



K-BRO LINEN INCOME FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE THREE AND SIX MONTHS ENDED

JUNE 30, 2010 AND 2009

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

August 11, 2010

The following Management's Discussion and Analysis ("MD&A") is supplemental to, and should be read in conjunction with, the unaudited interim Consolidated Financial Statements of K-Bro Linen Income Fund ("the Fund") for the six months ended June 30, 2010 and the audited Consolidated Financial Statements, as well as the MD&A for the year ended December 31, 2009. The Fund and its wholly-owned subsidiary K-Bro Linen Systems Inc. is collectively 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 August 11, 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 Canadian Generally Accepted Accounting Principles ("GAAP") and are therefore unlikely to be comparable to similar measures presented by other issuers. Please see "*Terminology*" for further discussion.

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INTRODUCTION

Core Business

The Fund is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc.

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

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 Cyclicalities – 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 generally formalized through contracts in the healthcare sector that are typically long term (from seven to ten years), while contracts in the hospitality sector usually 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 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 million pounds of linen per year. Most healthcare customers generate between 500,000 pounds of linen per year for a hospital and up to 20 million pounds of linen per year for a healthcare region.

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 bases 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 ("KOR") services and on-site services. For three major hospitals in Toronto, K-Bro performs the sterilization of operating room linen packs.

SUMMARY OF RESULTS AND KEY EVENTS

Long-Term Contract Signings and Extensions in Vancouver

In June, 2010 K-Bro was selected as the successful proponent of a competitive RFP process and announced the signings of ten year contracts with Vancouver Coastal Health Authority ("VCHA"), Fraser Health Authority ("FHA"), Provincial Health Services Authority and Providence Health Care Society. Service for the majority of the new volume from the former Tilbury Regional Hospital Laundry is expected to commence in November, 2010. The contracts are renewable for a further five years at the customer's option. Certain existing contracts with VCHA and FHA were extended to November, 2015 as part of this process.

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 greater Vancouver, British Columbia. 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.

The business acquisition has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the net assets acquired at January 29, 2010. The allocation was based on management's best estimate of the fair value of net assets acquired. The purchase price allocations are preliminary and are subject to change once the final valuations are completed and the final determination of the costs related to the acquisition have been made. The acquisition was funded using the Fund's revolving credit facility.

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

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

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

During the second quarter of 2010, the Fund incurred additional acquisition related costs in the amount of \$60,386 which have been recorded as Goodwill.

Sustained Revenue and EBITDA Growth in 2010

Revenue increased in the second quarter of 2010 to \$25.9 million or by 19.1% compared to the second quarter of 2009. This growth in the quarter represented an increase of \$455,617 or 2.1% from growth in the original six plants together with the growth of \$3.7 million or 17.0% as a result of the plant acquisition in greater Vancouver on January 29, 2010 (see discussion on page 4). See further discussion below under *Market Activities and Opportunities*.

EBITDA (see *Terminology*) increased in the second quarter of 2010 to \$4.3 million from \$4.1 million in the second quarter of 2009 which is an increase of 5.2%. The EBITDA margin has decreased to 16.7% in Q2, 2010 compared 18.9% in Q2, 2009. The decrease in margin is driven by increased corporate costs as a result of an increase in the accrual for the Long Term Incentive Plan, consulting fees associated with the IFRS conversion project, business travel related to the acquisition, legal fees attributed to the refinancing and recruitment costs for the new CFO and corporate controller. A significant component of the margin decrease is related to the transition of the recently acquired plant in Vancouver in Q1, 2010. The expected EBITDA margin from the second Vancouver plant is anticipated to be lower than the historical margins of our other plants due to the type and mix of volume that is processed in the facility.

Revolving Credit Facility Increased

In March, 2010, K-Bro increased its revolving credit facility to a limit of \$40 million. The term of the agreement was extended to June 30, 2012 and the working capital covenant was removed. The facility remained an interest-only arrangement.

Labour Cost Transitional Effects

Labour costs for plant staff as a percentage of revenue increased in the second quarter from 44.4% in 2009 to 46.3% in 2010. Excluding the impact of the lower margin realized in the new Vancouver plant, labour costs as a percentage of revenues are comparable to Q2, 2009.

Market Activities and Opportunities

Activities of significance in K-Bro's markets in 2010 have included:

British Columbia – K-Bro was selected as the successful proponent in a competitive RFP process related to the outsourcing of the Tilbury Regional Hospital Laundry. There were no other significant wins or losses in this market during the period ended June 30, 2010.

Alberta – Processing commenced in Q4, 2009 for Alberta Hospital in Edmonton which is part of Alberta Health Services ("AHS"). This volume was previously processed by the hospital using an on premise laundry. In the February, 2010 provincial budget, AHS 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. The impact of this announcement to K-Bro is unknown. K-Bro's Edmonton contracts with AHS expire December 31, 2010 and discussions in this regard are ongoing.

K-Bro currently has several proposals pending and has entered into discussions with potential new healthcare and hospitality customers. In addition, K-Bro continues to seek 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 feels that it is positioned to withstand market volatility and uncertainty given that:

- Approximately 68% of our revenues are from large publicly funded healthcare customers.
- K-Bro's payout ratio for the six months was 55.0% and for the quarter ended June 30, 2010 was 52.6%. The undistributed portion of cashflow provides K-Bro with funds for future growth and a safeguard against economic 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 further natural gas and electricity forward contracts for a three year term commencing upon expiration in February, 2010 of pre-existing hedges.
- K-Bro's revolving credit facility is with a major Canadian bank and has a term to June 30, 2012 with an annual option to renew for an additional year. At June 30, 2010, K-Bro had unutilized borrowing capacity of \$25.9 million or 65% of the line available.

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 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 K-Bro Linen Systems Inc.

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	Q2, 2010	Q2, 2009	YTD 2010	YTD 2009
Growth (% change from comparative period)	Revenue	19.1%	-0.4%	15.3%	4.2%
	EBITDA ¹	5.2%	24.5%	8.3%	38.9%
	Distributable cash	7.0%	16.2%	4.9%	42.5%
Profitability (actual for the period)	EBITDA	\$4,324	\$4,111	\$8,232	\$7,603
	EBITDA margin	16.7%	18.9%	16.5%	17.6%
	Net earnings	\$1,965	\$2,168	\$3,737	\$3,760
Stability	Payout ratio	52.6%	56.2%	55.0%	57.7%
	Distributions per Unit	\$0.275	\$0.275	\$0.550	\$0.550
	Debt to total capitalization	17.9%	9.6%	17.9%	9.6%
	Unutilized line of credit	\$25,914	\$23,015	\$25,914	\$23,015

¹ EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, gain or loss on disposals, financial charges and amortization). See *Terminology*.

OUTLOOK

Management believes that the remainder of 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 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;
- The overall volume will grow as a result of the long-term contracts to commence processing of the Tilbury volume;
- 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 likely be minimal;
- The 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; and
- The acquisition completed in January, 2010 (see *Summary of Results and Key Events*).

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 volumes.
- Provincial governments in a deficit position are re-examining healthcare costs and are evaluating the 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 harmonized sales tax (“HST”) to be implemented on July 1, 2010 in BC and Ontario will lower the input cost of some materials and services through input tax credits realized on amounts previously exempt. This positive impact will be slightly offset by taxes on utilities for which K-Bro was previously exempt.
- A CPI that remains very low which is 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 supplies remain high. 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 fiscal 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 \$500,000 to \$1.0 million. The Fund expects that a definitive decision regarding the conversion will be made and communicated before the end of Q3, 2010. 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 present level of cash distributions is sustainable for the Fund in its current structure for fiscal 2010.

RESULTS OF OPERATIONS

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

Overall Performance

The second quarter of 2010 saw revenue increase by \$4,156 or 19.1% over the second quarter of 2009. Operating costs increased to 83.3% of revenue in the current quarter compared to 81.1% in Q2, 2009. The causes of this are discussed later under *Operating Expenses*. As a result, EBITDA increased in the current quarter by \$213 (5.2%) over the second quarter of 2009.

Quarterly Financial Information

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

Fiscal year	2010		2009				2008	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Revenue	\$25,902	\$23,932	\$21,635	\$22,659	\$21,746	\$21,493	\$21,547	\$22,063
Operating expenses	21,578	20,024	17,830	18,521	17,635	18,001	18,223	18,466
EBITDA ¹	4,324	3,908	3,805	4,138	4,111	3,492	3,324	3,597
EBITDA as a % of revenue	16.7%	16.3%	17.6%	18.3%	18.9%	16.2%	15.4%	16.3%
Amortization	2,084	2,033	1,856	1,885	1,870	1,892	1,950	1,903
Financial charges	189	127	96	60	65	91	142	148
Loss on disposal of equipment	57	-	50	1	-	3	49	-
Earnings before income taxes	1,994	1,748	1,803	2,192	2,176	1,506	1,183	1,546
Income tax (expense) recovery	(29)	24	145	(97)	(8)	85	202	64
Net earnings	1,965	1,772	1,948	2,095	2,168	1,591	1,385	1,610
Net earnings as a % of revenue	7.6%	7.4%	9.0%	9.2%	10.0%	7.4%	6.4%	7.3%
Basic earnings per Unit	\$0.29	\$0.26	\$0.28	\$0.30	\$0.31	\$0.23	\$0.21	\$0.23
Diluted earnings per Unit	\$0.28	\$0.25	\$0.27	\$0.30	\$0.31	\$0.23	\$0.21	\$0.23
Total assets	93,279	95,103	82,816	83,565	84,639	86,344	85,793	88,241
Total long-term financial liabilities	18,094	20,145	8,500	9,676	11,263	11,536	8,636	10,825
Funds provided (used) by operations	4,538	3,830	3,549	5,568	3,539	(796)	5,594	5,570
Long-term debt, end of period	\$13,836	\$15,912	\$4,043	\$5,107	\$6,735	\$7,210	\$4,061	\$6,219
Distributions declared per unit	\$0.27	\$0.28	\$0.27	\$0.28	\$0.27	\$0.28	\$0.27	\$0.28

¹ EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, gain or loss on disposals, financial charges and amortization). See *Terminology*.

The reader is referred to the Fund's 2009 and 2008 Annual Reports, MD&A and Q1, 2010 report for a discussion and analysis of the results of the quarters preceding June 30, 2010.

Revenues

Revenues by sector consist of:

Fiscal year	2010		2009				2008	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sector								
Healthcare	\$17,646	\$17,137	\$16,662	\$16,524	\$16,723	\$16,937	\$16,782	\$16,226
Hospitality	8,256	6,795	4,973	6,135	5,023	4,556	4,765	5,837
Total	\$25,902	\$23,932	\$21,635	\$22,659	\$21,746	\$21,493	\$21,547	\$22,063

Operating Expenses

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

Linen - Costs as a percentage of revenue decreased in the quarter from 11.7% 2009 to 10.0 % in 2010. The decrease is due to a higher percentage of hospitality revenue in 2010 compared 2009 (32% versus 23%) which is largely due to revenue profile of the recently acquired plant in Vancouver. In general, hospitality customers own their own linen.

Utilities - Utility costs as a percentage of revenue increased from 6.6% in 2009 to 7.8% in 2010. Of the \$597 increase, \$329 is attributed to additional costs resulting from the acquisition of the new plant and the remainder is due to higher electricity and water rates experienced. K-Bro has executed its strategy to utilize natural gas and electricity hedges to take advantage of the current prices in order to lock in future variable costs.

Delivery, Repairs and maintenance and Materials and supplies - These costs as a percentage of revenue remained stable in Q2, 2010 compared to Q2, 2009. The quarter on quarter variance is \$391 of which \$365 is attributed to the new plant.

Occupancy - Occupancy costs as a percentage of revenue increased from 3.3% in 2009 to 3.6% in 2010 or by a total of \$224. The majority of the increase is due to the newly acquired plant. Also contributing to the increase are annual landlord adjustments for property taxes and operating costs.

Corporate - Costs increased in Q2, 2010 by \$363 over Q1, 2009. This is primarily attributable to an increase in the accrual for the Long Term Incentive Plan (see below), consulting fees associated with the IFRS conversion project, recruitment and additional salary costs relating to the new CFO and travel costs associated with the acquisition transition.

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 June 30, 2010 a total of 114,074 units were unvested. LTIP expense for Q2, 2010, included in Corporate expenses, was \$331 (Q2, 2009 - \$206).

Effects of Inflation/Deflation

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 ("CPI"). To the extent that such indices are impacted by inflation, this would be reflected in K-Bro's increased 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. The economic deflation presently experienced in the Canadian economy has limited the automatic CPI increase to revenues.

Amortization of Property, Plant and Equipment

Amortization of property, plant 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 of those assets. Amortization of property, plant and equipment for the quarter has increased from the comparable period in 2009 primarily due to the greater Vancouver plant acquisition in January, 2010 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 of those assets. Amortization expense in 2010 increased compared to 2009 as the acquisition of the second plant in Vancouver was completed on January 29, 2010. As well, software expenses are now included as an intangible asset and additions have increased the amortization charge. Software purchases in the quarter total \$29 and are with respect to the new systems implementation and software upgrade.

Financial Charges

Financial charges in the current quarter increased by \$125 over 2009 as a result of an increased long-term debt balance offset somewhat by lower market interest rates (see *Liquidity and Capital Resources – Financing Activities*).

Income Tax

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.

Currently, the Fund is only taxable on amounts that are not distributed to Unitholders. Once the Fund is subject to the new rules under Bill C-52 (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 \$4,538 in the second quarter of 2010, an increase of \$999 from the funds used by operating activities in the second quarter of 2009. This \$999 increase is attributable to an increase in cashflow from operations of \$88 and an increased working capital requirement of \$911 in the quarter compared to the corresponding period in 2009.

The increased working capital requirement is the result of: a decrease in accounts receivable resulting from the timing of receipts from major customers, an increase in accounts payable and accrued liabilities (in Q1, 2009 there were large payments of accrued volume rebates), an increase in the purchase of linens in service and a decrease in prepaid expenses (primarily computer software costs associated with the upgrade project that are now included in intangible assets).

Financing Activities

The Fund declared distributions to unitholders at an annualized rate of \$1.10 per unit for a total amount of \$1,926 (2009 - \$1,926) and \$3,853 (2009 - \$3,853) for the three and six month periods ended June 30, respectively.

During the second quarter of 2010, cash used in financing activities associated with net repayments of long-term debt amounted to \$2,076, compared to cash used in financing of \$476 in Q2, 2009.

Financing activities resulted in a Long-term debt at June 30, 2010 of \$13,836 compared with \$4,043 at December 31, 2009 (see *Investing Activities* below). During the first quarter of 2010, K-Bro was advanced funds from the credit facility in the amount of \$12,362 in order to finance the acquisition of the second Vancouver plant. K-Bro repaid \$2,076 during the quarter ended June 30, 2010.

K-Bro has incurred no events of default under the terms of its credit facility agreement.

On June 24, 2005, K-Bro entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of \$4,000 of this debt has been fixed at 5.95% for a period of five years. On June 24, 2010, the interest rate swap expired and was not renewed for an additional period.

Investing Activities

During the current quarter, K-Bro used \$426 (2009 - \$608) of funds for maintenance capital expenditures and \$24 (2009 - \$529) of funds for strategic capital expenditures for a total cash investment in property, plant and equipment of \$450 (2009 - \$1,137) for the quarter. Management defines maintenance capital expenditures as additions to, or replacements of, property and equipment to maintain K-Bro's current business operations.

During the current quarter, the Fund invested \$29 (2009 - \$nil) of funds in intangibles. The Fund 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 \$1,000, of which \$915 has been incurred to date (\$438 in Q2, 2009). This investment is recorded in intangible assets but treated as a maintenance capital expenditure for purposes of calculating Distributable Cash (see *Terminology*).

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.

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 2010 are primarily related to the requirements of handling additional volume and gaining efficiencies.

During the second quarter of 2010, the Fund disposed \$19 of laundry equipment and \$74 of furniture for foreign workers, for gross proceeds of \$4. There were no significant disposals of equipment were recorded in the second quarter of 2009.

Contractual Obligations

At June 30, 2010, 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	13,836	-	13,836	-	-
Operating leases and utility commitments	17,590	2,828	8,897	3,247	2,618
Linen purchase obligations	1,718	1,718	-	-	-

The source of funds for these commitments will be from operating cash flow and the undrawn portion of the revolving credit facility.

Financial Position

Capital Structure		
	June 30, 2010	Dec 31, 2009
Long-term debt	\$13,836	\$4,043
Unitholders' equity	63,286	63,793
Total capitalization	\$77,122	67,836
Debt to total capitalization	17.9%	6.0%

For the three months ended June 30, 2010, the Fund had a payout ratio (see *Terminology*) of 52.6%, a debt to total capitalization of 17.9%, an unused revolving credit facility of \$25,914 and has not incurred any events of default under the terms of its credit facility agreement.

As at June 30, 2010, the Fund had net working capital of \$8,660 compared to its working capital position of \$7,895 at December 31, 2009.

Management believes that the Fund has the capital resources and liquidity necessary to meet its commitments, support its operations and finance its growth strategies. In addition to the Fund's ability to generate cash from operations and its revolving credit facility, the Fund is also able to issue additional units to provide for capital spending and sustain its property, plant and equipment.

DISTRIBUTIONS FOR THE PERIOD

Fiscal year		2010		2009	
Period	Payment Date	Per Unit Distribution	Distribution Amount (\$)	Per Unit Distribution	Distribution Amount (\$)
Fund Units					
First quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,754,774
April	May 15	\$0.09167	\$635,508	\$0.09167	\$635,508
May	June 15	\$0.09167	\$635,508	\$0.09167	\$635,508
June	July 15	\$0.09167	\$635,508	\$0.09167	\$635,508
Second quarter		\$0.27501	\$1,906,524	\$0.27501	\$1,906,524
Year to date		\$0.55002	\$3,813,048	\$0.55002	\$3,661,298
Exchangeable Shares					
First quarter		\$0.27501	\$19,914	\$0.27501	\$19,913
April	May 15	\$0.09167	\$6,638	\$0.09167	\$6,638
May	June 15	\$0.09167	\$6,638	\$0.09167	\$6,638
June	July 15	\$0.09167	\$6,637	\$0.09167	\$6,638
Second quarter		\$0.27501	\$19,913	\$0.27501	\$19,914
Year to date		\$0.55002	\$39,827	\$0.55002	\$39,827
Total Distributions		\$0.55002	\$3,852,875	\$0.55002	\$3,701,125

For the six months ended June 30, 2010, the Fund distributed \$0.55002 per unit compared with Distributable Cash (see *Terminology*) per unit of \$1.01. The actual payout ratio was 55.0%.

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

DISTRIBUTABLE CASH (see *Terminology*)

(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	2010		2009				2008	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Per consolidated financial statements:								
Cash provided (used) by operating activities	\$4,538	\$3,830	\$3,549	\$5,568	\$3,539	\$(796)	\$5,594	\$5,570
Add (deduct):								
Net changes in non-cash working capital items ²	(417)	(63)	146	(1,505)	494	4,183	(2,424)	(2,135)
Maintenance capital expenditures ³	(455)	(430)	(187)	(256)	(608)	(133)	(180)	(68)
Distributable cash	\$3,666	\$3,337	\$3,508	\$3,807	\$3,425	\$3,254	\$2,990	\$3,367
Distributable cash per weighted average diluted Units outstanding	\$0.53	\$0.48	\$0.50	\$0.54	\$0.49	\$0.46	\$0.44	\$0.48
Distributions declared ⁴	\$1,926	\$1,926	\$1,927	\$1,927	\$1,926	\$1,926	\$1,927	\$1,926
Distributions declared per unit	\$0.27	\$0.28	\$0.27	\$0.28	\$0.27	\$0.28	\$0.27	\$0.28
Payout ratio (see "Terminology")⁴	52.6%	57.7%	54.9%	50.6%	56.2%	59.2%	64.4%	57.2%
Weighted average units outstanding during the period – Basic	6,878	6,935	6,935	6,930	6,946	6,970	6,969	6,969
Weighted average units outstanding during the period – Diluted	6,951	6,992	6,989	6,994	7,010	6,999	6,998	6,996
Trailing-twelve Months ("TTM")								
Distributable cash	14,318	14,078	13,994	13,476	13,036	12,558	11,044	9,564
Distributions	7,707	7,706	7,706	7,706	7,705	7,705	7,554	7,138
Payout ratio	55.0%	54.7%	55.1%	57.2%	59.1%	61.4%	68.4%	74.6%
Cumulative since IPO February 3, 2005								
Distributable cash	53,152	49,486	46,149	42,641	38,834	35,409	32,155	29,165
Distributions	35,131	33,204	31,278	29,351	27,424	25,498	23,572	21,645
Payout ratio	66.1%	67.1%	67.8%	68.8%	70.7%	72.0%	73.3%	74.2%

1. 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.
2. 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.
3. Maintenance capital expenditure is discussed under *Investing Activities*. Also included are software costs included in Intangible Assets.
4. The level of distributions paid compared to distributable cash is reviewed periodically to take into account the current and prospective performance of the business and other items considered to be prudent.

OUTSTANDING UNITS

At June 30, 2010, the Fund had 6,932,562 Fund Units outstanding and 72,411 Special Trust Units outstanding (unchanged from March 31, 2010 and December 31, 2009). The basic and the diluted weighted average number of units outstanding for the first six months of 2010 were 6,862,601 and 6,936,239 respectively (6,957,894 and 7,022,075 respectively for Q2, 2009).

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 approved LTIP compensation of \$1.4 million (2009 - \$0.8 million) and approved the funding and transfer of \$1.4 million (2009 - \$0.8 million) of cash to the LTIP Trust in March 2010 in order to fund the purchase of Units by the LTIP Trust. In April 2010, the LTIP Trust purchased 87,423 Units of the Fund (2009 - 68,171). As at June 30, 2010, 115,780 Units held by the LTIP Trust have vested (December 31, 2009 - 72,739). The cost of the 114,074 unvested units held in trust by the LTIP at June 30, 2010 (December 31, 2009 - 69,692) was \$1,600,938 (December 31, 2009 - \$834,137). 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 Mr. 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 June 30, 2010, the Fund incurred fees totaling \$34,500 (three months ended June 30, 2009 - \$34,500). For the six months ended June 30, 2010, the Fund incurred fees totaling \$69,000 (six months ended June 30, 2009 - \$69,000)

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements, in conformity with GAAP, requires K-Bro to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Management regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances. This involves varying degrees of judgment and uncertainty and, therefore, amounts currently reported in the financial statements could differ in the future. There have been no changes in these accounting estimates from those reported at December 31, 2009.

TERMINOLOGY

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 of their useful life. Accordingly, EBITDA comprises revenues less operating costs before: financing costs, capital asset and intangible 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. 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.

(\$ 000's)	Three months ended June 30		Six months ended June 30	
	2010	2009	2010	2009
Net earnings	\$ 1,965	\$ 2,168	\$ 3,737	\$ 3,760
<i>Add (deduct):</i>				
Income tax recovery (expense)	29	8	5	(77)
Financial charges	189	65	316	154
Amortization of property, plant and equipment	1,444	1,331	2,859	2,684
Amortization of intangible assets	640	539	1,258	1,079
Loss on disposal of property, plant and equipment	57	-	57	3
EBITDA	\$ 4,324	\$ 4,111	\$ 8,232	\$ 7,603

Distributable Cash

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

Cash Distributions per Unit and Payout Ratios

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

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

CHANGES IN ACCOUNTING POLICIES

The Fund's unaudited interim Consolidated Financial Statements have been prepared in accordance with Canadian GAAP and incorporate the same accounting principles and methods used in the preparation of the Fund's annual audited Consolidated Financial Statements. See Note 2 of the Fund's annual audited Consolidated Financial Statements for more information regarding the significant accounting principles used to prepare the 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 ("Transition Date") 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.

Major differences with current accounting policies

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 when 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
<p>Financial Statement Preparation:</p> <ul style="list-style-type: none"> ▪ Identify differences between IFRS and Canadian GAAP accounting policies ▪ Selection of IFRS policies ▪ Select choices under IFRS 1 ▪ Develop financial statement format ▪ Quantify effects of change in initial IFRS1 disclosures and 2010 financial statements 	<p>Senior Management sign-off and audit committee review for all items by end of fourth quarter, 2009.</p>	<p>Differences have been identified and documented. Recommendation regarding IFRS policies and selection of choices under IFRS 1 have been finalized.</p>
<p>Staffing: Define and introduce appropriate level of IFRS expertise for each of the following:</p> <ul style="list-style-type: none"> ▪ Accounting staff ▪ Senior executives and Board, including Audit Committee 	<p>Appropriate level of expertise to be in place by second quarter 2009.</p>	<p>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.</p>
<p>Infrastructure: Ensure information technology is fully compliant for IFRS as follows:</p> <ul style="list-style-type: none"> ▪ Capability of system to produce dual financial statements (Canadian GAAP and IFRS) during the transition years ▪ Programs upgrades/changes ▪ Gathering disclosure data ▪ Budget/forecast monitoring process 	<p>Ready for parallel processing of 2010 general ledgers and for planning/monitoring process.</p>	<p>Process currently underway in conjunction with financial systems software upgrade.</p>
<p>Business Policy Assessment: Financial Covenants</p> <ul style="list-style-type: none"> ▪ Identify impact of IFRS on financial covenants ▪ Complete any required renegotiations/changes 	<p>Renegotiations to be completed by fourth quarter 2010.</p>	<p>Process of identifying metrics affected by conversion to IFRS currently underway. Preliminary discussions with bank held.</p>
<p>Business Policy Assessment: Compensation Arrangements</p> <ul style="list-style-type: none"> ▪ Identify impact on compensation arrangements ▪ Make any required changes 	<p>Fourth quarter 2010.</p>	<p>Process of identifying metrics affected by conversion to IFRS currently underway.</p>
<p>Business Policy Assessment: Customer and Supplier Contracts</p> <ul style="list-style-type: none"> ▪ Evaluate impact of IFRS on current customer or supplier contracts. 	<p>Complete review by end of second quarter 2010.</p>	<p>Discussions with key suppliers underway; no noted impacts to current customers</p>
<p>Control Environment: ICFR</p> <ul style="list-style-type: none"> ▪ For all accounting policy changes identified, assess ICFR design and effectiveness implications. ▪ Implement changes where appropriate. 	<p>Fourth quarter 2009.</p>	<p>Reviewed in conjunction with accounting policies. No substantive changes identified as being required.</p>

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

K-Bro's financial instruments at June 30, 2010 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders and long-term debt. 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.

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

CRITICAL RISKS AND UNCERTAINTIES

As at June 30, 2010, there are no material changes in the Fund's risks or risk management activities since December 31, 2009. The Fund's results of operations, business prospects, financial condition, cash distributions to Unitholders and the trading price of the Fund's units are subject to a number of risks. These risk factors include: dependence on long-term contracts and the associated renewal risk thereof; the effects of market volatility and uncertainty; potential future tax changes; the competitive environment; our ability to acquire and successfully integrate and operate additional businesses; utility costs; the labour markets; the fact that our credit facility imposes numerous covenants and encumbers assets; and, environmental matters.

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

CONTROLS AND PROCEDURES

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

Disclosure Controls and Procedures

As of December 31, 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 six months ended June 30, 2010, no changes were made to internal controls over financial reporting that would have materially affected, or would be reasonably considered to materially affect, these controls.

Internal Controls over Financial Reporting

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

During the six months ended June 30, 2010, 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.

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.