



**K-BRO LINEN INCOME FUND**

**UNAUDITED INTERIM  
CONSOLIDATED FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2010 AND 2009**

# K-Bro Linen Income Fund

## Consolidated Balance Sheets

	September 30, 2010 (Unaudited)	December 31, 2009
<b>ASSETS</b>		
<b>Current assets</b>		
Accounts receivable	\$13,071,096	\$9,450,990
Linen in service	7,735,049	7,304,877
Prepaid expenses and deposits	1,198,102	1,212,988
Future income taxes	-	448,920
	<u>22,004,247</u>	<u>18,417,775</u>
<b>Restricted escrow funds</b> (Note 4)	250,000	-
<b>Property, plant and equipment</b>	34,799,243	33,583,038
<b>Intangible assets</b> (Note 4)	15,829,789	14,594,973
<b>Goodwill</b> (Note 4)	<u>20,048,628</u>	<u>16,220,250</u>
	<u>\$92,931,907</u>	<u>\$82,816,036</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$13,121,809	\$9,880,299
Distribution payable to Unitholders	642,146	642,146
Future income taxes	<u>513,250</u>	<u>-</u>
	14,277,205	10,522,445
<b>Long-term debt</b> (Note 5)	11,097,490	4,043,068
<b>Unamortized lease inducements</b>	576,940	610,547
<b>Future income taxes</b>	<u>3,138,774</u>	<u>3,846,961</u>
	<u>29,090,409</u>	<u>19,023,021</u>
<b>Contingencies and commitments</b> (Note 6)		
<b>UNITHOLDERS' EQUITY</b>		
<b>Exchangeable shares</b> (Note 7b)	724,110	724,110
<b>Fund Units</b> (Note 7b)	70,675,516	70,675,516
<b>Fund Units held in trust by LTIP</b>	(1,600,938)	(834,137)
<b>Contributed surplus</b> (Note 7c)	1,020,034	572,376
<b>Deficit</b>	(6,991,820)	(7,309,840)
<b>Accumulated other comprehensive income (loss)</b> (Note 7d)	<u>14,596</u>	<u>(35,010)</u>
	<u>63,841,498</u>	<u>63,793,015</u>
	<u>\$92,931,907</u>	<u>\$82,816,036</u>

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

# K-Bro Linen Income Fund

## Consolidated Statements of Earnings and Deficit (Unaudited)

	Three months ended Sept 30,		Nine months ended Sept 30,	
	2010	2009	2010	2009
<b>Revenue</b>	<u>\$27,498,209</u>	<u>\$22,659,028</u>	<u>\$77,331,483</u>	<u>\$65,898,373</u>
<b>Expenses</b>				
Wages and benefits	12,731,147	10,291,687	35,501,138	29,713,610
Linen	2,698,299	2,568,886	7,817,242	7,686,722
Utilities	2,142,246	1,528,325	6,177,294	4,655,949
Delivery	991,838	852,459	2,893,150	2,430,003
Occupancy costs	940,691	759,381	2,820,758	2,208,377
Materials and supplies	910,100	786,604	2,779,813	2,368,815
Repairs and maintenance	913,055	818,083	2,587,079	2,356,747
Corporate	1,243,478	915,853	3,595,886	2,737,601
	<u>22,570,854</u>	<u>18,521,278</u>	<u>64,172,360</u>	<u>54,157,824</u>
<b>Earnings before the undernoted</b>	<u>4,927,355</u>	<u>4,137,750</u>	<u>13,159,123</u>	<u>11,740,549</u>
<b>Other expenses</b>				
Amortization of property, plant and equipment	(1,418,475)	(1,345,539)	(4,277,447)	(4,029,356)
Amortization of intangible assets	(640,667)	(539,285)	(1,899,118)	(1,617,855)
Financial charges	(173,668)	(60,383)	(489,205)	(214,947)
Loss on disposal of property, plant and equipment	(104,729)	(362)	(161,350)	(3,679)
	<u>(2,337,539)</u>	<u>(1,945,569)</u>	<u>(6,827,120)</u>	<u>(5,865,837)</u>
<b>Earnings before income taxes</b>	2,589,816	2,192,181	6,332,003	5,874,712
<b>Income tax expense</b>	<u>(229,158)</u>	<u>(96,617)</u>	<u>(234,670)</u>	<u>(19,579)</u>
<b>Net earnings for the period</b>	2,360,658	2,095,564	6,097,333	5,855,133
<b>Deficit - beginning of period</b>	(7,426,040)	(7,499,272)	(7,309,840)	(7,405,966)
Distributions to Unitholders (Note 8)	<u>(1,926,438)</u>	<u>(1,926,438)</u>	<u>(5,779,313)</u>	<u>(5,779,313)</u>
<b>Deficit - end of period</b>	<u>\$(6,991,820)</u>	<u>\$(7,330,146)</u>	<u>\$(6,991,820)</u>	<u>\$(7,330,146)</u>
<b>Net earnings per Unit:</b>				
Basic	<u>\$0.34</u>	<u>\$0.30</u>	<u>\$0.88</u>	<u>\$0.84</u>
Diluted	<u>\$0.34</u>	<u>\$0.30</u>	<u>\$0.87</u>	<u>\$0.83</u>
<b>Weighted average number of Units outstanding:</b>				
Basic	<u>6,891,583</u>	<u>6,929,824</u>	<u>6,910,245</u>	<u>6,950,274</u>
Diluted	<u>6,970,893</u>	<u>6,994,005</u>	<u>6,996,292</u>	<u>7,014,454</u>

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

# K-Bro Linen Income Fund

## Consolidated Statements of Comprehensive Income (Unaudited)

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	Three months ended Sept 30,		Nine months ended Sept 30,	
	2010	2009	2010	2009
<b>Net earnings for the period</b>	\$2,360,658	\$2,095,564	\$6,097,333	\$5,855,133
<b>Other comprehensive income</b>				
Gain (loss) on derivative instruments designated as cash flow hedges, net of future income taxes of NIL (nine months ended September 30, 2010 - (\$19,316); three months ended September 30, 2009 -\$2,113; nine months ended September 30, 2009 - (\$20,193))	<u>-</u>	<u>(5,527)</u>	<u>49,606</u>	<u>52,159</u>
<b>Other comprehensive income for the period</b>	<u>-</u>	<u>(5,527)</u>	<u>49,606</u>	<u>52,159</u>
<b>Comprehensive income for the period</b>	<u>\$2,360,658</u>	<u>\$2,090,037</u>	<u>\$6,146,939</u>	<u>\$5,907,292</u>

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

# K-Bro Linen Income Fund

## Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended Sept 30,		Nine months ended Sept 30,	
	2010	2009	2010	2009
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net earnings for the period	\$2,360,658	\$2,095,564	\$6,097,333	\$5,855,133
Items not affecting cash				
Amortization of property, plant and equipment	1,418,475	1,345,539	4,277,447	4,029,356
Amortization of intangible assets	640,667	539,285	1,899,118	1,617,855
Amortization of lease inducements	(5,491)	(14,058)	(33,607)	(42,174)
Loss on disposal of property, plant and equipment	104,729	362	161,350	3,679
Future income taxes	229,158	96,617	234,670	19,579
	<u>4,748,196</u>	<u>4,063,309</u>	<u>12,636,311</u>	<u>11,483,428</u>
Net change in non-cash working capital items (Note 9)	<u>431,750</u>	<u>1,504,950</u>	<u>911,786</u>	<u>(3,172,200)</u>
Cash provided by operating activities	<u>5,179,946</u>	<u>5,568,259</u>	<u>13,548,097</u>	<u>8,311,228</u>
<b>Financing activities</b>				
Increase (decrease) in long-term debt – revolving line of credit	(2,738,632)	(1,627,584)	7,054,422	1,045,682
Distributions paid to Unitholders	<u>(1,926,438)</u>	<u>(1,926,438)</u>	<u>(5,779,313)</u>	<u>(5,779,313)</u>
Cash provided by (used in) financing activities	<u>(4,665,070)</u>	<u>(3,554,022)</u>	<u>1,275,109</u>	<u>(4,733,631)</u>
<b>Investing activities</b>				
Purchase of property, plant and equipment	(529,985)	(2,014,237)	(1,994,015)	(3,584,097)
Proceeds from disposal of property, plant and equipment	12,562	-	16,882	6,500
Purchase of intangibles	2,547	-	(233,934)	-
Business acquisition	-	-	(12,362,139)	-
Escrow funds	<u>-</u>	<u>-</u>	<u>(250,000)</u>	<u>-</u>
Cash used in investing activities	<u>(514,876)</u>	<u>(2,014,237)</u>	<u>(14,823,206)</u>	<u>(3,577,597)</u>
<b>Change in cash</b>	-	-	-	-
<b>Cash – beginning of period</b>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Cash – end of period</b>	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>	<u>\$-</u>
<b>Supplementary cash flow information</b>				
Interest paid	<u>\$110,448</u>	<u>\$85,622</u>	<u>\$359,969</u>	<u>\$244,256</u>
<b>Non-cash financing and investing activities</b>				
Equipment purchases included in accounts payable and accrued liabilities	<u>\$357,508</u>	<u>\$459,298</u>	<u>\$357,508</u>	<u>\$459,298</u>

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

# **K-Bro Linen Income Fund**

## **Notes to the Interim Consolidated Financial Statements (Unaudited)**

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### **1 Business description**

K-Bro Linen Income Fund (the "Fund") is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc. K-Bro Linen Systems Inc. provides a range of services to healthcare institutions, hotels and other commercial accounts. These services include the processing, management and distribution of linen.

### **2 Basis of presentation**

These accompanying unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") for interim financial statements. The accounting principles and methods of computation adopted in these financial statements are the same as those of the audited consolidated financial statements for the fiscal year ended December 31, 2009. However, these interim unaudited consolidated financial statements do not include all information and disclosures required under GAAP for annual financial statements. Accordingly, these unaudited consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009.

### **3 Adoption of new accounting policies**

#### **Business combinations**

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

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

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 3 Adoption of new accounting policies (continued)

#### Consolidated Financial Statements and Non-controlling Interests

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

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

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

### 4 Business acquisition

On January 29, 2010, the Fund completed the asset acquisition of the laundry business, linen, certain working capital and equipment of a plant located in Greater Vancouver, British Columbia. The business acquisition has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the net assets acquired at January 29, 2010. The allocation was based on management's best estimate of the fair value of net assets acquired. The purchase price allocations are preliminary and are subject to change once the final valuations are completed and the final determination of the costs related to the acquisition have been made. The acquisition was funded through the Fund's revolving credit facility.

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

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

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 4 Business acquisition (continued)

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

During the third quarter of 2010, the Fund incurred no additional acquisition costs. All of the goodwill acquired in the transaction is deductible for tax purposes.

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

### 5 Long-term debt

	Sept 30, 2010	Dec 31, 2009
Bankers' Acceptance, interest at BA 30 day rates plus 2.5% depending on certain financial ratios, due October 20, 2010	\$4,000,000	\$4,000,000
Prime rate loan, secured with a general security agreement, interest at prime plus 1.0% depending on certain financial ratios, monthly repayment of interest only, maturing on June 30, 2012	<u>7,097,490</u>	<u>43,068</u>
	<u>\$11,097,490</u>	<u>\$4,043,068</u>

Interest expense of \$356,587 (September 30, 2009 - \$244,256) on the Bankers' Acceptance and prime rate loan are included in finance costs.

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



# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 6 Contingencies and commitments

#### a) Contingencies

##### Letters of credit

The Fund has an outstanding letter of credit issued as part of normal business operations in the amount of \$250,000 (2009 – \$250,000) expiring January 24, 2011.

#### b) Commitments

##### Operating leases and utility commitments

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

Remainder of 2010	\$ 771,606
2011	5,077,973
2012	4,294,183
2013	2,064,579
2014	1,392,781
Subsequent	2,632,638
	<u>\$16,233,760</u>

##### Linen purchase commitments

At September 30, 2010, the Fund was committed to linen expenditure obligations in the amount of \$1,444,861 (December 31, 2009 – \$1,898,431).

##### Capital equipment commitments

At September 30, 2010, the Fund was committed to capital expenditure obligations in the amount of \$908,290 (December 31, 2009 – \$nil).

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 7 Unitholders' equity

a) Authorized

The declaration of trust provides that an unlimited number of Units and an unlimited number of Special Trust Units may be issued.

b) Issued and outstanding

<b>Fund Units</b>	<b>Units</b>	<b>\$</b>
Balance at September 30, 2010 and December 31, 2009	<u>6,932,562</u>	<u>\$70,675,516</u>
<b>Exchangeable shares</b>		
Balance at September 30, 2010 and December 31, 2009	<u>72,411</u>	<u>\$724,110</u>
Total Fund Units and Exchangeable shares issued	<u>7,004,973</u>	

The exchangeable shares were issued by the Fund's subsidiary to certain members of management and are exchangeable on a one-to-one basis for Fund Units. The risks and privileges of these shares are the same as for Fund Units. Special Trust Units are attached to and issued in conjunction with Exchangeable Shares for the sole purpose of entitling holders thereof to voting rights at any meeting of holders of Fund Units and Special Trust Units.

c) Contributed surplus

	<b>Sept 30, 2010</b>	<b>Dec 31, 2009</b>
Balance, beginning of period	\$572,376	\$340,728
Net equity based compensation recorded	1,075,070	650,730
Issuance of vested Units to participants	<u>(627,412)</u>	<u>(419,082)</u>
Balance, end of period	<u>\$1,020,034</u>	<u>\$572,376</u>

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 7 Unitholders' equity (continued)

d) Accumulated other comprehensive income (loss)

	Sept 30, 2010	Dec 31, 2009
Balance, beginning of period	\$(35,010)	\$(111,740)
Other comprehensive income during the period	<u>49,606</u>	<u>76,730</u>
Balance, end of period	<u>\$14,596</u>	<u>\$(35,010)</u>

### 8 Distributions to Unitholders

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

Distributions declared during the nine months ended September 30, 2010 were at the rate of \$0.09167 per Unit per month (\$1.10 per Unit annualized) for a total declared distribution of \$5,779,313 (nine months ended September 30, 2009 - \$5,779,313).

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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

	<b>Three months ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash provided (used) by changes in</b>		
Accounts receivable	\$(1,863,101)	\$393,408
Linen in service	209,068	85,175
Prepaid expenses and deposits	(44,156)	(314,585)
Accounts payable and accrued liabilities	<u>2,129,939</u>	<u>1,340,952</u>
	<u>\$431,750</u>	<u>\$1,504,950</u>
	<b>Nine months ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash provided (used) by changes in</b>		
Accounts receivable	\$(2,156,399)	\$(376,670)
Linen in service	69,828	511,864
Prepaid expenses and deposits	14,886	(471,821)
Accounts payable and accrued liabilities	<u>2,983,471</u>	<u>(2,835,573)</u>
	<u>\$911,786</u>	<u>\$(3,172,200)</u>

# K-Bro Linen Income Fund

## Notes to the Interim Consolidated Financial Statements (Unaudited)

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### 10 Segmented information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through seven operating divisions in Vancouver (two locations), Victoria, Calgary, Edmonton, Toronto and Quebec City. The services offered and the economic characteristics associated with these divisions are similar, therefore these divisions have been aggregated into one reportable segment which operates exclusively in Canada. The results of the second Vancouver operation acquired (see Note 4) are reported commencing January 29, 2010.

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

	<b>Three months ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Healthcare	\$17,839,279	\$16,524,395
Hospitality	9,658,930	6,134,633
Total	<u>\$27,498,209</u>	<u>\$22,659,028</u>

  

	<b>Nine months ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
Healthcare	\$52,621,552	\$50,185,055
Hospitality	24,709,931	15,713,318
Total	<u>\$77,331,483</u>	<u>\$65,898,373</u>

In Edmonton, the Fund is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region. This contract expires on December 31, 2010 and negotiations for a contract extension are ongoing. In Calgary, the major customer is contractually committed to February 28, 2018 and in Vancouver the major customer is contractually committed to November 12, 2015.

For the nine months ended September 30, 2010, the Fund has recorded revenue of \$39.8 million (nine months ended September 30, 2009 – \$39.1 million) from these three major customers, representing 52% (2009 – 59%) of total revenue.

### 11 Related party transaction

The Fund has incurred expenses in the normal course of business for advisory consulting services provided by a Trustee primarily relating to acquisitions. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the three months ended September 30, 2010, the Fund incurred such fees totalling \$34,500 (three months ended September 30, 2009 – \$34,500). For the nine months ended September 30, 2010, the Fund incurred such fees totalling \$103,500 (nine months ended September 30, 2009 – \$103,500).

# **K-Bro Linen Income Fund**

Notes to the Interim Consolidated Financial Statements  
(Unaudited)

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## **12 Subsequent Event**

On October 21, 2010, the Trustees of K-Bro announced the proposed conversion from an income trust to a corporation (the "Conversion"). Pursuant to the Conversion, holders of Trust Units and holders of exchangeable shares of K-Bro Linen Systems Inc. will receive common shares of a newly-formed corporation (K-Bro Linen Inc.) on a one-for-one basis. Upon completion of the Conversion K-Bro Linen Inc. will indirectly own and operate the existing business of K-Bro and its subsidiaries.