

# **K-Bro Linen Income Fund**

Consolidated Financial Statements  
**December 31, 2009 and 2008**

March 10, 2010

## **Auditors' Report**

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

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

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

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

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants**

# K-Bro Linen Income Fund

## Consolidated Balance Sheets

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

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

Approved on behalf of the Fund

(Signed) "Ross Smith"

Trustee

(Signed) "Matthew Hills"

Trustee

# K-Bro Linen Income Fund

## Consolidated Statements of Earnings and Deficit

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

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

# K-Bro Linen Income Fund

## Consolidated Statements of Comprehensive Income

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

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

# K-Bro Linen Income Fund

## Consolidated Statements of Cash Flows

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

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

# **K-Bro Linen Income Fund**

Notes to Consolidated Financial Statements

**December 31, 2009 and 2008**

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## **1 Business description**

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

## **2 Significant accounting policies**

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

### **a) Basis of presentation**

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

### **b) Linen in service**

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

### **c) Revenue recognition**

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

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

December 31, 2009 and 2008

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d) Property, plant and equipment

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

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

e) Intangible assets

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

f) Impairment of long-lived assets

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

g) Future income taxes

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

The incorporated subsidiary of the Fund calculates income taxes using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates applicable to the period that the temporary differences are expected to reverse. Future income tax assets are only recognized to the extent that, in the opinion of management, they will more likely than not be realized. The effect on future income tax assets or liabilities is recognized in income in the period that the tax rate change occurs.



# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

December 31, 2009 and 2008

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

h) Goodwill

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

i) Volume rebates

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

j) Financial instruments

The Fund has made the following classifications:

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

Initially, all financial assets and financial liabilities must be recorded on the balance sheet at fair value. Subsequent measurement is determined by the classification of each financial asset and liability. Unrealized gains and losses on financial assets that are held as available for sale are recorded in other comprehensive income until realized, at which time they are recorded in the consolidated statement of earnings. All derivatives, including embedded derivatives that must be separately accounted for, are recorded at fair value on the consolidated balance sheet. Transaction costs related to financial instruments are capitalized and then amortized over the expected life of the financial instrument using the effective interest method.

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements December 31, 2009 and 2008

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### k) Adoption of new accounting policies

#### Goodwill and intangible assets

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

#### Credit risk and the fair value of financial assets and financial liabilities

Emerging Issues Committee (“EIC”) EIC 173, *Credit risk and the fair value of financial assets and financial liabilities* concludes that an entity’s own credit risk and the credit risk of the counterparty should be taken into account when determining the fair value of financial assets and financial liabilities including derivative instruments. This Abstract is to apply to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of this Abstract did not have a significant impact to the Fund’s consolidated financial statements.

#### Financial Instruments - Disclosures

Section 3862, *Financial Instruments – Disclosures* was amended in June 2009 by the CICA to improve fair value and liquidity risk disclosures. Section 3862 now requires that all financial instruments measured at fair value be categorized into one of three hierarchy levels, described below, for disclosure purposes. Each level is based on the transparency of the inputs used to measure the fair values of assets and liabilities:

- Level 1 – inputs are unadjusted quoted prices of identical instruments in active markets.
- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – inputs used in a valuation technique are not based on observable market data in determining fair values of the instruments.

Determination of fair value and the resulting hierarchy requires the use of observable market data whenever available. The classification of a financial instrument in the hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The Fund has also enhanced the liquidity disclosures by including the sources of funding. The additional disclosures required as a result of the adoption of these standards are included in the notes to the consolidated financial statements (Note 15).

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

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- l) Future changes in accounting policies
  - (i) International Financial Reporting Standards

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

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

- (ii) Business combinations

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

- (iii) Consolidated financial statements

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

- (iv) Non-controlling interests

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

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## 3 Business acquisition

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

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

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

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

## 4 Property, plant and equipment

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

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

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

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements  
December 31, 2009 and 2008

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## 5 Intangible assets

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

## 6 Long-term debt

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

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

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

# K-Bro Linen Income Fund

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The balance consists of:

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

## 7 Financial charges

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

## 8 Unamortized lease inducements

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

The balance consists of:

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

December 31, 2009 and 2008

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## 9 Income taxes

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

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

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

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

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



# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

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## 10 Contingencies and commitments

### a) Contingencies – Letters of credit

The Fund has an outstanding letter of credit issued as part of normal business operations in the amount of \$250,000 (2008 – \$250,000) expiring January 24, 2011. A \$185,000 letter of credit outstanding at December 31, 2008 was cancelled in March 2009.

### b) Commitments

#### (i) Operating leases and utility commitments

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

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

#### (ii) Linen purchase commitments

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

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## 11 Unitholders' equity

a) Authorized

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

b) Issued and outstanding

<b>Fund Units</b>	<b>#</b>	<b>\$</b>
Balance at December 31, 2007	5,423,862	52,210,472
Issued on February 27, 2008 at \$12.85 per Unit	1,362,000	17,501,700
Offering costs – net of future tax recovery of \$341,000	-	(842,959)
Issued on March 28, 2008 at \$12.85 per Unit	146,700	1,885,095
Offering costs – net of future tax recovery of \$31,500	-	(78,792)
	<u>1,508,700</u>	<u>18,465,044</u>
Balance at December 31, 2009 and 2008	6,932,562	<u>70,675,516</u>
<b>Exchangeable Shares / Special Trust Units</b>	<b>#</b>	<b>\$</b>
Balance at December 2009 and 2008	<u>72,411</u>	<u>724,110</u>
Total Fund Units and Exchangeable Shares / Special Trust Units issued	<u>7,004,973</u>	

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

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c) Contributed surplus

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

d) Accumulated other comprehensive loss

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

e) Weighted average number of units outstanding

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

# **K-Bro Linen Income Fund**

Notes to Consolidated Financial Statements

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## **12 Long Term Incentive Plan**

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

In accordance with the LTIP agreement and in conjunction with the performance of the Fund in the prior fiscal year, the Compensation, Nominating and Corporate Governance Committee of the Trustees of the Fund in 2009 approved LTIP compensation of \$0.8 million (2008 – \$0.3 million) and approved the funding and transfer of \$0.8 million (2008 – \$0.3 million) of cash to the LTIP Trust in April 2009 and March 2008 respectively in order to fund the purchase of Units by the LTIP Trust. In April 2009, the LTIP Trust purchased 68,173 Units of the Fund (2008 – 24,751). As at December 31, 2009, 72,739 Units held by the LTIP Trust have vested (December 31, 2008 – 38,961). The cost of the 69,692 unvested units held in trust by the LTIP at December 31, 2009 (December 31, 2008 – 35,297) was \$834,137 (December 31, 2008 - \$457, 079).

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

## **13 Distributions to unitholders**

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

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

# K-Bro Linen Income Fund

Notes to Consolidated Financial Statements

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

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

## 15 Financial instruments

### a) Fair value

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

### b) Financial risk management

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

### c) Price risk

#### (i) Currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar. The Fund is not significantly exposed to foreign currency risk as all revenues are received in Canadian dollars and minimal expenses are incurred in foreign currencies. For large capital expenditure commitments denominated in a foreign currency, the Fund will enter into foreign exchange forward contracts if considered prudent to mitigate this risk. At December 31, 2009, no foreign exchange forward option

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

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contracts were outstanding. Based on the Fund's US dollar liability for equipment purchases at December 31, 2009, a 1% change in the Canadian-US dollar foreign exchange rate would result in a \$2,300 change in the amount recorded in property, plant and equipment.

(ii) Interest rate risk

The Fund is subject to interest rate risk as its credit facility bears interest at rates that depend on certain financial ratios of the Fund and vary in accordance with market interest rates. On June 24, 2005, the Fund entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of \$4 million of this debt has been fixed at 5.95% for a period of five years. The floating rate of interest that was swapped for this fixed rate was 2.90% at December 31, 2009. Based on the outstanding balance on the Fund's revolving credit facility for which the interest rate has not been fixed at December 31, 2009, a 1% fluctuation in the Canadian prime rate would result in a negligible change in annual interest expense. Management does not believe that the impact of interest rate fluctuations will be significant.

(iii) Other price risk

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

d) Credit risk

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

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

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

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

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e) Liquidity risk

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

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

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

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

f) Hedge accounting

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

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

## 16 Capital management

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

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

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

# K-Bro Linen Income Fund

## Notes to Consolidated Financial Statements

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amortization expense. For the purpose of the calculation of the Fund's financial ratios under the credit facility, EBITDA is calculated on a rolling four quarter basis.

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

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

### 17 Segmented information

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

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

In Edmonton, the Fund is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region. This contract expires on December 31, 2010. In Calgary, the major customer is contractually committed to February 28, 2018 and in Vancouver the major customer is contractually committed to January 15, 2013. For the year ended December 31, 2009, the Fund has recorded revenue of \$52.4 million (2008 – \$49.4 million) from these three major customers, representing 60% (2008 – 58%) of total revenue.



# **K-Bro Linen Income Fund**

Notes to Consolidated Financial Statements

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## **18 Related party transaction**

The Fund has incurred expenses in the normal course of business for advisory consulting services provided by a Trustee primarily relating to acquisitions. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the year ended December 31, 2009, the Fund incurred such fees totalling \$138,000 (2008 – \$74,000).

## **19 Subsequent Events**

### a) Business acquisition

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

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

### b) Revolving credit facility

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

## **20 Comparative Amounts**

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