# Management's Discussion & Analysis

## Year Ended December 31, 2013

dependable.

K-Bro Linen Inc.

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

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 Inc. ("the Corporation") for the years ended December 31, 2013 and 2012, as well as the unaudited interim condensed Consolidated Financial Statements for the periods ended March 31, 2013, June 30, 2013 and September 30, 2013. The Corporation and its wholly-owned subsidiaries, including K-Bro Linen Systems Inc., are 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 Directors. All information in this document has been reviewed and approved by the Audit Committee and Board of Directors. This review was performed by management with information available as of March 12, 2014.

In the interest of providing current Shareholders of K-Bro Linen Inc. and potential investors with information regarding current results and future prospects, our public communications often include written or verbal forward-looking statements. Forward-looking statements are disclosures regarding possible events, conditions, or results of operations that are based on assumptions about future economic conditions and courses of action, and include future-oriented financial information.

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; (vii) changing trends in government outsourcing; and (viii) 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) expected impact of labour cost initiatives; and (iii) 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 measures in this document that do not have any standardized meaning as prescribed by IFRS and, therefore, are considered additional GAAP measures. These measures may not be comparable to similar measures presented by other issuers. Please see "*Terminology*" for further discussion.

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# INTRODUCTION

## Core Business

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 eight processing facilities in seven Canadian cities including Victoria, Vancouver, Calgary, Edmonton, Toronto, Montréal and Québec 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.

Our partnerships with healthcare institutions and hospitality clients across Canada demonstrate K-Bro's commitment to build relationships that foster continuous improvement, provide flexibility to adjust to changing circumstances as required and which incorporate incentives, penalties and sharing of risks and rewards as circumstances warrant. As a result, clients across the country have entered into long-term relationships with us, with most having renewed their contracts several times.

In this competitive industry, K-Bro is distinctive in Canada in its ability to deliver products and services that provide value to our customers. 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 in which K-Bro operates exhibits the following characteristics and trends:

> *Stable Industry with Moderate Cyclicality* – As evidenced by the stability in the number of approved hospital beds in the healthcare system and hotel rooms in the hospitality industry. The potential for step-changes in volumes and revenues that align with contractual arrangements exists within this 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* – Healthcare institutions and regional authorities are facing funding pressures and must continually evaluate the allocation of scarce resources. Consequently 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 institutions and hospitality providers 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 30 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. Since 2005, K-Bro has entered four new geographic markets across Canada. 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 and hospitality linen to be processed and the policies of applicable governments.

**Introduce Related Services –** In addition to focusing on its core services, the Corporation also attempts to capitalize on attractive business opportunities by introducing closely-related services that enable it to provide more complete solutions to K-Bro's healthcare and hospitality 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.

## FOURTH QUARTER OVERVIEW

In the fourth quarter of 2013, revenue was $32.3 million which was 2.2% higher than the $31.6 million generated in the comparative quarter of 2012. This year-over-year increase was due to organic growth from new volume and price increases at existing customers across the plants. EBITDA decreased from $5.8 million in Q4, 2012 to $5.4 million in Q4, 2013, this decrease was predominantly a result of the transition costs and reduced productivity during the transition period to transfer operations in Edmonton, partially offset by organic growth and price increases, and a settlement pertaining to disputed development costs in the amount of $0.6 million.

## SELECTED ANNUAL FINANCIAL INFORMATION

| *(thousands, except share and per share amounts)* | **2013** | 2012 | 2011 |
|---|---|---|---|
| Revenue | **$ 131,202** | $ 126,290 | $ 116,859 |
| Earnings before income taxes | **14,509** | 15,324 | 10,888 |
| Net earnings | **10,336** | 11,149 | 7,928 |
| *Net earnings per share:* | | | |
| Basic | **$ 1.47** | $ 1.60 | $ 1.15 |
| Diluted | **$ 1.47** | $ 1.59 | $ 1.14 |
| Total assets | **112,330** | 94,800 | 91,425 |
| Long-term debt | **19,640** | 5,818 | 6,095 |
| Dividends declared to Shareholders | **8,142** | 7,977 | 7,706 |
| Dividends declared to Shareholders per share | **$ 1.15** | $ 1.13 | $ 1.10 |
| *Number of shares outstanding:* | | | |
| Basic | **7,022,699** | 6,981,432 | 6,918,955 |
| Diluted | **7,054,235** | 6,993,561 | 6,980,489 |

## SUMMARY OF 2013 RESULTS AND KEY EVENTS

### Financial Growth

K-Bro delivered strong financial results in 2013 driven by the operating results from all eight of its processing plants. Net earnings were $10.3 million or $1.47 per share (basic). Cash flow from operating activities was $19.2 million and distributable cash flow was $18.4 million. Revenue increased in fiscal 2013 to $131.2 million or by 3.9% compared to 2012. This revenue growth in the year is due to increased volumes arising from new clients including the Saskatchewan Health Region contract and organic volume and price growth in the remainder of the plants. EBITDA (see *Terminology*) decreased in the year to $23.3 million from $24.5 million in 2012, which is a decrease of 4.5%. The EBITDA margin decreased to 17.8% in 2013 compared 19.4% in 2012. Both the EBITDA and EBITDA margin decrease were predominantly a result of the negative impact of the transition to the new Edmonton facility.

## 3sHealth Contract

On December 12, 2013, K-Bro and 3sHealth completed negotiations and executed a 10-year agreement for the provision of laundry and linen processing services for the Province of Saskatchewan. The agreement encompasses a comprehensive linen supply and service program covering general, operating room and specialty linens. Services under the terms and conditions of this contract are expected to commence in 2015. The agreement is renewable for two additional three year periods at 3sHealth's option. Planning and design activities have commenced for the construction of a new processing facility in Regina, Saskatchewan. Expected costs of construction and commissioning of the facility are expected to be approximately $22 million for a leased facility. The Corporation intends to finance the construction through its revolving credit facilities.

## Edmonton Facility Development

During Q4, K-Bro completed construction of the new leased Edmonton facility. Management estimates that the total costs to commission the new facility to be approximately $27.8 million for new efficiency enhancing equipment, leaseholds and conversion costs, with immediate returns anticipated from reduced labour, lower energy consumption and other work-flow improvements. Transition into and start-up of the new facility commenced in Q3 and was completed in Q4. As anticipated, transition costs associated with moving into the new facility were incurred during the quarter and negatively impacted the EBITDA margin.

## Effects of Economic Uncertainty

K-Bro believes that it is positioned to withstand market volatility and uncertainty given that:

- Approximately 69.9% of its revenues in the quarter were from large publicly funded healthcare customers which are geographically diversified across multiple provinces;
- At December 31, 2013, K-Bro had unutilized borrowing capacity of $19.7 million or 49.3% of the revolving credit line available; and,
- K-Bro's prudent approach to managing capital has added cash flow and liquidity to the Corporation, thereby improving its ability to withstand the turmoil in the national and global capital markets.

K-Bro is a participant in the temporary foreign worker ("TFW") program in our facilities where genuine labour shortages exist, predominantly within our Alberta plants. During the year, the federal government reviewed the TFW program and proposed various rule changes. These proposed changes include stricter application requirements, the suspension of accelerated labour market opinions and an end to a provision whereby employers could pay wages lower than the prevailing wage to temporary foreign workers. The proposed rule changes have limited applicability to K-Bro and are not expected to have a material effect on the financial results or operations of the Corporation.

## KEY PERFORMANCE DRIVERS

K-Bro's key performance drivers focus on growth, profitability, stability and cost containment in order to maintain dividends and maximize Shareholder value. The following outlines our results on a period-to-period comparative basis in each of these areas:

| *(thousands, except percentages)* Category | Indicator | **Q4, 2013** | Q4, 2012 | **YTD 2013** | YTD 2012 |
|---|---|---|---|---|---|
| Growth | EBITDA[1] | **-6.2%** | 26.8% | **-4.9%** | 21.8% |
| | Revenue | **2.2%** | 8.3% | **3.9%** | 8.0% |
| | Distributable cash flow | **8.1%** | 14.9% | **-3.5%** | 13.8% |
| Profitability | EBITDA[1] | **$ 5,421** | $ 5,777 | **$ 23,317** | $ 24,517 |
| | EBITDA margin | **16.8%** | 18.3% | **17.8%** | 19.4% |
| | Adjusted EBITDA[2] | **$ 5,421** | $ 5,777 | **$ 24,030** | $ 24,517 |
| | Adjusted EBITDA margin[2] | **16.8%** | 18.3% | **18.3%** | 19.4% |
| | Net earnings | **$ 2,117** | $ 2,758 | **$ 10,336** | $ 11,149 |
| | Adjusted net earnings[3] | **$ 2,117** | $ 2,758 | **$ 10,835** | $ 11,149 |
| Stability | Debt to total capitalization[4] | **21.6%** | 7.9% | **21.6%** | 7.9% |
| | Unutilized line of credit | **$ 19,710** | $ 33,782 | **$ 19,710** | $ 33,782 |
| | Payout ratio | **42.8%** | 45.8% | **44.2%** | 41.8% |
| | Dividends declared per share | **$ 0.288** | $ 0.287 | **$ 1.150** | $ 1.133 |
| Cost containment | Wages and benefits | **46.7%** | 46.1% | **46.4%** | 46.1% |
| | Utilities | **6.6%** | 6.9% | **6.4%** | 6.6% |
| | Expenses included in EBITDA | **83.2%** | 81.7% | **82.2%** | 80.6% |

[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 depreciation and amortization). See *Terminology.*

[2] Adjusted EBITDA is defined as EBITDA (defined above) plus or minus non-recurring, infrequent and/or unusual transactions which did not occur during the preceding two years and are not expected to recur within the next two years. See *Terminology* for a complete description of the adjusted items.

[3] Adjusted net earnings is defined as net earnings plus or minus non-recurring, infrequent and/or unusual transactions net of corporate income taxes which did not occur during the preceding two years and are not expected to recur within the next two years. See *Terminology* for a complete description of the adjusted items.

[4] Debt to total capitalization is defined as total debt divided by total capital. See *Terminology.*

## OUTLOOK

K-Bro's focus is on profitable growth in the years to come as we execute our strategy of expanding geographically and adding new services for our customers. K-Bro is committed to building value for our shareholders, our customers and our employees.

K-Bro also has several proposals pending and has entered into discussions with potential new 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 acquisitions can be stated with any degree of accuracy.

# RESULTS OF OPERATIONS

## Quarterly Financial Information

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

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q4** | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Healthcare revenue | **22,607** | 21,874 | 22,124 | 22,288 | 22,222 | 21,418 | 21,713 | 21,257 |
| Hospitality revenue | **9,737** | 12,677 | 10,536 | 9,359 | 9,364 | 11,595 | 9,813 | 8,908 |
| Total revenue | **32,344** | 34,551 | 32,660 | 31,647 | 31,586 | 33,013 | 31,526 | 30,165 |
| Expenses included in EBITDA | **26,923** | 28,816 | 26,403 | 25,743 | 25,809 | 26,274 | 25,122 | 24,568 |
| EBITDA[(1)] | **5,421** | 5,735 | 6,257 | 5,904 | 5,777 | 6,739 | 6,404 | 5,597 |
| EBITDA as a % of revenue | **16.8%** | 16.6% | 19.2% | 18.7% | 18.3% | 20.4% | 20.3% | 18.6% |
| Adjusted EBITDA[(2)] | **5,421** | 6,448 | 6,257 | 5,904 | 5,777 | 6,739 | 6,404 | 5,597 |
| Depreciation and amortization | **2,304** | 1,887 | 1,940 | 1,974 | 1,924 | 2,283 | 2,263 | 2,207 |
| Financial charges | **176** | 169 | 127 | 123 | (66) | 272 | 67 | 84 |
| Loss (gain) on disposal of equipment | **25** | 5 | 78 | - | 39 | 1 | (10) | 129 |
| Earnings before income taxes | **2,916** | 3,674 | 4,112 | 3,807 | 3,880 | 4,183 | 4,084 | 3,177 |
| Income tax expense | **799** | 1,103 | 1,226 | 1,045 | 1,122 | 1,224 | 1,121 | 708 |
| Net earnings | **2,117** | 2,571 | 2,886 | 2,762 | 2,758 | 2,959 | 2,963 | 2,469 |
| Net earnings as a % of revenue | **6.5%** | 7.4% | 8.8% | 8.7% | 8.7% | 9.0% | 9.4% | 8.2% |
| Basic earnings per share | **0.301** | 0.366 | 0.411 | 0.393 | 0.393 | 0.422 | 0.424 | 0.356 |
| Diluted earnings per share | **0.300** | 0.364 | 0.410 | 0.391 | 0.393 | 0.420 | 0.423 | 0.353 |
| Adjusted net earnings[(3)] | **2,117** | 3,070 | 2,886 | 2,762 | 2,758 | 2,959 | 2,963 | 2,469 |
| Basic adjusted earnings per share[(3)] | **0.301** | 0.437 | 0.411 | 0.393 | 0.393 | 0.422 | 0.424 | 0.356 |
| Diluted adjusted earnings per share[(3)] | **0.300** | 0.435 | 0.410 | 0.391 | 0.393 | 0.420 | 0.423 | 0.353 |
| Total assets | **112,330** | 107,911 | 104,226 | 99,452 | 94,800 | 94,166 | 90,505 | 92,529 |
| Total long-term financial liabilities | **25,619** | 22,515 | 20,794 | 10,442 | 11,023 | 12,830 | 11,963 | 8,795 |
| Funds provided by operations | **6,399** | 5,106 | (1,499) | 9,180 | 7,928 | 6,223 | 5 | 6,653 |
| Long-term debt | **19,640** | 17,028 | 15,338 | 5,162 | 5,818 | 7,787 | 7,113 | 4,000 |
| Dividends declared per share | **0.288** | 0.288 | 0.288 | 0.288 | 0.287 | 0.288 | 0.283 | 0.275 |

(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 depreciation amortization). See *Terminology.*

(2) Adjusted EBITDA is defined as EBITDA (defined above) plus or minus non-recurring, infrequent and/or unusual transactions which did not occur during the preceding two years and are not expected to recur within the next two years. See *Terminology* for a complete description of the adjusted items.

(3) Adjusted net earnings is defined as net earnings plus or minus non-recurring, infrequent and/or unusual transactions net of corporate income taxes which did not occur during the preceding two years and are not expected to recur within the next two years. See *Terminology* for a complete description of the adjusted items.

## Revenue, EBITDA, Adjusted EBITDA and Earnings

For the year ended December 31, 2013, K-Bro's revenue was $131.2 million, compared to $126.3 million in the prior year. This represents a 3.9% increase in revenue and is due to a combination of organic growth and price increases at existing customers across the plants, offset by price concessions as the result of the new contract with AHS in Edmonton. In 2013 approximately 67.8% of K-Bro's revenue was generated from healthcare institutions compared to 68.6% in 2012.

EBITDA was $23.3 million in 2013, compared to $24.5 million in 2012. This 4.9% decrease was predominantly a result of the negative impact on efficiency and productivity as a result of the transfer of operations in Edmonton and the recognition of expenses for the remaining lease payments and decommissioning costs on the former processing facility. This was partially offset by organic growth and price increases from existing customers, and a settlement pertaining to disputed development costs in the amount of $0.6 million. This decline in EBITDA is consistent with the Company's expectations. The transition to the new facility commenced in Q3, 2013 and concluded in Q4.

Adjusted EBITDA, after normalization for the recognition of the remaining lease payments on the former Edmonton processing facility, was $24.0 million for the year compared to $24.5 million in 2012, or a 2.0% decline. Adjusted net earnings decreased to $10.8 million compared to $11.1 million in the comparative year. During the fourth quarter, the EBITDA and net earnings benefited from the settlement with the Landlord, however, the overall detrimental impact of reduced labour efficiencies and productivity and incremental utilities expenses throughout the 2013 fiscal year more than offset the financial benefit of the settlement.

Net earnings decreased in 2013 to $10.3 million from $11.1 million in 2012. Net earnings as a percentage of revenue decreased to 7.9% compared to 8.8% in 2012. This margin decrease is due to a flow through effect of the decrease in the EBITDA.

## Operating Expenses

Wages and benefits increased from $58.2 million in 2012 to $60.9 million in 2013 and increased as a percentage of revenues to 46.4% from 46.1%. Despite the control over labor costs, pressures continue to increase as the economy recovers, employment rates improve and provincially regulated minimum wages increase. Linen expenses increased to $13.8 million from $12.7 million and to 10.5% from 10.0% as a percentage of revenue.

Utility costs slightly decreased from 6.6% in 2012 to 6.4% as a percentage of revenue in 2013. The decrease is as a result of lower market rates in 2013.

Delivery costs have increased to $6.0 million or 4.6% of revenues compared to 4.4% in 2012. The rising cost of diesel fuel has contributed to the increase on a year-over-year basis. Additionally the delivery of linens to Saskatoon Health Region has increased delivery expenses as these services are being performed by the Corporation's Calgary facility. Incremental delivery costs for Saskatoon are offset by additional revenues.

Materials and supplies and repairs and maintenance as a percentage of revenue remained stable in 2013 compared to 2012. During the quarter a $0.3 million charge for estimated decommissioning costs of the former Edmonton facility was recorded to repairs and maintenance expense.

Occupancy costs increased to $4.7 million or 3.6% of revenues compared to $3.9 million and 3.1% in 2012. The increase is mainly attributable to the recognition of a liability and corresponding expense of $0.7 million for the remaining lease payments that relate to decommissioned facilities as well as increased lease costs of the new Edmonton processing plant. In the fourth quarter a settlement pertaining to disputed development costs was reached and a rental credit of $0.6 million was recorded as a reduction of occupancy costs.

Corporate costs increased in 2013 by $0.3 million over the comparative period of 2013 and remained constant as a percentage of revenues at approximately 4.1%. The increase in corporate costs is due increases in legal and consulting fees as well as the long term incentive compensation plan.

Depreciation of property, plant and equipment and amortization of intangible assets 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. Depreciation of property, plant and equipment and amortization of intangibles assets has decreased from the comparable period in 2012 primarily due to the full depreciation of assets that related to the previous Edmonton facility, prior to the move to the new Edmonton facility. Depreciation of the newly commissioned facility in Edmonton commenced in November 2013.

Income tax includes current and deferred income taxes based on taxable income and the temporary timing differences between the tax and accounting bases of assets and liabilities. The Corporation's effective tax rate increased to approximately 28.8% of net earnings from 27.2% in 2012. This increase was a result of an increase in the statutory rate from 25.3% to 25.6% as well as an increase in non-deductible expenses.

## LIQUIDITY AND CAPITAL RESOURCES

In 2013 cash generated by operating activities was $19.2 million, compared to cash generated by operating activities of $20.8 million in 2012. The change in cash from operations is due to the decrease in earnings offset by smaller changes in other operating accounts.

During 2013, cash generated from financing activities amounted to $5.7 million compared to $8.2 million used in 2012 mainly attributable to the purchase of property, plant and equipment for the new Edmonton facility. Financing activities in 2013 included $13.8 million in net proceeds of long term debt and $8.1 million in dividends paid to Shareholders.

The Corporation used cash of $24.9 million in investing activities during 2013 compared to $12.7 million in 2012. The increase in cash used in investing activities is driven by the purchase of property, plant and equipment primarily for existing operations and the new Edmonton facility.

### Contractual Obligations

At December 31, 2013, payments due under contractual obligations for the next five years and thereafter are as follows:

| *(thousands)* | Payments due by Period | | | | | |
|---|---|---|---|---|---|---|
| | | Total | < 1 Year | 1 - 3 Years | 4 - 5 Years | > 5 Years |
| Long-term debt | $ | 19,640 | - | 19,640 | - | - |
| Operating leases and utility commitments | $ | 27,727 | 4,343 | 7,426 | 3,122 | 12,836 |
| Linen purchase obligations | $ | 3,562 | 3,562 | - | - | - |
| Property, plant and equipment commitments | $ | 22,066 | 4,246 | 17,820 | - | - |

Scheduled lease payments for 2014 are expected to be $4.3 million. The operating lease obligations are secured by automotive equipment and are more fully described in the audited annual consolidated financial statements. The source of funds for these commitments will be from operating cash flow and, if necessary, the undrawn portion of the revolving credit facility.

### Financial Position

| *(thousands, except percentages)* | | 2013 | | 2012 |
|---|---|---|---|---|
| Long-term debt | $ | 19,640 | $ | 5,818 |
| Shareholders' equity | | 71,116 | | 67,685 |
| Total capitalization | $ | 90,756 | $ | 73,503 |
| Debt to total capitalization (see *Terminology* for definition) | | 21.6% | | 7.9% |

For the year ended December 31, 2013, the Corporation had a payout ratio (see *Terminology*) of 44.2%, a debt to total capitalization of 21.6%, an unused revolving credit facility of $19.7 million and has not incurred any events of default under the terms of its credit facility agreement.

As at December 31, 2013, the Corporation had net working capital of $9.4 million compared to its working capital position of $8.1 million at December 31, 2012.

Management believes that K-Bro has the capital resources and liquidity necessary to meet its commitments, support its operations and finance its growth strategies. In addition to K-Bro's ability to generate cash from operations and its revolving credit facility, K-Bro may also be able to access equity financing, depending upon pricing and availability, for capital spending to sustain its property, plant and equipment.

## DIVIDENDS

| Fiscal Period | Payment Date | # of Shares outstanding | 2013 Amount per Share | 2013 Total Amount[2] | 2012 Amount per Share | 2012 Total Amount[1] |
|---|---|---|---|---|---|---|
| January | February 15 | 7,055,207 | $ 0.09580 | $ 676 | $ 0.09167 | $ 642 |
| February | March 15 | 7,055,207 | 0.09580 | 676 | 0.09167 | 642 |
| March | April 13 | 7,055,207 | 0.09580 | 676 | 0.09167 | 642 |
| Q1 | | | $ 0.28741 | $ 2,028 | $ 0.27501 | $ 1,927 |
| April | May 15 | 7,055,207 | $ 0.09580 | $ 676 | $ 0.09167 | $ 642 |
| May | June 15 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| June | July 13 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| Q2 | | | $ 0.28741 | $ 2,036 | $ 0.28328 | $ 1,994 |
| July | August 15 | 7,095,343 | $ 0.09580 | $ 680 | $ 0.09580 | $ 676 |
| August | September 15 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| September | October 15 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| Q3 | | | $ 0.28741 | $ 2,039 | $ 0.28741 | $ 2,028 |
| October | November 15 | 7,095,343 | $ 0.09580 | $ 680 | $ 0.09580 | $ 676 |
| November | December 14 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| December | January 15 | 7,095,343 | 0.09580 | 680 | 0.09580 | 676 |
| Q4 | | | $ 0.28741 | $ 2,039 | $ 0.28741 | $ 2,028 |
| YTD | | | $ 1.15 | $ 8,142 | $ 1.13 | $ 7,977 |

(1) - The total amount of dividends paid was $0.09167 per share for a total of $642,273 per month for Jan- Apr 2012; when rounded in thousands $1,927 of dividends were paid for the quarterly period.

(2) - The total amount of dividends paid was $0.09580 per share for a total of $679,734 per month for May - Dec 2013; when rounded in thousands $2,039 of dividends were paid for each of the quarterly periods, respectively.

For the year ended December 31, 2013, the Corporation distributed $1.15 per share compared with $2.61 per diluted share of Distributable Cash (see *Terminology*). The actual payout ratio was 44.2%.

The Corporation's policy is to pay dividends to Shareholders from its available distributable cash flow while considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Directors of the Corporation. All such dividends are discretionary. Dividends are declared payable each month in equal amounts to Shareholders on the last business day of each month and are paid by the 15th of the following month.

The Corporation designates all dividends paid or deemed to be paid as Eligible Dividends for purposes of subsection 89(14) of the Income Tax Act (Canada), and similar provincial and territorial legislation, unless indicated otherwise.

## DISTRIBUTABLE CASH FLOW *(see Terminology)*

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

The Corporation's source of cash for dividends is distributable cash flow provided by operating activities. Distributable cash flow, reconciled to cash provided by operating activities as calculated under IFRS, is presented as follows:

| *(thousands, except per share amounts and percentages)* | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q4** | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Cash provided by operating activities | **$ 6,399** | $ 5,106 | $ (1,499) | $ 9,180 | $ 7,928 | $ 6,223 | $ 5 | $ 6,653 |
| *Deduct (add):* | | | | | | | | |
| Net changes in non-cash working capital items[1] | **1,201** | 332 | (6,956) | 4,049 | 2,866 | 598 | (5,544) | 1,659 |
| Share-based compensation expense[2] | **261** | 279 | 377 | 320 | 176 | 177 | 250 | 502 |
| Maintenance capital expenditures[3] | **180** | 293 | 240 | 173 | 486 | 168 | 232 | 134 |
| Distributable cash flow | **$ 4,757** | $ 4,202 | $ 4,840 | $ 4,638 | $ 4,400 | $ 5,280 | $ 5,067 | $ 4,358 |
| Distributable cash flow per weighted average diluted shares outstanding | **$ 0.673** | $ 0.596 | $ 0.688 | $ 0.657 | $ 0.624 | $ 0.750 | $ 0.719 | $ 0.622 |
| Dividends declared | **2,039** | 2,039 | 2,036 | 2,028 | 2,028 | 2,028 | 1,994 | 1,927 |
| Dividends declared per share | **0.288** | 0.288 | 0.288 | 0.288 | 0.287 | 0.288 | 0.283 | 0.275 |
| Payout ratio[4] | **42.8%** | 48.4% | 41.9% | 43.9% | 46.1% | 38.3% | 39.4% | 44.2% |
| Weighted average shares outstanding during the period, basic | **7,031** | 7,031 | 7,020 | 7,019 | 7,007 | 7,007 | 6,979 | 6,932 |
| Weighted average shares outstanding during the period, diluted | **7,065** | 7,055 | 7,038 | 7,054 | 7,019 | 7,040 | 7,009 | 7,003 |
| **Trailing-twelve months ("TTM")** | | | | | | | | |
| Distributable cash flow | **18,437** | 18,080 | 19,158 | 19,358 | 19,105 | 18,535 | 18,535 | 17,358 |
| Dividends | **8,142** | 8,131 | 8,120 | 8,077 | 7,977 | 7,876 | 7,774 | 7,706 |
| Payout ratio[3] | **44.2%** | 45.0% | 42.5% | 41.7% | 41.8% | 42.5% | 42.0% | 44.4% |

[1] 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 flow calculation.

[2] Share-based compensation expenses have historically been excluded from the calculation of distributable cash flow. Previously the share-based compensation was recorded as part of the net changes in non-cash working capital items, however the amount has been disclosed separately commencing in Q4, 2012. The comparative figures for the quarterly periods as presented have been restated to reflect this revised presentation.

[3] Maintenance capital expenditures includes costs required to maintain or replace assets which do not have a discrete return on investment.

[4] The ratio of dividends paid compared to distributable cash flow is periodically reviewed by the Board of Directors to take into account the current and prospective performance of the business and other items considered to be prudent. Payout ratio is calculated on the dividends declared per share divided by the distributable cash flow per weighted average diluted shares outstanding.

## OUTSTANDING SHARES

At December 31, 2013, the Corporation had 7,095,343 common shares outstanding. Basic and diluted weighted average number of common shares outstanding for 2013 were 7,022,699 and 7,054,235 respectively, (6,981,432 and 6,993,561, respectively for the comparative 2012 periods).

In accordance with the LTI plan and in conjunction with the performance of the Corporation in the 2012 fiscal year, on April 24, 2013 the Compensation, Nominating and Corporate Governance Committee of the Board of Directors approved LTI compensation of $1.5 million (2012 – $1.2 million) to be paid as shares issued from treasury. As at December 31, 2013, the market value of the shares held in trust by the LTI trustee was $2.5 million (December 31, 2012 – $1.4 million) which was comprised of 63,604 in unvested common shares (December 31, 2012 – 48,191) with a nil aggregate cost (December 31, 2012 – $0.3 million).

As at March 12, 2014, there were 7,095,343 common shares issued and outstanding.

## RELATED PARTY TRANSACTIONS

The Corporation incurred expenses in the normal course of business for advisory consulting services provided by Mr. Matthew Hills, a director of the Corporation, 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, 2013, the Corporation incurred fees totaling $138,000 (2012 – $138,000).

## CRITICAL ACCOUNTING ESTIMATES

The Corporation's summary of significant accounting policies are contained in note 2 to the audited consolidated financial statements.

The Corporation's financial statements include estimates and assumptions made by management in respect of operating results, financial conditions, contingencies, commitments, and related disclosures. Actual results may vary from these estimates. The following are, in the opinion of management, the Corporation's most critical accounting estimates, being those that involve the most difficult, subjective and complex judgments, and/or requiring estimates that are inherently uncertain and which may change in subsequent reporting periods.

K-Bro has continuously refined and documented its management and internal reporting systems to ensure that accurate, timely, internal and external information is gathered and disseminated. Management also regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances.

K-Bro has hired individuals and consultants who have the skills required to make such estimates and ensures that individuals or departments with the most knowledge of the activity are responsible for the estimates. Furthermore, past estimates are reviewed and compared to actual results, and actual results are compared to budgets in order to make more informed decisions on future estimates.

K-Bro's leadership team's mandate includes ongoing development of procedures, standards and systems to allow K-Bro staff to make the best decisions possible and ensuring those decisions are in compliance with the Corporation's policies.

Preparation of the Corporation's consolidated financial statements requires management to make estimates and assumptions that affect:

- volume rebates;
- linen in service;
- intangible assets;
- goodwill;
- income taxes;
- provisions; and,
- allowance for doubtful accounts.

**Volume Rebates**

The Corporation earns revenue from linen management and laundry services 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 reasonable that the criteria 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.

**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.

**Intangible Assets**

The Corporation accounts for intangible assets and goodwill in accordance with IFRS 3, *Business Combinations* and IAS 38, *Intangible Assets*. In a business combination, K-Bro may acquire the assets and assume certain liabilities of an acquired entity. The allocation of the purchase price for these transactions involves judgment in determining the fair values assigned to the tangible and intangible assets acquired and the liabilities assumed on the acquisition. The determination of these fair values involves a variety of assumptions, including revenue growth rates, expected operating income, discount rates, and earnings multiples. If K-Bro's estimates or assumptions change prior to finalizing the purchase price allocation for a transaction, a revision to the purchase price allocation or the carrying value of the related assets and liabilities acquired may impact our net income in future periods.

The Corporation early adopted the amendment to IAS 36 that removed the requirement to disclose the recoverable amount of CGU's with significant carrying amounts of goodwill.

At the date of the acquisition, K-Bro must estimate the value of acquired intangible assets that do not have a well defined market value, such as the value of customer lists and relationships and non-competition agreements.

Valuing these assets involves estimates of the future net benefit to K-Bro and the useful life of such benefits and is based upon various internal and external factors. A change in those estimates could cause a material change to the value of the intangible assets.

Although intangible assets are amortized over their useful life, if the estimated value of an intangible asset has declined below its amortized book value, a write-down would be recorded in the period in which the event causing the decline in value occurred, which would increase amortization expense and decrease the intangible assets balance. At this time, K-Bro does not believe any intangible assets have a book value in excess of their fair market value.

# TERMINOLOGY

## *Additional 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 dividends to Shareholders. 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, loss on disposal and impairment charges, and income taxes.

EBITDA is not a calculation based on IFRS 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.

| | Three Months Ended December 31, | | Year Ended December 31, | |
|---|---|---|---|---|
| *(thousands)* | **2013** | 2012 | **2013** | 2012 |
| Net earnings | **$ 2,117** | $ 2,758 | **$ 10,336** | $ 11,149 |
| *Add:* | | | | |
| Income tax expense | **799** | 1,122 | **4,173** | 4,175 |
| Interest expense and financial charges, net | **176** | (66) | **595** | 357 |
| Depreciation of property, plant and equipment | **1,774** | 1,617 | **5,965** | 6,350 |
| Amortization of intangible assets | **530** | 307 | **2,140** | 2,327 |
| Loss on disposal of property, plant and equipment | **25** | 39 | **108** | 159 |
| **EBITDA** | **$ 5,421** | $ 5,777 | **$ 23,317** | $ 24,517 |

## *Non-GAAP Measures*

### Adjusted EBITDA

*Adjusted EBITDA* is a measure which has been reported in order to assist in the comparison of historical EBITDA to current results. The calculation of Adjusted EBITDA normalizes the impact of non-recurring infrequent and/or unusual transactions which did not occur during the preceding two years and are not expected to recur within the next two years, and the related impact on EBITDA (as defined above). During the third quarter ended September 30, 2013, a charge equivalent to the remaining lease payments for decommissioned facilities was recognized as occupancy costs. The normalization of this expense from the calculation of EBITDA is considered by Management to be a more accurate representation of continuing operations.

| (thousands) | Three Months Ended December 31, 2013 | 2012 | Year Ended December 31, 2013 | 2012 |
|---|---|---|---|---|
| EBITDA | **$ 5,421** | $ 5,777 | **$ 23,317** | $ 24,517 |
| *Add:* | | | | |
| Occupancy expense of decommissioned facilities | **-** | - | **713** | - |
| **Adjusted EBITDA** | **$ 5,421** | $ 5,777 | **$ 24,030** | $ 24,517 |

## Adjusted Net Earnings and Adjusted Net Earnings per Share

*Adjusted net earnings* and *adjusted net earnings per share* are measures which have been reported in order to assist in the comparison of historical net earnings to current results. The calculation of Adjusted net earnings normalizes the impact of non-recurring infrequent and/or unusual transactions net of corporate income taxes which did not occur during the preceding two years and are not expected to recur within the next two years, and the related impact on net earnings and net earnings per share. The normalization of this net expense in the calculation of adjusted net earnings and adjusted net earnings per share is considered by management to be a more accurate representation of the net earnings from continuing operations.

| (thousands) | Three Months Ended December 31, 2013 | 2012 | Year Ended December 31, 2013 | 2012 |
|---|---|---|---|---|
| Net earnings | **$ 2,117** | $ 2,758 | **$ 10,336** | $ 11,149 |
| *Add/(deduct), net of corporate income taxes:* | | | | |
| Occupancy expense of decommissioned facilities | **-** | - | **499** | - |
| Adjusted net earnings | **$ 2,117** | $ 2,758 | **$ 10,835** | $ 11,149 |
| | | | | |
| Adjusted net earnings, per share: | | | | |
| Basic | **$ 0.30** | $ 0.39 | **$ 1.54** | $ 1.60 |
| Diluted | **$ 0.30** | $ 0.39 | **$ 1.54** | $ 1.59 |

## Distributable Cash Flow

Distributable cash flow is a measure used by management to evaluate its performance. While the closest IFRS measure is cash provided by operating activities, distributable cash flow is considered relevant because it provides an indication of how much cash generated by operations is available after capital expenditures. It shall be noted that although we consider this measure to be distributable cash flow, financial and non-financial covenants in our credit facilities and dealer agreements may restrict cash from being available for dividends, re-investment in the Corporation, potential acquisitions, or other purposes. Investors should be cautioned that distributable cash flow may not actually be available for growth or distribution from the Corporation. References to “Distributable cash flow” are to cash provided by (used in) operating activities (including the net change in non-cash working capital balances) less capital expenditures.

### Payout Ratio

*Payout ratio* is defined by management as the actual cash dividend divided by distributable cash. This is a key measure used by investors to value K-Bro, assess its performance and provide an indication of the sustainability of dividends. The payout ratio depends on the distributable cash and the Corporation's dividend policy.

### Debt to Total Capitalization

*Debt to total capitalization* is defined by management as the total long-term debt divided by the Corporation's total shareholder's equity. This is a measure used by investors to assess the Corporation's financial structure.

Distributable Cash Flow, Payout Ratio, Debt to Total Capitalization, Adjusted EBITDA, Adjusted net earnings, and Adjusted net earnings per share are not calculations based on IFRS and are not considered an alternative to IFRS measures in measuring K-Bro's performance. Distributable Cash Flow, Payout Ratio, Adjusted EBITDA, Adjusted net earnings, and Adjusted net earnings per share do not have standardized meanings in IFRS and are therefore not likely to be comparable with similar measures used by other issuers.

### Off Balance Sheet Arrangements

As at December 31, 2013, the Corporation has not entered into any off balance sheet arrangements.

## CHANGES IN ACCOUNTING POLICIES

The Corporation has prepared its December 31, 2013 audited Consolidated Financial Statements in accordance with IFRS. See note 2 of the Corporation's audited Consolidated Financial Statements for more information regarding the significant accounting principles used to prepare the audited Consolidated Financial Statements.

The Corporation has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

- IFRS 10, *Consolidated Financial Statements*, replaces the guidance on control and consolidation in IAS 27, *Consolidated and Separate Financial Statements*, and SIC-12, *Consolidation - Special Purpose Entities*. IFRS 10 requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. Detailed guidance is provided on applying the definition of control. The accounting requirements for consolidation have remained largely consistent with IAS 27. The Corporation assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.
- IFRS 12, *Disclosures of interests in other entities* includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, structured entities and other off balance sheet vehicles.
- IFRS 13, *Fair value measurement*, provides a single framework for measuring fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the assets or liability under current market conditions, including assumptions about risk. The Corporation adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS did not require any adjustments to valuation techniques used by the Corporation to measure fair value and did not result in any measurement adjustments as at January 1, 2013.
- IAS 36, Amendment, *Impairment of Assets*, removes the requirement to disclose the recoverable amount of CGU's with significant carrying amounts of goodwill. The Corporation has early adopted this amendment on January 1, 2013.

# RECENT ACCOUNTING PRONOUNCMENTS

There are no changes in accounting standards applicable to future periods that are relevant and significant to the Corporation other than as disclosed in the most recent audited Consolidated Financial Statements as at and for the year ended December 31, 2013.

# FINANCIAL INSTRUMENTS

K-Bro's financial instruments at December 31, 2013 consist of accounts receivable, accounts payable and accrued liabilities and long-term debt. The Corporation 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 typically 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 on foreign currency, utilities and textiles or option contracts.

# CRITICAL RISKS AND UNCERTAINTIES

As at December 31, 2013, there are no material changes in the Corporation's risks or risk management activities since December 31, 2012. The Corporation's results of operations, business prospects, financial condition, cash dividends to Shareholders and the trading price of the Corporation's Shares 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 Corporation Shares, see *Risk Factors – Risks Related to K-Bro and the Laundry and Linen Industry* detailed in the Corporation'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 ("CEO") and the Vice-President and Chief Financial Officer ("CFO"), are responsible for establishing and maintaining disclosure controls and procedures, as well as internal control over financial reporting.

## Disclosure Controls and Procedures

The Corporation has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements of K-Bro was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Corporation's CEO and CFO have evaluated the effectiveness of these disclosure controls and procedures for the year ended December 31, 2013, and the CEO and CFO have concluded that these controls were operating effectively.

## Internal Controls over Financial Reporting

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"). Consequently the CEO and CFO confirm that the additions to these controls that occurred during the year ended December 31, 2013 did not materially affect, or are reasonably likely to materially affect, the Corporation's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2013, the CEO and CFO have concluded that these controls were operating effectively.

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.

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Additional information regarding K-Bro including required securities filings are available on our website at www.k-brolinen.com and on the Canadian Securities Administrators' website at www.sedar.com; the System for Electronic Document Analysis and Retrieval ("SEDAR").

Vous pouvez obtenir des renseignements supplémentaires sur la Société, y compris les documents déposés auprès des autorités de réglementation, sur notre site Web, au www.k-brolinen.com et sur le site Web des autorités canadiennes en valeurs mobilières au www.sedar.com, le site Web du Système électronique de données, d'analyse et de recherche (« SEDAR »).