,433,498	40,142,329
Linen	10,191,609	10,238,433
Utilities	6,272,505	6,626,307
Delivery	3,280,422	3,643,869
Repairs and maintenance	3,176,857	3,008,801
Materials and supplies	3,015,370	2,914,738
Occupancy costs	2,991,442	3,032,291
Corporate	3,625,066	3,111,187
	<u>71,986,769</u>	<u>72,717,955</u>
<b>Earnings before the undernoted</b>	<u>15,545,857</u>	<u>12,395,339</u>
<b>Other expenses</b>		
Amortization of property, plant and equipment	(5,346,744)	(5,053,611)
Amortization of intangible assets	(2,157,140)	(2,149,978)
Financial charges (note 7)	(311,087)	(686,731)
Loss on disposal of property, plant and equipment	(53,752)	(506,668)
Write-off of new plant start-up costs (note 2k)	-	(132,631)
	<u>(7,868,723)</u>	<u>(8,529,619)</u>
<b>Earnings before income taxes</b>	7,677,134	3,865,720
<b>Income tax recovery (note 9)</b>	<u>124,742</u>	<u>856,151</u>
<b>Net earnings for the year</b>	<u>7,801,876</u>	<u>4,721,871</u>
<b>Deficit – beginning of year, as previously stated</b>	(7,309,749)	(4,573,837)
<b>Adjustment due to accounting policy change (note 2k)</b>	<u>(96,217)</u>	<u>-</u>
<b>Deficit – beginning of year, as restated</b>	<u>(7,405,966)</u>	<u>(4,573,837)</u>
<b>Distributions to unitholders (note 13)</b>	<u>(7,705,750)</u>	<u>(7,554,000)</u>
<b>Deficit – end of year</b>	<u>(7,309,840)</u>	<u>(7,405,966)</u>
	<b>\$</b>	<b>\$</b>
<b>Net earnings per unit (note 11e)</b>		
Basic	<u>1.12</u>	<u>0.70</u>
Diluted	<u>1.11</u>	<u>0.70</u>

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



# K-Bro Linen Income Fund

## Consolidated Statements of Comprehensive Income

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	Year ended December 31,	
	2009 \$	2008 \$ Restated (see note 2k)
<b>Net earnings for the year</b>	7,801,876	4,721,871
<b>Other comprehensive income (loss) for the year</b>		
Gain (loss) on derivative instruments designated as cash flow hedges, net of future income taxes of \$29,584 (2008 – (\$50,340))	<u>76,730</u>	<u>(113,639)</u>
<b>Comprehensive income for the year</b>	<u>7,878,606</u>	<u>4,608,232</u>

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

# K-Bro Linen Income Fund

## Consolidated Statements of Cash Flows

	Year ended December 31,	
	2009 \$	2008 \$ Restated (see note 2k)
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net earnings for the year	7,801,876	4,721,871
Items not affecting cash		
Amortization of property, plant and equipment	5,346,744	5,053,611
Amortization of intangible assets	2,157,140	2,149,978
Amortization of lease inducements	(56,231)	(42,174)
Loss on disposal of property, plant and equipment	53,752	506,668
Future income taxes	(124,742)	(856,151)
	15,178,539	11,533,803
Net change in non-cash working capital items (note 14)	(3,318,158)	3,788,404
Cash provided by operating activities	11,860,381	15,322,207
<b>Financing activities</b>		
Decrease in long-term debt revolving line of credit	(18,217)	(12,565,822)
Distributions paid to unitholders	(7,705,750)	(7,415,697)
Fund units issued – net of offering costs	-	18,092,544
Cash used in financing activities	(7,723,967)	(1,888,975)
<b>Investing activities</b>		
Purchase of property, plant and equipment	(3,479,019)	(9,744,642)
Proceeds from disposal of property, plant and equipment	21,500	163,259
Purchase of intangible assets	(678,895)	-
Business acquisition (note 3)	-	(3,311,349)
Escrow funds (note 3)	-	(540,500)
Cash used in investing activities	(4,136,414)	(13,433,232)
<b>Change in cash</b>	-	-
<b>Cash – beginning of year</b>	-	-
<b>Cash – end of year</b>	-	-
<b>Supplementary cash flow information</b>		
Interest paid	316,646	533,361
<b>Non-cash financing and investing activities</b>		
Equipment purchases included in accounts payable and accrued liabilities	585,739	1,082,763
Distribution included in distribution payable	-	138,303

*The accompanying notes are an integral part of these financial statements*

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 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 Significant accounting policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The precise determination of many assets and liabilities is dependent upon future events. Accordingly, the preparation of financial statements for a reporting period necessarily involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. These consolidated financial statements have, in management’s opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

### a) Basis of presentation

These consolidated financial statements include the Fund, its wholly owned subsidiary K-Bro Linen Systems Inc. and the LTIP Trust, a variable interest entity (note 12). All intercompany balances and transactions have been eliminated upon consolidation.

### b) Linen in service

Linen in service is recorded at cost. Operating room linen is amortized using the straight-line method over the estimated service life of 24 months. General linen is amortized based on usage which results in an estimated average service life of 24 months.

### c) Revenue recognition

Revenue from linen management and laundry services is largely based on written service agreements whereby the Fund agrees to collect, launder, deliver and replenish linens. The Fund recognizes revenue in the period in which the services are provided.

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

### December 31, 2009 and 2008

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#### d) Property, plant and equipment

Property, plant and equipment are recorded at cost. Amortization is provided over the estimated useful life of the asset using the following annual rates and methods:

Building	5% declining balance
Laundry equipment	15% declining balance
Office and delivery equipment	20% declining balance
Computer hardware	30% declining balance
Leasehold improvements	Straight-line over the initial lease period

#### e) Intangible assets

Intangible assets with a finite life which relate to contracts the Fund has with certain customers are recorded at cost and are amortized using the straight-line method over the remaining life of the contract plus one renewal period, ranging from 1 month to 157 months. Those which relate to computer software will be amortized using the straight-line method over sixty months when put into service.

#### f) Impairment of long-lived assets

The Fund assesses impairment of its long-lived assets (property, plant and equipment and finite life intangible assets) when events or changes in circumstances cause the carrying value of an asset to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value.

#### g) Future income taxes

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is currently only taxable on any amount not distributed to unitholders and income tax liabilities relating to distributions of the Fund are taxed in the hands of the unitholders. As substantially all taxable income of the Fund is distributed to the unitholders, no provision for current income taxes on earnings of the Fund is made in the financial statements. On June 11, 2007, the Canadian federal government substantively enacted legislation whereby the income tax rules applicable to publicly traded trusts was significantly modified. In particular, income earned by a trust will be taxed in a manner similar to income earned and distributed by a corporation. The legislation is effective for the 2007 taxation year but the application of the rules is delayed to the 2011 taxation year with respect to trusts that were publicly traded prior to November 1, 2006 within certain guidelines. For the Fund, only temporary differences expected to reverse after January 1, 2011 are taken into account in the determination of the provision for income taxes.

The incorporated subsidiary of the Fund calculates income taxes using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates applicable to the period that the temporary differences are expected to reverse. Future income tax

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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assets are only recognized to the extent that, in the opinion of management, they will more likely than not be realized. The effect on future income tax assets or liabilities is recognized in income in the period that the tax rate change occurs.

Income tax obligations relating to distributions of the Fund are the obligations of the unitholders and, accordingly, no provision for income taxes has been made in respect of the assets and liabilities of the Fund. The enactment of the new legislation did not have a significant impact on the Fund's consolidated financial statements.

h) Goodwill

Goodwill represents the excess of the cost of business acquisitions over the fair value of net identifiable assets acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. Goodwill will be written down when the carrying value exceeds the fair value. Management has determined that there was no goodwill impairment at December 31, 2009 or 2008.

i) Volume rebates

Certain customers receive a rebate based on specified annual processing volumes. A volume rebate liability is recognized at the time it is expected that the customer will meet the specified annual volume levels.

j) Financial instruments

The Fund has made the following classifications:

- Accounts receivable are classified as loans and receivables and are initially measured at fair value. Subsequent periodic revaluations are recorded at amortized cost using the effective interest method.
- Accounts payable and accrued liabilities, distribution payable and long-term debt are classified as other liabilities and are initially measured at fair value and subsequent periodic revaluations are recorded at amortized cost using the effective interest method.

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 on the consolidated balance sheet. Transaction costs related to financial instruments are capitalized and then amortized over the expected life of the financial instrument using the effective interest method.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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k) Adoption of new accounting policies

Goodwill and intangible assets

In February 2008, the CICA issued a new accounting standard – Section 3064 “*Goodwill and intangible assets*” which replaced the existing standard for goodwill and other intangible assets in Section 3062 and research and development costs in Section 3450. The new Section was adopted by the Fund beginning January 1, 2009. It established standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. In accordance with this new policy, deferred charges at December 31, 2008 of \$132,631 were written off retrospectively against equity in 2009 with restatement of comparative amounts. The adoption of this standard resulted in an increase of \$132,631 in the “Write-off of new plant start-up costs” expense, an increase in the “Future income tax recovery” of \$36,414, and reduced basic earnings per unit by \$0.02 and diluted earnings per unit by \$0.01 for the year ended December 31, 2008. Also as required by this standard, certain computer software costs have been recorded in 2009 as a finite life intangible asset.

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 Consolidated Financial Statements

**December 31, 2009 and 2008**

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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 consolidated financial statements (Note 15).

1) Future changes in accounting policies

(i) 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 Fund will convert to these new standards according to the timetable set with these new rules. 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’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.

(ii) Business combinations

Section 1582 “Business combinations” will be applicable to business combinations for which the acquisition date is on or after January 1, 2011. Early adoption is permitted. The section improves the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

(iii) Consolidated financial statements

Section 1601 “Consolidated financial statements” will be applicable to financial statements beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for the preparation of consolidated financial statements. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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(iv) Non-controlling interests

Section 1602 “Non-controlling interests” will be applicable to financial statements beginning on or after January 1, 2011. Early adoption is permitted. This section establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Fund has not yet determined the impact of the adoption of this new Section on the consolidated financial statements.

### 3 Business acquisition

On January 31, 2008, the Fund completed the acquisition of the laundry business, linen, property and equipment of Buanderie HMR Inc. located in Quebec City, Quebec. The business acquisition was accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the net assets acquired at January 31, 2008. The allocation was based on management’s best estimate of the fair value of net assets acquired.

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

	\$
Consideration	
Purchase price including acquisition costs	3,851,849
Less	
Restricted escrow funds	<u>(540,500)</u>
Net cash consideration	<u>3,311,349</u>
Net assets acquired	
Net working capital	62,397
Linen	125,000
Property, plant and equipment	2,160,000
Intangible assets	850,000
Goodwill	<u>113,952</u>
	<u>3,311,349</u>

Of the cash consideration payable to the vendor, \$540,500 was deposited into escrow with an escrow agent. The full amount of the funds held in escrow were released to the vendor in 2009 upon the determination that specified earnings before interest, income taxes and amortization were met in the twelve-month period subsequent to the acquisition. Goodwill was correspondingly increased by the amount released.



# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

## 4 Property, plant and equipment

	<b>2009</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Land	70,000	-	70,000
Building	550,000	51,449	498,551
Equipment			
Laundry <sup>(1)</sup>	37,503,351	13,654,741	23,848,610
Office	692,182	242,396	449,786
Delivery	420,806	218,475	202,331
Computer hardware	1,336,725	800,426	536,299
Leasehold improvements	11,131,484	3,154,023	7,977,461
	<b>51,704,548</b>	<b>18,121,510</b>	<b>33,583,038</b>

(1) Of this total, \$585,739 is included in accounts payable.

	<b>2008</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	\$	amortization	\$
		\$	\$
Land	70,000	-	70,000
Building	550,013	25,209	524,804
Equipment			
Laundry <sup>(2)</sup>	34,865,253	10,047,651	24,817,602
Office	644,938	147,653	497,285
Delivery	467,656	204,865	262,791
Computer hardware	1,293,542	616,283	677,259
Leasehold improvements	10,985,452	1,811,154	9,174,298
	<b>48,876,854</b>	<b>12,852,815</b>	<b>36,024,039</b>

(2) Of this total, \$1,082,763 is included in accounts payable.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

## 5 Intangible assets

	<b>2009</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	<b>\$</b>	<b>amortization</b>	<b>\$</b>
		<b>\$</b>	<b>\$</b>
Finite life intangible assets			
Healthcare contracts	15,700,000	5,546,553	10,153,447
Operating room contracts	3,500,000	2,401,162	1,098,838
Hospitality contracts	4,697,000	2,033,207	2,663,793
Computer software under development	678,895	-	678,895
	<u>24,575,895</u>	<u>9,980,922</u>	<u>14,594,973</u>
			<b>2008</b>
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	<b>\$</b>	<b>amortization</b>	<b>\$</b>
		<b>\$</b>	<b>\$</b>
Finite life intangible assets			
Healthcare contracts	15,700,000	4,418,441	11,281,559
Operating room contracts	3,500,000	1,912,790	1,587,210
Hospitality contracts	4,697,000	1,492,551	3,204,449
	<u>23,897,000</u>	<u>7,823,782</u>	<u>16,073,218</u>

## 6 Long-term debt

K-Bro Linen Systems Inc. has a revolving credit facility of up to \$30,000,000 of which \$4,293,068 is drawn (including letters of credit totalling \$250,000 per note 10 a). The facility is a two-year committed facility maturing February 28, 2011. It is extendable annually for another year at the lender's option. Interest payments only are due during the term of the facility. See also note 19b.

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

Drawings under the revolving credit facility are available by way of Bankers' Acceptances, Canadian prime rate loans, letters of credit or standby letters of guarantee. Drawings under the revolving credit facility bear interest at a floating rate, plus an applicable margin based on certain financial performance ratios. At December 31, 2009 for Bankers' Acceptances the margin varied from 2.50% to 3.50% and for Canadian prime rate loans, the margin varied from 1.00% to 2.00%.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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The balance consists of:

	<b>2009</b>	<b>2008</b>
	\$	\$
Bankers' Acceptances, 2.90% (2008 – 3.64%)	4,000,000	4,000,000
Prime rate loan, 3.25% (2008 – 4.00%)	43,068	61,285
	<u>4,043,068</u>	<u>4,061,285</u>

## 7 Financial charges

	<b>Year ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
	\$	\$
Interest on long-term debt	316,646	533,361
Other charges, net	(5,559)	153,370
	<u>311,087</u>	<u>686,731</u>

## 8 Unamortized lease inducements

The Fund entered into a ten-year lease in 2007 that included certain lease inducements consisting of a tenant allowance and a rent-free period. Tenant allowances are recorded as a liability when credited or received and amortized on a straight-line basis as a reduction of rent expense over the term of the related lease. For lease contracts with escalating lease payments, total rent expense for the lease term is expensed on a straight-line basis over the lease term. The difference between rent expensed and amounts paid is recorded as an increase or deferral in unamortized lease inducements.

The balance consists of:

	<b>2009</b>	<b>2008</b>
	\$	\$
Lease inducements received	698,783	698,783
Accumulated (amortization) deferral, net	(43,426)	1,384
	<u>655,357</u>	<u>700,167</u>
Less current portion, included in accrued liabilities	(44,810)	(44,810)
	<u>610,547</u>	<u>655,357</u>

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 9 Income taxes

A reconciliation of the expected income tax recovery to the actual income tax recovery is as follows:

	<b>Year ended December 31, 2009</b>	<b>2008</b>
	\$	\$
		<b>Restated (see note 2k)</b>
Canadian statutory rates (federal and provincial)	<u>30.1%</u>	<u>30.7%</u>
Expected expense for income taxes	(2,310,050)	(1,186,389)
Change resulting from:		
Non-deductible items	(39,166)	(42,471)
Impact of substantively enacted rates and other	225,515	(114,962)
Income of the Fund allocated to unitholders	<u>2,248,443</u>	<u>2,199,973</u>
Actual provision for income tax recovery	<u>124,742</u>	<u>856,151</u>

Future income tax assets (liabilities) are attributable to the following items:

	<b>2009</b>	<b>2008</b>
	\$	\$
		<b>Restated (see note 2k)</b>
Linen in service	108,162	172,119
Accounts payable and accrued liabilities	<u>340,758</u>	<u>253,913</u>
Current future income tax asset	<u>448,920</u>	<u>426,032</u>
Property and equipment	(1,094,774)	(725,530)
Intangible assets and goodwill	(3,145,543)	(3,767,294)
Offering costs and other	<u>393,356</u>	<u>573,593</u>
Long-term future income tax liability	<u>(3,846,961)</u>	<u>(3,919,231)</u>
Future income tax liability, net	<u>(3,398,041)</u>	<u>(3,493,199)</u>

The benefit of deductible temporary differences of \$nil (2008 – \$300,000) relating to offering costs borne directly by the Fund have not been recorded. The amount of goodwill deductible for tax purposes is \$3,862,485 (2008 – \$3,321,984).

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 10 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 (2008 – \$250,000) expiring January 24, 2011. A \$185,000 letter of credit outstanding at December 31, 2008 was cancelled in March 2009.

b) Commitments

(i) Operating leases and utility commitments

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

	\$
2010	5,112,785
2011	4,020,401
2012	3,938,840
2013	1,868,786
2014	1,358,620
Subsequent	2,615,211
	<u>18,914,643</u>

(ii) Linen purchase commitments

At December 31, 2009, the Fund was committed to linen expenditure obligations in the amount of \$1,898,431 (December 31, 2008 – \$2,196,023).

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 11 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

<b>Fund Units</b>	<b>#</b>	<b>\$</b>
Balance at December 31, 2007	<u>5,423,862</u>	<u>52,210,472</u>
Issued on February 27, 2008 at \$12.85 per Unit	1,362,000	17,501,700
Offering costs – net of future tax recovery of \$341,000	-	(842,959)
Issued on March 28, 2008 at \$12.85 per Unit	146,700	1,885,095
Offering costs – net of future tax recovery of \$31,500	<u>-</u>	<u>(78,792)</u>
	<u>1,508,700</u>	<u>18,465,044</u>
Balance at December 31, 2009 and 2008	<u>6,932,562</u>	<u>70,675,516</u>
<b>Exchangeable Shares / Special Trust Units</b>	<b>#</b>	<b>\$</b>
Balance at December 2009 and 2008	<u>72,411</u>	<u>724,110</u>
Total Fund Units and Exchangeable Shares / Special Trust Units 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.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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c) Contributed surplus

	<b>Year ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
	\$	\$
Balance, beginning of year	340,728	413,671
Net stock based compensation recorded	650,730	319,628
Issuance of vested Units to participants	<u>(419,082)</u>	<u>(392,571)</u>
Balance, end of year	<u>572,376</u>	<u>340,728</u>

d) Accumulated other comprehensive loss

	<b>Year ended December 31</b>	
	<b>2009</b>	<b>2008</b>
	\$	\$
Balance, beginning of year	(111,740)	1,899
Other comprehensive income (loss) during the year	<u>76,730</u>	<u>(113,639)</u>
Balance, end of year	<u>(35,010)</u>	<u>(111,740)</u>

e) Weighted average number of units outstanding

	<b>Year ended December 31,</b>	
	<b>2009</b>	<b>2008</b>
	#	#
Weighted average unit calculation		
Basic		
Units – opening	7,004,973	5,496,273
Weighted average units issued during the year	–	1,262,115
Weighted average unvested units purchased for LTIP	<u>(58,478)</u>	<u>(39,083)</u>
Weighted average units for the year	<u>6,946,495</u>	<u>6,719,305</u>
Diluted		
Basic weighted average units	6,946,495	6,719,305
Dilutive effect of LTIP units	<u>53,224</u>	<u>28,217</u>
	<u>6,999,719</u>	<u>6,747,522</u>

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 12 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 the Fund's long-term incentive plan (the "LTIP"). The Fund is neither a trustee nor a direct participant of the LTIP; however, under certain circumstances the Fund 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 the Fund has consolidated the LTIP Trust in accordance with the 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 the Fund 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.

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 68,173 Units of the Fund (2008 – 24,751). As at December 31, 2009, 72,739 Units held by the LTIP Trust have vested (December 31, 2008 – 38,961). The cost of the 69,692 unvested units held in trust by the LTIP at December 31, 2009 (December 31, 2008 – 35,297) was \$834,137 (December 31, 2008 - \$457, 079).

The basic net earnings per unit calculation exclude the unvested units held by the LTIP Trust.

## 13 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 15<sup>th</sup> day of the following month.

During the year ended December 31, 2009, the Fund declared total distributions to Unitholders and Exchangeable Unitholders of \$7,705,750 (2008 – \$7,554,000) or \$1.10 per unit (2008 – \$1.10).



# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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

	Year ended December 31,	
	2009	2008
	\$	\$
<b>Cash provided (used) by changes in</b>		
Accounts receivable	(781,051)	719,182
Linen in service	450,962	929,238
Prepaid expenses and deposits	(589,035)	188,696
Accounts payable and accrued liabilities	<u>(2,399,034)</u>	<u>1,951,288</u>
	<u>(3,318,158)</u>	<u>3,788,404</u>

## 15 Financial instruments

### a) Fair value

The Fund's financial instruments at December 31, 2009 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders, long-term debt, and an interest rate swap agreement. The carrying value of accounts receivable, accounts payable and accrued liabilities, and distribution payable to unitholders approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Fund's long-term debt is estimated based on market prices for same or similar instruments and approximates carrying value. The interest rate swap agreement is a derivative designated as an effective hedge and is measured at fair value with subsequent changes in fair value being charged to other comprehensive income. All of the Fund's financial instruments are classified as Level 2 using the fair value hierarchy described in Note 2 k.

### b) Financial risk management

The Fund's activities are exposed to a variety of financial risks: price risk, credit risk and liquidity risk. The Fund's overall risk management program focuses on the unpredictability of financial and economic markets and seeks to minimize potential adverse effects on the Fund's financial performance. Risk management is carried out by financial management in conjunction with overall Fund governance.

### c) Price risk

#### (i) Currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar. The Fund is not significantly exposed

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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to foreign currency risk as all revenues are received in Canadian dollars and minimal expenses are incurred in foreign currencies. For large capital expenditure commitments denominated in a foreign currency, the Fund will enter into foreign exchange forward contracts if considered prudent to mitigate this risk. At December 31, 2009, no foreign exchange forward option contracts were outstanding. Based on the Fund's US dollar liability for equipment purchases at December 31, 2009, a 1% change in the Canadian-US dollar foreign exchange rate would result in a \$2,300 change in the amount recorded in property, plant and equipment.

(ii) Interest rate risk

The Fund is subject to interest rate risk as its credit facility bears interest at rates that depend on certain financial ratios of the Fund and vary in accordance with market interest rates. On June 24, 2005, the Fund entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of \$4 million 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 was 2.90% at December 31, 2009. Based on the outstanding balance on the Fund's revolving credit facility for which the interest rate has not been fixed at December 31, 2009, a 1% fluctuation in the Canadian prime rate would result in a negligible change in annual interest expense. Management does not believe that the impact of interest rate fluctuations will be significant.

(iii) Other price risk

The Fund's exposure to other price risk is limited since there are no significant financial instruments which fluctuate as a result of changes in market prices.

d) Credit risk

The Fund's financial assets that are exposed to credit risk consist primarily of accounts receivable and an interest rate swap agreement. The Fund, in the normal course of business, is exposed to credit risk from its customers. The allowance for doubtful accounts and past due receivables are reviewed by management at each balance sheet reporting date. The Fund updates its estimate of the allowance for doubtful accounts based on the evaluation of the recoverability of accounts receivable balances of each customer taking into account historic collection trends, the contractual relationship with the customer and the nature of the customer which in many cases is a publicly funded health care entity. The Fund is exposed to credit loss in the event of non-performance by counterparties to the interest rate swap. Management believes that the risks associated with concentrations of credit risk with respect to accounts receivable and the interest rate swap are limited due to the nature of the customers and the swap counterparty serviced by the Fund and the generally short payment terms and frequent settlement of swap differences.

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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The aging of the Fund's receivables and related allowance for doubtful accounts are:

	<b>2009</b>	<b>2008</b>
	\$	\$
<b>Current</b>	6,223,678	6,701,444
<u>Past due amounts:</u>		
1 – 30 days	2,698,973	1,851,171
Greater than 30 days	570,626	160,028
Less: allowance for doubtful accounts	<u>(42,287)</u>	<u>(42,704)</u>
Accounts receivable, net	<u>9,450,990</u>	<u>8,669,939</u>

e) Liquidity risk

The Fund's accounts payable and distribution payable are due within one year.

The Fund has long-term debt with a maturity date of February 28, 2011 (see note 6 and 19b). The degree to which the Fund is leveraged may reduce its ability to obtain additional financing for working capital and to finance investments to maintain and grow the current levels of cash flows from operations. The Fund may be unable to extend the maturity date of the credit facility.

Management, to reduce liquidity risk, has historically renewed the terms of the credit facility in advance of its maturity dates and the Fund has maintained financial ratios that management believes are conservative compared to financial covenants applicable to the credit facility. A significant portion of the available facility remains undrawn.

Management measures liquidity risk through comparisons of current financial ratios with financial covenants contained in the credit facility.

f) Hedge accounting

Where derivatives are held for risk management purposes or when transactions meet the criteria, including documentation requirements, specified in the CICA Handbook Section 3865, hedge accounting is applied to the risks being hedged. When hedge accounting is not applied, the change in the fair value of the derivative is recognized in earnings.

The Fund applied hedge accounting on the interest rate swap agreement outstanding at December 31, 2009.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 16 Capital management

The Fund views its capital resources as the aggregate of its debt, unitholders' equity and amounts available under its credit facility. In general, the overall capital of the Fund is evaluated and determined in the context of its financial objectives and its strategic plan.

With respect to its level of indebtedness, the Fund determines the appropriate level in the context of its cash flow and overall business risks. The Fund has historically generated cash flow in excess of distributions and has used such excess to fund capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. The Fund would consider increasing its level of indebtedness relative to cash flow to assist in the financing of an acquisition or expansion. As well, the Fund will review its level of indebtedness in the context of the change in taxation impacting the Fund commencing 2011.

The Fund's indebtedness is subject to a number of covenants and restrictions including the requirement to meet certain financial ratios and financial condition tests which are subject to an appropriate cure period if necessary. One such ratio is the Total Funded Debt / EBITDA Ratio as defined in the credit facility (see note 6). The maximum ratio allowed for a 12-month trailing period is 2.75, which is increased to 3.25 for the two quarters immediately following an acquisition. For the twelve months ended December 31, 2009, this ratio was calculated at 0.27 (2008 – 0.38). Management also uses this ratio as a key indicator in managing the Fund's capital. EBITDA is defined in the credit facility as net earnings plus interest expense, income taxes, and amortization expense. For the purpose of the calculation of the Fund's financial ratios under the credit facility, EBITDA is calculated on a rolling four quarter basis.

With respect to its equity, the current level of capital is considered adequate in the context of current operations and the present strategic plan of the Fund. Any major acquisitions or expansions may be financed in part with additional equity. The Fund will also review its level of equity in the context of the change in taxation impacting the Fund commencing 2011.

The Fund's capital resources, comprised of long-term debt, unitholders' equity and amounts available under its committed revolving credit facility, totalled \$93.4 million at December 31, 2009 (2008 – \$93.4 million). Available liquidity as at December 31, 2009 consisting of unused committed revolving credit facility was \$25.7 million (2008 – \$25.5 million). The Fund has incurred no events of default under the terms of its credit facility agreement.

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## 17 Segmented information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through operating divisions in Vancouver, Victoria, Calgary, Edmonton, Toronto and Quebec City. The services offered and the economic characteristics associated with these divisions are similar, therefore they have been aggregated into one reportable segment which operates exclusively in Canada. The results of the Quebec City operation acquired (see note 3) are reported commencing February 1, 2008.

	<b>Year ended December 31, 2009</b>	
	<b>\$</b>	<b>%</b>
Healthcare	66,845,537	76.4
Hospitality	20,687,089	23.6
	<hr/>	<hr/>
Total	87,532,626	100.0
	<hr/>	<hr/>
	<b>Year ended December 31, 2008</b>	
	<b>\$</b>	<b>%</b>
Healthcare	64,698,218	76.0
Hospitality	20,415,076	24.0
	<hr/>	<hr/>
Total	85,113,294	100.0
	<hr/>	<hr/>

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 year ended December 31, 2009, the Fund has recorded revenue of \$52.4 million (2008 – \$49.4 million) from these three major customers, representing 60% (2008 – 58%) of total revenue.

## 18 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 year ended December 31, 2009, the Fund incurred such fees totalling \$138,000 (2008 – \$74,000).

# **K-Bro Linen Income Fund**

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## **19 Subsequent Events**

### a) 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 Burnaby, British Columbia. The business acquisition will be accounted for using the purchase method, whereby the purchase consideration will be allocated to the fair values of the net assets acquired at January 29, 2010. The purchase price to be allocated to the net assets acquired is approximately \$12.6 million including estimated acquisition costs. The acquisition has been funded through the Fund's revolving credit facility.

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.

### b) Revolving credit facility

In March, 2010 K-Bro Linen Systems Inc. secured an additional \$10,000,000 of credit under its revolving credit facility that will now have a limit of \$40,000,000. The term of the agreement was extended to June 30, 2012 and the working capital covenant was removed.

## **20 Comparative Amounts**

Certain comparative amounts have been reclassified to conform to the current year's financial statement presentation.

## CORPORATE INFORMATION

### Auditors

PricewaterhouseCoopers LLP

### Banker

Toronto Dominion Bank

### Transfer Agent and Registrar

Valiant Trust Company  
310, 606 – 4<sup>th</sup> Street SW  
Calgary, Alberta T2P 1T1  
Phone 403-233-2801 Fax 403-233-2857

### Stock Exchange and Symbol

Toronto Stock Exchange  
Trading Symbol KBL.UN

### Board of Trustees

Ross Smith (Chair)  
Matthew Hills  
Steven Matyas  
Linda McCurdy  
Michael Percy

### Audit Committee

Ross Smith (Chair)  
Steven Matyas  
Michael Percy

### Compensation, Nominating and Corporate Governance Committee

Steven Matyas (Chair)  
Michael Percy  
Ross Smith

### Legal Counsel

Goodmans LLP  
McLennan Ross LLP

### Officers

Linda McCurdy  
President and CEO

Sean Curtis, Senior Vice President  
and General Manager, Edmonton

Doug Thomson, FCA, Vice President  
and Chief Financial Officer

Jerry Ostrzyzek, Vice President Eastern Operations  
and General Manager, Toronto

Ron Graham, General Manager, Vancouver

Jeff Gannon, General Manager, Calgary

### Annual General Meeting

The Annual General Meeting of the Unitholders will be held at the Sheraton Centre Hotel, Carleton Room, in Toronto on Thursday, June 17, 2009 at 1 o'clock in the afternoon. All Unitholders are cordially invited to attend.

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