# MANAGEMENT'S DISCUSSION & ANALYSIS

## YEAR ENDED DEC 31 2017

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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, 2017 and 2016, as well as the unaudited interim condensed Consolidated Financial Statements for the periods ended March 31, 2017, June 30, 2017 and September 30, 2017. The Corporation and its wholly-owned subsidiaries, including K-Bro Linen Systems Inc. and Fishers Topco Ltd., 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 14, 2018.

In the interest of providing current holders ("Shareholders") of common shares 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 costs, minimum wage legislation 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; (viii) changes or proposed changes to minimum wage laws in Ontario, British Columbia, Alberta and the United Kingdom (the "UK"), which could have an adverse effect on expenses in respect of employees situated in those jurisdictions and while a portion of such expenses may be passed on to or be recoverable from customers, there can be no assurances that that will occur; (ix) the availability of future financing and (x) foreign exchange rates. 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; (iii) frequency of one-time costs impacting quarterly and annual financial results; and (iv) the level of capital expenditures. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Certain statements regarding forward-looking information included in this MD&A may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this MD&A. Forward looking information included in this MD&A includes the expected annual healthcare revenues to be generated from the Corporation's contracts with the William Osler Health System and Trillium Health Partners and other new customers, the anticipated capital costs for the Toronto and Vancouver facilities, calculation of costs, including one-time costs impacting the quarterly financial results, and statements with respect to future expectations on margins and volume growth.

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 non-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

The Corporation is the largest owner and operator of laundry and linen processing facilities in Canada and a market leader for laundry and textile rental services in Scotland and the North East of England. K-Bro and its wholly owned subsidiaries, operate across Canada and the United Kingdom ("UK"), providing a range of linen services to healthcare institutions, hotels and other commercial accounts that include the processing, management and distribution of general linen and operating room linen.

The Corporation's operations in Canada include nine processing facilities and two distribution centres under three distinctive brands,: K-Bro Linen Systems Inc., Buanderie HMR and Les Buanderies Dextraze. The Corporation operates in ten Canadian cities: Québec City, Montréal, Toronto, Regina, Saskatoon, Prince Albert, Edmonton, Calgary, Vancouver and Victoria.

The Corporation's operations in the UK include Fishers Topco Ltd. ("Fishers") which was acquired by K-Bro on November 27, 2017. Fishers was established in 1900 and is a leading operator of laundry and linen processing facilities in Scotland, providing linen rental, workwear hire and cleanroom garment services to the hospitality, healthcare, manufacturing and pharmaceutical sectors. The Corporation operates seven sites, including one distribution center, which are located in Cupar, Perth, Newcastle, Livingston, Inverness and Coatbridge.

## Industry and Market

In Canada, K-Bro provides laundry and linen services to 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 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 Canadian laundry and linen services industry, such as uniform rental companies (which own and launder uniforms worn by their customers' employees) typically do not offer services that significantly overlap with those offered by K-Bro.

In the UK, Fishers provides laundry and linen services to healthcare, hospitality and other commercial customers. Typical services offered by Fishers include the processing, management and distribution of general, workwear and clean room garment services. Other types of processors in Fishers industry in the UK include independent privately owned facilities (i.e., typically, small single facility companies), public sector central laundries and public and private sector OPLs.

Our partnerships with healthcare institutions and hospitality clients across Canada and the UK

demonstrate K-Bro's commitment to building relationships that foster continuous improvement, providing flexibility to adjust to changing circumstances as required and which incorporate incentives, penalties and the sharing of risks and rewards as circumstances warrant.

In this competitive industry, K-Bro is distinctive 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* – In Canada, 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 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 Canadian customers include some of the largest healthcare institutions and hospitality providers in Canada. In the UK, Fishers customer includes some of the largest hotel chains operating in Scotland. Healthcare customers include acute care hospitals and long-term care facilities primarily in Canada. 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 41 million pounds of linen per year for a Canadian 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, and in late 2017 entered into the UK market. 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. K-Bro performs the sterilization of operating room linen packs for six major hospitals in Toronto.

## FOURTH QUARTER OVERVIEW

In the fourth quarter of 2017, revenue increased by 21.0% to $47.5 million from $39.3 million in the comparative period. This increase was due to the acquisition of Fishers, additional awarded healthcare volume from the Vancouver lower mainland contract, William Osler Health System volume, Trillium Health Partners volume, organic growth at existing customers, and new customers secured in existing markets.

EBITDA was $4.5 million for the three months ended December 31, 2017, compared to $6.4 million in the comparative period of 2016. The change in EBITDA and margin was primarily associated with the one-time transaction costs related to the acquisition of Fishers which was $2.8 million, offset by efficiencies gained as a result of the capital expenditures made in Toronto.

## SELECTED ANNUAL FINANCIAL INFORMATION

| (thousands, except percentages and per share amounts) | Canadian Division 2017 | UK Division 2017 | 2017 | 2016 [1] | 2015[1] |
|---|---|---|---|---|---|
| Revenue | $ 165,831 | $ 4,728 | $ 170,559 | $ 159,089 | $ 144,537 |
| Earnings before income taxes | 12,402 | (2,923) | 9,479 | 16,367 | 17,261 |
| Net earnings | 8,599 | (2,881) | 5,718 | 11,527 | 12,068 |
| Adjusted net earnings | 8,599 | (50) | 8,549 | 11,527 | 12,068 |
| *Net earnings (loss) per share:* | | | | | |
| Basic | $ 0.947 | $ (0.317) | $ 0.629 | $ 1.449 | $ 1.524 |
| Diluted | $ 0.943 | $ (0.316) | $ 0.627 | $ 1.443 | $ 1.522 |
| *Adjusted net earnings (loss) per share:* | | | | | |
| Basic | $ 0.947 | $ (0.006) | $ 0.941 | $ 1.449 | $ 1.524 |
| Diluted | $ 0.943 | $ (0.005) | $ 0.938 | $ 1.443 | $ 1.522 |
| Total assets | | | 295,213 | 168,289 | 143,023 |
| Long-term debt | | | 42,780 | 25,800 | 2,349 |
| *Weighted average number of shares outstanding:* | | | | | |
| Basic | | | 9,083,693 | 7,955,026 | 7,920,609 |
| Diluted | | | 9,114,874 | 7,986,729 | 7,930,492 |

1) Prior to the acquisition of Fishers on November 27, 2017, K-Bro was reporting and operating as a single Canadian division.

## SUMMARY OF 2017 RESULTS, KEY EVENTS AND OUTLOOK

### Financial Growth

K-Bro's Canadian division delivered strong financial results in 2017 driven by the operating results from all nine of its processing plants and two distribution centers. In the UK, net earnings were impacted as a result of $2.8 million in acquisition costs incurred in the quarter. Net earnings were $5.7 million or $0.63 per Common Share (basic). Cash flow from operating activities was $18.8 million and distributable cash flow was $20 million. Revenue increased in fiscal 2017 to $170.6 million or by 7.2% compared to 2016. This increase was due to the acquisition of Fishers, additional awarded healthcare volume from the Vancouver lower mainland contract, William Osler Health System volume, Trillium Health Partners volume, organic growth at existing customers, and new customers secured in existing markets.

EBITDA (see Terminology) decreased in 2017 to $24.0 million or by 14.7% compared to $28.1million in 2016. The Corporation's EBITDA margin decreased from 17.7% in 2016 compared to 14.1% in 2017. The change in EBITDA and margin was primarily associated with one-time transaction costs of $2.8 million related to the acquisition of Fishers, the relocation of our new Toronto facility, offset by the efficiencies gained as a result of the capital expenditures made in Toronto. Management estimates the one-time costs incurred related to the Toronto transition and capacity constraints at certain plants on a year-to-date basis to be approximately $4.7 million.

### *Acquisition of Fishers*

Fishers was acquired by K-Bro on November 27, 2017 for cash consideration of $57.6 million (in Sterling £33.9 million). Fishers, an operator of laundry and linen processing facilities established in 1900, is a leading commercial laundry business in Scotland and the North East of England which provides linen rental, workwear hire and cleanroom garment services to the hospitality, healthcare, manufacturing and pharmaceutical sectors. The company operates seven facilities, including one distribution center, which are located in in Cupar, Perth, Newcastle, Livingston, Inverness and Coatbridge.

K-Bro financed the cash portion of the acquisition, the repayment of Fishers' outstanding debt facilities and the payment of management fees and transaction costs from existing cash resources and existing loan facilities, including an amendment to its existing revolving credit facility.

As part of the Fishers' acquisition, the purchase price included an earn out to be paid dependent upon financial performance of Fishers for the year ended December 31, 2017. Based off the Fishers' audited financial statements and the calculation in accordance with the share purchase agreement, no additional consideration for the earnout is payable as at December 31, 2017 or in future periods.

The acquired business contributed revenues of $4.7 million (in Sterling £2.8 million) and a net loss of $2.9 million (in Sterling £1.7 million) to the Corporation for the period from November 27, 2017 to December 31, 2017.

If the acquisition had occurred on January 1, 2017, consolidated pro-forma revenue and profit for the year ended December 31, 2017 would have been $223.5 million and $8.8 million respectively. These amounts have been calculated using the Fishers results and adjusting them for:

- differences in the accounting policies between the group and the subsidiary; and
- the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from January 1, 2017, together with the consequential tax effects.

Pro-forma net profit includes expenses which are not expected to be recurring as part of normal operations, which include transaction costs incurred in the sale of Fishers' for $1.0 million (in Sterling £0.6 million), and loss on disposal of assets of $1.1 million (in Sterling £0.6 million).

### *Equity Offerings*

On April 25, 2017 the Corporation closed a bought deal offering of 1,518,000 common shares at $38.00/share. The net proceeds of the offering after deducting expenses of the offering and the underwriter's fee were $55.0 million. The net proceeds of the offering were used to reduce the revolving debt to nil, and to fund the build out of the Corporation's state-of-the-art facilities in Toronto and Vancouver, and for general corporate purposes.

| (in millions) | | 2017 |
|---|---|---|
| Build out of Corporation's facilities in Toronto and Vancouver | $ | 22.3 |
| Repayment of indebtedness | | 32.4 |
| General corporate purposes | | 0.3 |
| Use of proceeds as at December 31, 2017 | | 55.0 |
| Amount remaining | | - |
| **Net proceeds from share issuance on April 25, 2017** | **$** | **55.0** |

On December 12, 2017 the Corporation closed a bought deal offering of 924,600 common shares at $37.35/share. The net proceeds of the offering after deducting expenses of the offering and the underwriter's fee were $32.7 million. The net proceeds of the offering were used to partially pay down indebtedness that was incurred under K-Bro's amended $100 million senior secured revolving credit facility to fund the acquisition of Fishers.

| (in millions) | | 2017 |
|---|---|---|
| Cash Consideration for acquisition of Fishers | $ | 57.6 |
| Indebtedness incurred to fund acquisition | | (57.6) |
| Repayment of indebtedness | | 32.7 |
| Use of proceeds as at December 31, 2017 | | 32.7 |
| Amount remaining | | - |
| **Net proceeds from share issuance on December 12, 2017** | $ | 32.7 |

### *Revolving Credit Facility*

On November 27, 2017, K-Bro completed an amendment to its existing revolving credit facility, which extended the agreement to July 31, 2021, and increased the available limit from $85 million to $100 million plus a $25 million accordion, of which $44.4 million is utilized (including letters of credit totaling $1.7 million as at December 31, 2017). Management intends to continually assess its opportunities to maintain a conservative amount of leverage and balance sheet flexibility in the short and long-term basis in order to ensure that sufficient capital is available for future growth needs. A copy of the Corporation's amended and restated credit agreement is available under the Corporation's profile at www.sedar.com.

### *Near-Term and Long-Term Growth and Margin Impact*

Management has embarked on a strategy in its Toronto and Vancouver markets that it believes will position K-Bro for accelerated growth in its healthcare and hospitality businesses. The strategy includes capital investments to build large efficient state-of-the-art facilities with meaningful additional capacity in Toronto and Vancouver. In addition, K-Bro will invest to upgrade one of its current Vancouver plants to create a more efficient facility with meaningful additional capacity.

These investments are being made because management believes that new opportunities, both current and future, justify the significant additional capacity. As previously announced we have secured $7.6 million of new revenue from William Osler Health Systems and Trillium Health Partners. The transition of the William Osler Health Systems to K-Bro was completed in the second quarter of 2017 and the transition of Trillium Health Partners to K-Bro commenced in the third quarter and was completed early in the fourth quarter of 2017. Management believes that many new customer opportunities will present themselves to K-Bro going forward.

Furthermore, during the prior year in Vancouver we re-signed most of our current healthcare volume through to 2027 and were awarded six new healthcare accounts representing an additional $5.2 million in annual revenue with additional new customer opportunities going forward. Service to these six new healthcare customers commenced during Q4 2017, which was earlier than anticipated to help facilitate the logistical management and strategic requirements of the customers.

The construction and/or upgrade of three of our large facilities will enable us to bid on a significant amount of additional business, but also will create margin pressure through 2018 as K-Bro incurs one-time and transition costs associated with these large investments. While the margin pressure may vary by quarter through 2018, management believes that the one-time and transition costs incurred in 2017 and 2018 will position K-Bro to achieve more growth and a lower cost structure into the future and that K-Bro will return to normalized margins closer to those achieved in 2015 as it enters 2019.

Key events in our Toronto and Vancouver markets are summarized below.

### *Vancouver Facility Development*

As announced on March 2, 2016, K-Bro has commenced the planning and development of a new state-of-the- art facility with a projected investment of up to $55 million. As at December 31, 2017, K-Bro has incurred $29.8 million of the total expected capital costs. The new Vancouver plant will be located in Burnaby, and K-Bro expects to transition to the new facility during the second quarter of 2018. The new facility will enable K-Bro to expand current capacity, to accommodate the additional awarded volume, and to provide the opportunity to consolidate the healthcare volume from its existing two Vancouver-area facilities. In addition to investing in the new facility, K-Bro will upgrade and replace equipment at one of its existing Vancouver-area facilities, which will be used to process the consolidated hospitality volume. K-Bro will not be renewing the lease for the remaining Vancouver-area facility and related assets will be transferred to the other K-Bro facilities. K-Bro believes it will achieve significant operating efficiencies at its new plant. It is anticipated that transition costs associated with the new Vancouver plant will negatively impact EBITDA margins over the second and third quarters of 2018 while the plant becomes operational.

### *Toronto Facility Development*

During the first quarter, K-Bro completed the transition to its new state-of-the-art facility in Toronto. Management estimates that the cost to commission the new leased facility is $37 million for new efficiency enhancing equipment, and leaseholds. As at December 31, 2017, K-Bro has incurred $37 million of the total expected capital cost. K-Bro's strategy includes significant growth in its healthcare and hospitality volumes, and the additional capacity and the long-term lease enables K-Bro to grow into the additional capacity as opportunities emerge.

### *Toronto Contract Awards*

On February 28, 2017 K-Bro was awarded a five year contract to provide laundry and linen services to St. Michael's Hospital. The contract contains two renewal options for an additional two years. The contract extends the existing relationship between K-Bro and St. Michaels Hospital and is a result of a competitive RFP process.

On March 24, 2017 K-Bro was awarded a contract to provide laundry and linen services to Trillium Health Partners. The new contract is for seven years with renewal options for an additional eight years, and is a result of a competitive RFP process. Expected additional annual revenue from the contract is $4 million and processing commenced in Q3 2017.

### *Toronto Collective Bargaining Agreement*

Teamsters Canada represented 14 drivers in our Toronto facility. The Collective Bargaining Agreement representing these employees expired on December 31, 2016. The members of the bargaining unit rejected K-Bro's contract proposal and on January 31, 2017 K-Bro locked out the 14 Toronto drivers and employed replacement drivers to service its Toronto accounts. There have been no service interruptions to any customers as a result of the lock-out. In September, K-Bro reinstated five drivers on terms agreed to between the employee and employer. No collective agreement has been negotiated and employees are operating in a non-union environment on terms substantially the same as the contract drivers. K-Bro has been advised that the Ministry of Labour is closing the file regarding this labour dispute. Management estimates transition and one-time costs associated with this lock-out were approximately $0.6 million on a year-to-date basis.

### *Alberta Contract Awards*

On March 1, 2018, K-Bro was awarded a one year extension to provide laundry and linen services to Calgary Alberta Health Services. The contract extends the existing relationship between K-Bro and Alberta Health Services Calgary.

# OUTLOOK

"We are very excited to add the Fishers platform as K-Bro's first acquisition outside of Canada. Fisher's is our largest acquisition to date and is aligned with our growth strategy. Fishers provides us with critical mass in an attractive new geographical region and is well positioned for future growth ." said Linda McCurdy, President & Chief Executive Officer of K-Bro. "The UK linen hospitality market is mature and highly fragmented and we expect to leverage Fishers' leading market position, experienced local management team, entrenched customer relationships and proven track record of stable and profitable operations to take advantage of the significant organic growth and consolidation opportunities available to us, similar to what we have achieved in Canada."

"We continue to make progress in the construction of our new Vancouver facility with a targeted completion date of early 2018. We view 2017 and 2018 as transition years that will impact our margins but once complete will enable us to realize additional efficiencies, increase capacity and increase market share. While the margin pressure may vary by quarter through 2018, we believe that the one-time and transition costs incurred in 2018 will position the company to achieve more growth and a lower cost structure into the future and that the company will return to normalized margins closer to those achieved in 2015 as it enters 2019. We remain excited about our growth plans and are confident in our ability to continue to provide value to our customers and our Shareholders."

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.

## Effects of Economic Uncertainty

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

- Approximately 66.1% of its revenues in the quarter were from large publicly funded healthcare customers which are geographically diversified across multiple provinces;
- at December 31, 2017, K-Bro had unutilized borrowing capacity of $55.6 million or 55.6% of its revolving credit facility 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.

# 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 table outlines our results on a period-to-period comparative basis in each of these areas:

| *(thousands, except percentages and per share amounts)* Category | Indicator | Canadian Division Q4 2017 | UK Division Q4 2017 | **Q4 2017** | Q4 2016 [5] | Canadian Division YTD 2017 | UK Division YTD 2017 | **YTD 2017** | YTD 2016 [5] |
|---|---|---|---|---|---|---|---|---|---|
| Growth | EBITDA[1] | 10.1% | | **-29.6%** | 5.3% | -5.8% | | **-14.7%** | 4.4% |
| | Adjusted EBITDA[2] | 10.1% | | **15.2%** | 5.3% | -5.8% | | **-4.7%** | 4.4% |
| | Revenue | 9.0% | | **21.0%** | 4.2% | 4.2% | | **7.2%** | 10.1% |
| | Distributable cash flow | | | **-52.0%** | 25.5% | | | **-9.2%** | 3.4% |
| Profitability | EBITDA[1][6] | $ 6,961 | $ (2,508) | **$ 4,453** | $ 6,321 | $ 26,493 | $ (2,508) | **$ 23,985** | $ 28,131 |
| | EBITDA margin | 16.3% | -53.0% | **9.4%** | 16.1% | 16.0% | -53.0% | **14.1%** | 17.7% |
| | Adjusted EBITDA[2] | $ 6,961 | $ 323 | **$ 7,284** | $ 6,321 | $ 26,493 | $ 323 | **$ 26,816** | $ 28,131 |
| | Adjusted EBITDA margin[2] | 16.3% | 6.8% | **15.3%** | 16.1% | 16.0% | 6.8% | **15.7%** | 17.7% |
| | Net earnings | $ 1,594 | $ (2,881) | **$ (1,287)** | $ 2,197 | $ 8,599 | $ (2,881) | **$ 5,718** | $ 11,527 |
| | Adjusted net earnings[3] | $ 1,594 | $ (50) | **$ 1,544** | $ 2,197 | $ 8,599 | $ (50) | **$ 8,549** | $ 11,527 |
| Stability | Debt to total capitalization[4] | | | **18.4%** | 18.1% | | | **18.4%** | 18.1% |
| | Unutilized line of credit | | | **$ 55,570** | $ 57,550 | | | **$ 55,570** | $ 57,550 |
| | Cash on hand | | | **$ 11,276** | $ - | | | **$ 11,276** | $ - |
| | Payout ratio | | | **107.1%** | 41.7% | | | **55.5%** | 43.5% |
| | Dividends declared per share | | | **$ 0.300** | $ 0.300 | | | **$ 1.200** | $ 1.200 |
| Cost containment | Wages and benefits | 41.7% | 37.4% | **41.3%** | 41.1% | 41.4% | 37.4% | **41.2%** | 40.9% |
| | Utilities | 5.7% | 7.7% | **5.9%** | 6.4% | 6.0% | 7.7% | **6.1%** | 6.1% |
| | Expenses included in EBITDA | 83.7% | 153.0% | **90.6%** | 83.9% | 84.0% | 153.0% | **85.9%** | 82.3% |

[1] EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, finance expense (recovery) and depreciation and amortization). See *Terminology.*

[2] Adjusted EBITDA is defined as EBITDA (defined above) with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See *Terminology* for a complete description of the adjusted items.

[3] Adjusted net earnings is defined as net earnings with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. 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.*

[5] Prior to the acquisition of Fishers on November 27, 2017, K-Bro was reporting and operating as a single Canadian division.

[6] EBITDA in prior periods has been restated with 'gain (loss) on disposal of assets' in included expenses.

# RESULTS OF OPERATIONS

## Quarterly Financial Information - Consolidated

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

| *Quarterly Financial Information - Consolidated* | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| **(thousands, except percentages and per share amounts)** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Healthcare revenue | 31,385 | 29,021 | 28,499 | 28,053 | 28,374 | 27,333 | 27,553 | 28,124 |
| Hospitality revenue | 16,124 | 14,577 | 11,995 | 10,905 | 10,877 | 14,224 | 11,916 | 10,688 |
| Total revenue | 47,509 | 43,598 | 40,494 | 38,958 | 39,251 | 41,557 | 39,469 | 38,812 |
| Expenses included in EBITDA [4] | 43,056 | 35,487 | 33,837 | 34,194 | 32,930 | 34,019 | 31,973 | 32,036 |
| EBITDA[1][4] | 4,453 | 8,111 | 6,657 | 4,764 | 6,321 | 7,538 | 7,496 | 6,776 |
| EBITDA as a % of revenue (EBITDA margin) | 9.4% | 18.6% | 16.4% | 12.2% | 16.1% | 18.1% | 19.0% | 17.5% |
| Adjusted EBITDA[2] | 7,284 | 8,111 | 6,693 | 4,764 | 6,321 | 7,538 | 7,496 | 6,776 |
| Adjusted EBITDA as a % of revenue (Adjusted EBITDA margin) | 15.3% | 18.6% | 16.5% | 12.2% | 16.1% | 18.1% | 19.0% | 17.5% |
| Depreciation and amortization | 4,105 | 3,213 | 3,246 | 2,809 | 2,866 | 2,748 | 2,674 | 2,737 |
| Finance expense (recovery) | 786 | 101 | 61 | 185 | 247 | (11) | 110 | 393 |
| Earnings before income taxes | (438) | 4,797 | 3,350 | 1,770 | 3,208 | 4,801 | 4,712 | 3,646 |
| Income tax expense | 849 | 1,379 | 1,013 | 520 | 1,011 | 1,387 | 1,328 | 1,114 |
| Net earnings (loss) | (1,287) | 3,418 | 2,337 | 1,250 | 2,197 | 3,414 | 3,384 | 2,532 |
| Net earnings (loss) as a % of revenue | -2.7% | 7.8% | 5.8% | 3.2% | 5.6% | 8.2% | 8.6% | 6.5% |
| Basic earnings (loss) per share | (0.132) | 0.359 | 0.257 | 0.157 | 0.276 | 0.429 | 0.426 | 0.319 |
| Diluted earnings (loss) per share | (0.132) | 0.358 | 0.256 | 0.156 | 0.274 | 0.427 | 0.425 | 0.318 |
| Adjusted net earnings[3] | 1,544 | 3,418 | 2,337 | 1,250 | 2,197 | 3,414 | 3,384 | 2,532 |
| Basic adjusted earnings (loss) per share[3] | 0.159 | 0.359 | 0.257 | 0.157 | 0.276 | 0.429 | 0.426 | 0.319 |
| Diluted adjusted earnings (loss) per share[3] | 0.158 | 0.358 | 0.256 | 0.156 | 0.274 | 0.427 | 0.425 | 0.318 |
| Total assets | 295,213 | 199,452 | 195,957 | 180,583 | 168,289 | 153,923 | 148,068 | 146,816 |
| Total long-term financial liabilities | 57,594 | 9,205 | 8,407 | 41,134 | 33,949 | 17,596 | 14,360 | 12,717 |
| Funds provided by operations | 6,395 | 3,788 | 2,297 | 6,300 | 6,071 | 7,581 | 4,143 | 6,726 |
| Long-term debt | 42,780 | - | - | 32,363 | 25,800 | 10,338 | 7,252 | 5,970 |
| Dividends declared per share | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 |

(1) EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, finance expense (recovery) and depreciation and amortization). See Terminology.

(2) Adjusted EBITDA is defined as EBITDA (defined above) with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

(3) Adjusted net earnings is defined as net earnings with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

(4) EBITDA in prior periods has been restated with 'gain (loss) on disposal of assets' in included expenses.

Historically, the Corporation's financial and operating results are stronger in the second and third quarters as a result of seasonality and the associated higher hospitality volumes. Other fluctuations in net income from quarter-to-quarter can also be attributed to hiring and labour cost trends, timing of linen purchases, utility costs, timing of repairs and maintenance expenditures, business development, capital spending patterns and changes in corporate tax rates and income tax expenses.

For the year ended December 31, 2017, the Corporation's distributable cash flow was $20 million with a debt to total capitalization of 18.4% Due to the strategic plans K-Bro expects to execute in the coming fiscal year, management expects the debt to total capitalization to increase, mainly as a result of strategic capital expenditures as part of the investment in the new Vancouver facility. Management believes the unutilized balance of $55.6 million with respect to its revolving credit facility is sufficient for the Corporation's operations in the foreseeable future. However, management intends to continually assess its opportunities to maintain a conservative amount of leverage and balance sheet flexibility in the short and long-term basis in order to ensure that sufficient capital is available for future growth needs.

## Quarterly Financial Information – Canadian Division

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

| *Quarterly Financial Information - Canadian Division* | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| **(thousands, except percentages and per share amounts)** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Healthcare revenue | 31,375 | 29,021 | 28,499 | 28,053 | 28,374 | 27,333 | 27,553 | 28,124 |
| Hospitality revenue | 11,406 | 14,577 | 11,995 | 10,905 | 10,877 | 14,224 | 11,916 | 10,688 |
| Total revenue | 42,781 | 43,598 | 40,494 | 38,958 | 39,251 | 41,557 | 39,469 | 38,812 |
| Expenses included in EBITDA [4] | 35,820 | 35,487 | 33,837 | 34,194 | 32,930 | 34,019 | 31,973 | 32,036 |
| EBITDA[1][4] | 6,961 | 8,111 | 6,657 | 4,764 | 6,321 | 7,538 | 7,496 | 6,776 |
| EBITDA as a % of revenue (EBITDA margin) | 16.3% | 18.6% | 16.4% | 12.2% | 16.1% | 18.1% | 19.0% | 17.5% |
| Adjusted EBITDA[2] | 6,961 | 8,111 | 6,693 | 4,764 | 6,321 | 7,538 | 7,496 | 6,776 |
| Adjusted EBITDA as a % of revenue (Adjusted EBITDA margin) | 16.3% | 18.6% | 16.5% | 12.2% | 16.1% | 18.1% | 19.0% | 17.5% |
| Depreciation and amortization | 3,708 | 3,213 | 3,246 | 2,809 | 2,866 | 2,748 | 2,674 | 2,737 |
| Finance expense (recovery) | 768 | 101 | 61 | 185 | 247 | (11) | 110 | 393 |
| Earnings before income taxes | 2,485 | 4,797 | 3,350 | 1,770 | 3,208 | 4,801 | 4,712 | 3,646 |
| Income tax expense | 891 | 1,379 | 1,013 | 520 | 1,011 | 1,387 | 1,328 | 1,114 |
| Net earnings | 1,594 | 3,418 | 2,337 | 1,250 | 2,197 | 3,414 | 3,384 | 2,532 |
| Net earnings as a % of revenue | 3.7% | 7.8% | 5.8% | 3.2% | 5.6% | 8.2% | 8.6% | 6.5% |
| Basic earnings per share | 0.164 | 0.359 | 0.257 | 0.157 | 0.276 | 0.429 | 0.426 | 0.319 |
| Diluted earnings per share | 0.163 | 0.358 | 0.256 | 0.156 | 0.274 | 0.427 | 0.425 | 0.318 |
| Adjusted net earnings[3] | 1,594 | 3,418 | 2,337 | 1,250 | 2,197 | 3,414 | 3,384 | 2,532 |
| Basic adjusted earnings per share[3] | 0.164 | 0.359 | 0.257 | 0.157 | 0.276 | 0.429 | 0.426 | 0.319 |
| Diluted adjusted earnings per share[3] | 0.163 | 0.358 | 0.256 | 0.156 | 0.274 | 0.427 | 0.425 | 0.318 |

(1) EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, finance expense (recovery) and depreciation and amortization). See Terminology.

(2) Adjusted EBITDA is defined as EBITDA (defined above) with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

(3) Adjusted net earnings is defined as net earnings with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

(4) EBITDA in prior periods has been restated with 'gain (loss) on disposal of assets' in included expenses.

## Quarterly Financial Information – UK Division

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

| ***Quarterly Financial Information - UK Division*** <br> ***(in reporting currency Canadian $)*** | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| **(thousands, except percentages and per share amounts)** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Healthcare revenue | 10 | | | | | | | |
| Hospitality revenue | 4,718 | | | | | | | |
| Total revenue | 4,728 | | | | | | | |
| Expenses included in EBITDA | 7,236 | | | | | | | |
| EBITDA[1] | (2,508) | | | | | | | |
| EBITDA as a % of revenue (EBITDA margin) | -53.0% | | | | | | | |
| Adjusted EBITDA[2] | 323 | | | | | | | |
| Adjusted EBITDA as a % of revenue (Adjusted EBITDA margin) | 6.8% | | | | | | | |
| Depreciation and amortization | 397 | | | | | | | |
| Finance expense (recovery) | 18 | | | | | | | |
| Earnings before income taxes | (2,923) | | | | | | | |
| Income tax recovery | (42) | | | | | | | |
| Net loss | (2,881) | | | | | | | |
| Net loss as a % of revenue | -60.9% | | | | | | | |
| Basic loss per share | (0.296) | | | | | | | |
| Diluted loss per share | (0.295) | | | | | | | |
| Adjusted net earnings[3] | (50) | | | | | | | |
| Basic adjusted loss per share[3] | (0.005) | | | | | | | |
| Diluted adjusted loss per share[3] | (0.005) | | | | | | | |

| ***Quarterly Financial Information - UK Division*** <br> ***(in local currency Sterling £)*** | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| **(thousands, except percentages and per share amounts)** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Healthcare revenue | 6 | | | | | | | |
| Hospitality revenue | 2,755 | | | | | | | |
| Total revenue | 2,761 | | | | | | | |
| Expenses included in EBITDA | 4,227 | | | | | | | |
| EBITDA[1] | (1,466) | | | | | | | |
| EBITDA as a % of revenue (EBITDA margin) | -53.1% | | | | | | | |
| Adjusted EBITDA[2] | 188 | | | | | | | |
| Adjusted EBITDA as a % of revenue (Adjusted EBITDA margin) | 6.8% | | | | | | | |
| Depreciation and amortization | 232 | | | | | | | |
| Finance expense (recovery) | (3) | | | | | | | |
| Earnings before income taxes | (1,695) | | | | | | | |
| Income tax recovery | (25) | | | | | | | |
| Net loss | (1,670) | | | | | | | |
| Net loss as a % of revenue | -60.5% | | | | | | | |
| Basic loss per share | (0.172) | | | | | | | |
| Diluted loss per share | (0.171) | | | | | | | |
| Adjusted net earnings[3] | (16) | | | | | | | |
| Basic adjusted loss per share[3] | (0.002) | | | | | | | |
| Diluted adjusted loss per share[3] | (0.002) | | | | | | | |

(1) EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, finance expense (recovery) and depreciation and amortization). See Terminology.

(2) Adjusted EBITDA is defined as EBITDA (defined above) with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

(3) Adjusted net earnings is defined as net earnings with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. See Terminology for a complete description of the adjusted items.

## Revenue, Earnings and EBITDA

For the year ended December 31, 2017, K-Bro's revenue increased by 7.2% to $170.6 million from $159.1 million in the comparative period. This increase was due to additional volume from the acquisition of Fishers, additional awarded healthcare volume from the Vancouver lower mainland contract signed in 2016, William Osler Health System volume, Trillium Health Partners volume, organic growth at existing customers, and new customers secured in existing markets. In 2017, approximately 68.6% of K-Bro's revenue was generated from healthcare institutions, which is slightly lower compared to 70.0% in 2016, primarily related to the acquisition of Fishers which is hospitality based.

EBITDA decreased in the year to $24.0 million from $28.1 million in 2016, which is a decrease of 14.7%. The EBITDA margin decreased to 14.1% in 2017 compared to 17.7% in 2016, due to transaction costs related to the acquisition of Fishers, transition costs related to the transition to our new Toronto facility, training costs related to new staff, labour costs associated transitioning volume in Vancouver during Q4 2017 and costs related to mitigating the effect related to the lock-out of the unionized delivery drivers in Toronto, offset by higher revenues. In addition, throughout 2017 the company incurred significant overtime and one-time costs to support new business, strong volumes and temporary capacity constraints in certain markets that we operate in.

Net earnings decreased by $5.8 million from $11.5 million in 2016 to $5.7 million in 2017. Net earnings as a percentage of revenue decreased by 3.8%, from 7.2% in 2016 to 3.4% in 2017. This decrease in net earnings is primarily due to the flow through items in EBITDA discussed above and higher depreciation of property, plant and equipment and interest expense, offset by a lower income tax expense.

## Operating Expenses

Wages and benefits increased to $70.4 million in 2017 from $65.1 million in 2016, and increased as a percentage of revenue from 40.9% in 2016 to 41.2% in the same period of 2017. The increase in the period is due to the incremental labour required to process the increased volumes, significant overtime costs and one-time costs to support new business, strong volumes and temporary capacity constraints in certain of our markets as well as one-time transition costs associated with the Toronto facility move and rising labour costs from incremental increases in the wage rate. Wages and benefits include $1.8 million related to the incremental volume processed as a result of the acquisition of Fishers.

Linen expenses increased to $19.0 million in 2017 from $17.5 million in 2016, and increased as a percentage of revenue to 11.1% from 11.0% in 2016. The increase is a result of increased healthcare volumes from new customers. Linen expenses include $0.6 million related to the incremental volume processed as a result of the acquisition of Fishers.

Utility costs increased to $10.4 million compared to $9.8 million in 2016 and remained constant as a percentage of revenue at 6.1%. The increase is primarily due to the incremental volume processed, the transition to the new Toronto facility, the new carbon levy in Ontario and Alberta, offset by improved efficiencies in the new Toronto facility. Utility costs include $0.4 million related to the incremental volume processed as a result of the acquisition of Fishers.

Delivery costs increased to $18.3 million and to 10.7% as a percentage of revenues compared to $16.0 million and 10.0% in 2016. The increase is a result of increased business activity, higher cost of diesel, transition costs related to the new Toronto facility and temporary costs to mitigate the effects related to the lock-out of the Toronto unionized delivery drivers. Delivery costs include $1.0 million related to the incremental volume processed as a result of the acquisition of Fishers.

Occupancy costs increased to $6.5 million and to 3.8% as a percentage of revenue, compared to $5.3

million and 3.3% in 2016. This increase is a result of the new Toronto facility and additional warehousing costs to address the temporary storage requirements related to the additional volume from the Vancouver lower mainland contract. Occupancy costs include $0.2 million related to the incremental volume processed as a result of the acquisition of Fishers.

Materials and supplies increased to $5.5 million and to 3.2% as a percentage of revenue, compared to $4.8 million and 3.0% in 2016, due to higher costs associated with the move to the new Toronto facility and to support the increased volumes in certain markets. Materials and supplies include $0.2 million related to the incremental volume processed as a result of the acquisition of Fishers.

Repairs and maintenance increased to $5.6 million and to 3.3% as a percentage of revenues, compared to $4.9 million and 3.1% in 2016, primarily related to the timing of scheduled maintenance activities. Repairs and maintenance include $0.2 million related to the incremental volume processed as a result of the acquisition of Fishers.

Corporate costs increased to $10.9 million and to 6.4% as a percentage of revenues compared to $7.5 million and 4.7% in 2016, primarily due to the timing of costs and initiatives to support the Corporation's growth and business strategies across the plants. Corporate costs include an additional $3.0 million related to the acquisition of Fishers of which $2.8 million are transaction related costs and $0.2 million relates to the ongoing operations of Fishers.

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. The increase during the quarter is related to the completion of the new Toronto facility and the acquisition of Fishers.

Income tax includes current and future income taxes based on taxable income and the temporary timing differences between the tax and accounting bases of assets and liabilities. Income tax reflects the provision on the earnings of the Corporation.

## LIQUIDITY AND CAPITAL RESOURCES

In 2017 cash generated by operating activities was $18.8 million, compared to $24.5 million during 2016. The change in cash from operations is primarily due to the change in working capital items driven mainly from the timing of business activity and payments related to capital commitments.

During 2017, cash generated by financing activities was $93.8 million compared to $13.8 million in 2016. Financing activities in 2017 consisted of net proceeds from the revolving credit facility, $87.7 million net proceeds from issuance of Common Shares, offset by net repayment to the revolving credit facility, and dividends paid to Shareholders.

During 2017, cash used in investing activities was $101.3 million compared to $38.4 million in 2016. Investing activities related primarily to the acquisition of Fishers, purchase of plant equipment for the new Vancouver plant, cash settlement of plant equipment for the new Toronto plant, and the purchase of equipment in existing plants to facilitate strategic growth.

## Contractual Obligations

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 | $ | 42,780 | - | 42,780 | - | - |
| Operating lease commitments | $ | 68,276 | 9,588 | 15,379 | 11,115 | 32,194 |
| Utility commitments | $ | 9,676 | 5,827 | 2,575 | 1,274 | - |
| Linen purchase obligations | $ | 10,232 | 10,232 | - | - | - |
| Property, plant and equipment commitments | $ | 28,748 | 28,748 | - | - | - |

The operating lease obligations are secured by automotive equipment and plants, and are more fully described in the Corporation's 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)* | | 2017 | | 2016 |
|---|---|---|---|---|
| Cash and cash equivalents | $ | (11,276) | $ | - |
| Long-term debt | | 42,780 | | 25,800 |
| Shareholders' equity | | 201,587 | | 116,672 |
| Total capitalization | $ | 233,091 | $ | 142,472 |
| Debt to total capitalization (see *Terminology* for definition) | | 18.4% | | 18.1% |

For the year ended December 31, 2017, the Corporation had a debt to total capitalization ratio of 18.4%, unused borrowing capacity of $55.6 million and has not incurred any events of default under the terms of its credit agreement.

As at December 31, 2017, the Corporation had net working capital of $32.0 million compared to its working capital position of $13.8 million at December 31, 2016. The increase in working capital is primarily attributable to timing differences related in the cash settlement of new plant equipment, and deposits related to the acquisition of equipment related across the plants.

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 believes it is also able to issue additional Common Shares or increase its borrowing capacity, if necessary, to provide for capital spending and sustain its property, plant and equipment.

## DIVIDENDS

| Fiscal Period | Payment Date | # of Shares outstanding | 2017 Amount per Share | 2017 Total Amount (1)(2)(3)(4) | 2016 Amount per Share | 2016 Total Amount (5)(6)(7) |
|---|---|---|---|---|---|---|
| January | February 15 | 8,023,480 | $ 0.10000 | $ 802 | $ 0.10000 | $ 799 |
| February | March 15 | 8,023,480 | 0.10000 | 802 | 0.10000 | 799 |
| March | April 13 | 8,023,480 | 0.10000 | 802 | 0.10000 | 799 |
| Q1 | | | $ 0.30000 | $ 2,407 | $ 0.30000 | $ 2,396 |
| April | May 15 | 9,541,480 | $ 0.10000 | $ 954 | $ 0.10000 | $ 799 |
| May | June 15 | 9,583,902 | 0.10000 | 958 | 0.10000 | 802 |
| June | July 14 | 9,583,902 | 0.10000 | 958 | 0.10000 | 802 |
| Q2 | | | $ 0.30000 | $ 2,871 | $ 0.30000 | $ 2,403 |
| July | August 15 | 9,583,902 | $ 0.10000 | $ 958 | $ 0.10000 | $ 802 |
| August | September 15 | 9,583,902 | 0.10000 | 958 | 0.10000 | 802 |
| September | October 13 | 9,583,902 | 0.10000 | 958 | 0.10000 | 802 |
| Q3 | | | $ 0.30000 | $ 2,875 | $ 0.30000 | $ 2,407 |
| October | November 15 | 9,583,902 | $ 0.10000 | $ 958 | $ 0.10000 | $ 802 |
| November | December 15 | 9,583,902 | 0.10000 | 958 | 0.10000 | 802 |
| December | January 15 | 10,508,502 | 0.10000 | 1,051 | 0.10000 | 802 |
| Q4 | | | $ 0.30000 | $ 2,968 | $ 0.30000 | $ 2,407 |
| YTD | | | $ 1.20000 | $ 11,121 | $ 1.20000 | $ 9,613 |

(1) The total amount of dividends paid was $0.10000 per share for a total of $802,348 per month for January - March 2017; when rounded in thousands, $2,407 of dividends were paid for the quarterly period.

(2) The total amount of dividends paid was $0.10000 per share for a total of $954,148 for April 2017, $958,390 for May 2017, and $958,390 for June 2017. When rounded in thousands, $2,871 of dividends were paid for the quarterly period.

(3) The total amount of dividends paid was $0.10000 per share for a total of $958,390 per month for July - September 2017; when rounded in thousands, $2,875 of dividends were paid in Q3.

(4) The total amount of dividends paid was $0.10000 per share for a total of $958,390 for October 2017, $958,390 for November 2017, and $1,050,850 for December 2017; when rounded in thousands, $2,968 of dividends were paid in Q4.

(5) The total amount of dividends paid was $0.10000 per share for a total of $798,571 per month for January - March 2016; when rounded in thousands, $2,396 of dividends were paid for the quarterly period.

(6) The total amount of dividends paid was $0.10000 per share for a total of $798,571 for April 2016, $802,348 for May 2016, and $802,348 for June 2016. When rounded in thousands, $2,403 of dividends were paid for the quarterly period.

(7) The total amount of dividends paid was $0.10000 per share for a total of $802,348 per month for July - September 2016; when rounded in thousands, $2,407 of dividends were paid in Q3 and Q4.

For the three months ended December 31, 2017, the Corporation declared a $0.300 per Common Share dividend compared to $0.284 per Common Share of Distributable Cash Flow (see *Terminology*). The payout ratio for the three months ended December 31, 2017 was 107.1%

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 percentages and per share amounts)* | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 |
| Cash provided by operating activities | $ 6,395 | $ 3,788 | $ 2,297 | $ 6,300 | $ 6,071 | $ 7,581 | $ 4,143 | $ 6,726 |
| *Deduct (add):* | | | | | | | | |
| Net changes in non-cash working capital items[1] | 2,942 | (3,917) | (4,161) | 1,214 | (336) | 1,102 | (2,625) | 665 |
| Share-based compensation | 333 | 276 | 494 | 405 | 368 | 337 | 330 | 483 |
| Maintenance capital expenditures[2] | 349 | 192 | 427 | 179 | 264 | 289 | 1,270 | 293 |
| Distributable cash flow | $ 2,771 | $ 7,237 | $ 5,537 | $ 4,502 | $ 5,775 | $ 5,853 | $ 5,168 | $ 5,285 |
| Dividends declared | 2,968 | 2,875 | 2,871 | 2,407 | 2,407 | 2,407 | 2,403 | 2,396 |
| Dividends declared per share | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 | 0.300 |
| Payout ratio[3] | 107.1% | 39.7% | 51.8% | 53.5% | 41.7% | 41.1% | 46.5% | 45.3% |
| Weighted average shares outstanding during the period, basic | 9,718 | 9,511 | 9,104 | 7,979 | 7,965 | 7,957 | 7,952 | 7,946 |
| Weighted average shares outstanding during the period, diluted | 9,755 | 9,548 | 9,133 | 7,999 | 8,004 | 7,991 | 7,965 | 7,965 |
| **Trailing-twelve months ("TTM")** | | | | | | | | |
| Distributable cash flow | 20,047 | 23,051 | 21,667 | 21,298 | 22,081 | 20,908 | 21,426 | 21,731 |
| Dividends | 11,121 | 10,560 | 10,092 | 9,624 | 9,613 | 9,602 | 9,591 | 9,579 |
| Payout ratio[3] | 55.5% | 45.8% | 46.6% | 45.2% | 43.5% | 45.9% | 44.8% | 44.1% |

(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) Maintenance capital expenditures include costs required to maintain or replace assets which do not have a discrete return on investment.

(3) 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 divided by the distributable cash flow.

## OUTSTANDING SHARES

As at December 31, 2017, the Corporation had 10,508,502 Common Shares outstanding. Basic and diluted weighted average number of Common Shares outstanding for 2017 were 9,083,693 and 9,114,874, respectively, (7,955,026 and 7,986,729, respectively, for the comparative 2016 periods).

In accordance with the Corporation's long term incentive plan (the "LTI Plan") and in conjunction with the performance of the Corporation in the 2016 fiscal year, on April 21, 2017 the Compensation, Nominating and Corporate Governance Committee of the Board of Directors approved LTI compensation of $1.7 million (2016 – $1.6 million) to be paid as Common Shares issued from treasury.

As at December 31, 2017, the value of the Common Shares held in trust by the LTI trustee was $2.3 million (December 31, 2016 – $1.9 million) which was comprised of 54,880 in unvested Common Shares (December 31, 2016 – 44,634) with a nil aggregate cost (December 31, 2016 – $nil).

As at March 14, 2018 there were 10,508,502 Common Shares issued and outstanding including 54,880 Common Shares issued but held as unvested treasury shares.

## 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. The amounts charged are recorded at their exchange amounts and are on arm's length terms. For the year ended December 31, 2017, the Corporation incurred fees totaling $138,000 (2016 – $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;
- segment information; and,
- business combinations.

The following discusses the most significant accounting judgments and estimates in the Corporation's consolidated financial statements.

**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.

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.

The Corporation reviews goodwill at least annually and other non-financial assets when there is any indication that the asset might be impaired. The Corporation applies judgment in assessing the likelihood of renewal of significant contracts included in the intangible assets. The Corporation has estimated the fair value of CGUs to which goodwill is allocated based on value in use using discounted cash flow models that required assumptions about future cash flows, margins, and discount rates. At this time, K-Bro does not believe any intangible assets have a book value in excess of their fair market value.

**Recognition of Rebate Liabilities**

In applying its accounting policy for volume rebates, the Corporation must determine whether the processing volume thresholds will be achieved. The most difficult and subjective area of judgment is whether a contract will generate satisfactory volume to achieve minimum levels. Management considers all appropriate facts and circumstances in making this assessment including historical experience,

current volumetric run-rates, and expected future events.

### Linen in Service

The estimated service lives of linen in service are reviewed at least annually and are updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence and legal or other limits of use.

### Segment Identification

When determining its reportable segments, the Corporation considers qualitative factors, such as operations that offer distinct products and services and are considered to be significant by the Chief Operating Decision Maker, identified as the Chief Executive Officer. Aggregation occurs when the operating segments have similar economic characteristics, and have similar (a) products and services; (b) geographic proximity; (c) type or class of customer for their products and services; (d) methods used to distribute their products or provide their services; and (e) nature of the regulatory environment, if applicable.

### Provisions

The Corporation is required to restore the leased premises of its leased plants. A provision has been recognized for the present value of the estimated expenditure required to remove any leasehold improvements and installed equipment.

Management regularly evaluates these estimates and judgments. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

# TERMINOLOGY

## EBITDA

We report on our EBITDA (Earnings before interest, taxes, depreciation and amortization) because it is a key measure used by management to evaluate performance. EBITDA is utilized in measuring compliance with debt covenants and in making decisions relating to 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, and income taxes.

EBITDA is a sub-total presented within the statement of earnings in accordance with the amendments made to IAS 1 which became effective January 1, 2016. EBITDA is not considered an alternative to net earnings in measuring K-Bro's performance. 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, | | Years Ended December 31, | |
|---|---|---|---|---|
| *(thousands)* | **2017** | 2016 | **2017** | 2016 |
| Net earnings (loss) | **$ (1,287)** | $ 2,197 | **$ 5,718** | $ 11,527 |
| *Add:* | | | | |
| Income tax expense | **849** | 1,011 | **3,761** | 4,840 |
| Finance expense | **786** | 247 | **1,133** | 739 |
| Depreciation of property, plant and equipment | **3,543** | 2,438 | **11,606** | 9,235 |
| Amortization of intangible assets | **562** | 428 | **1,767** | 1,790 |
| **EBITDA** | **$ 4,453** | $ 6,321 | **$ 23,985** | $ 28,131 |

### *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. Adjusted EBITDA is defined as EBITDA (defined above) with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. The calculation of Adjusted EBITDA normalizes the impact of the transaction costs related to the acquisition of Fishers, and the related impact on EBITDA (as defined above). During the fourth quarter in 2017, K-Bro incurred $2.8 million in transaction costs directly related to the acquisition of Fishers, which is not expected to occur in the normal course of operations. The normalization of this expense from the calculation of EBITDA is considered by Management to be a more accurate representation of continuing operations. One-time costs related to the Toronto plant transition, capacity constraints and the Toronto driver lock-out have not been adjusted for in the table below.

| | Canadian Division | UK Division | Three Months Ended December 31, | | Canadian Division | UK Division | Years Ended December 31, | |
|---|---|---|---|---|---|---|---|---|
| *(thousands)* | 2017 | 2017 | **2017** | 2016 [1] | 2017 | 2017 | **2017** | 2016 [1] |
| EBITDA | $ 6,961 | $ (2,508) | **$ 4,453** | $ 6,321 | $ 26,493 | $ (2,508) | **$ 23,985** | $ 28,131 |
| *Add:* | | | | | | | | |
| Transaction costs incurred in the acquisition of Fishers | - | 2,831 | **2,831** | - | - | 2,831 | **2,831** | - |
| **Adjusted EBITDA** | $ 6,961 | $ 323 | **$ 7,284** | $ 6,321 | $ 26,493 | $ 323 | **$ 26,816** | $ 28,131 |

## 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. Adjusted net earnings is defined as net earnings with the exclusion of certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations. The calculation of adjusted net earnings normalizes the impact of the transaction costs related to the acquisition of Fishers, 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 core operations.

| | Canadian Division | UK Division | Three Months Ended December 31, | | Canadian Division | UK Division | Years Ended December 31, | |
|---|---|---|---|---|---|---|---|---|
| *(thousands)* | 2017 | 2017 | **2017** | 2016 (1) | 2017 | 2017 | **2017** | 2016 (1) |
| Net earnings (loss) | $ 1,594 | $ (2,881) | **$ (1,287)** | $ 2,197 | $ 8,599 | $ (2,881) | **$ 5,718** | $ 11,527 |
| *Add (net of corporate income taxes):* | | | | | | | | |
| Transaction costs incurred in the acquisition of Fishers | - | 2,831 | **2,831** | - | - | 2,831 | **2,831** | - |
| **Adjusted net earnings** | $ 1,594 | $ (50) | **$ 1,544** | $ 2,197 | $ 8,599 | $ (50) | **$ 8,549** | $ 11,527 |
| Weighted average number of shares outstanding: | | | | | | | | |
| Basic | 9,717,890 | 9,717,890 | **9,717,890** | 7,964,645 | 9,083,693 | 9,083,693 | **9,083,693** | 7,955,026 |
| Diluted | 9,755,183 | 9,755,183 | **9,755,183** | 8,003,999 | 9,114,874 | 9,114,874 | **9,114,874** | 7,986,729 |
| Adjusted net earnings per share: | | | | | | | | |
| Basic | $0.164 | ($0.005) | **$0.159** | $0.276 | $0.947 | ($0.006) | **$0.941** | $1.449 |
| Diluted | $0.163 | ($0.005) | **$0.158** | $0.274 | $0.943 | ($0.005) | **$0.938** | $1.443 |

## 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. Management refers to "Distributable cash flow" as to cash provided by (used in) operating activities with the addition of net changes in non-cash working capital items, less share-based compensation, and maintenance 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 less cash and cash equivalents 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, 2017, the Corporation has not entered into any off balance sheet arrangements.

## CHANGES IN ACCOUNTING POLICIES

The Corporation has prepared its December 31, 2017 audited consolidated financial statements in accordance with IFRS. See Note 2 of the Corporation's audited annual Consolidated Financial Statements for more information regarding the significant accounting principles used to prepare the Consolidated Financial Statements.

## RECENT ACCOUNTING PRONOUNCEMENTS

The following standard has been issued but has not yet been applied in preparing the consolidated financial statements.

- IFRS 15, Revenue from Contracts with Customers, was issued in May 2014 by the IASB and supersedes IAS 18, "Revenue", IAS 11 "Construction Contracts" and other interpretive guidance associated with revenue recognition. IFRS 15 provides a single model to determine how and when an entity should recognize revenue, as well as requiring entities to provide more informative, relevant disclosures in respect of its revenue recognition criteria. IFRS 15 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The new standard introduces expanded disclosure requirements. The Corporation has undertaken a detailed review of contracts entered with key customers and other forms of agreements with customers and has evaluated the provisions under the five-step model specified by the new guidance. In addition, the Corporation continues to monitor additional interpretive guidance related to the new standard as it becomes available, as well as comparing the conclusions made on specific interpretative issues to other peers in the packaging industry, to the extent that such information is available. The standard will be implemented by the Corporation in 2018. The Corporation expects the new revenue recognition guidance will not have a material impact on the consolidated financial statements. The Corporation currently intends to select the modified retrospective approach with results in the cumulative effect of adoption recognized at the date of initial application at January 1, 2018.

- IFRS 9, Financial Instruments, was issued in July 2014 by the IASB and supersedes IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 retains but simplifies the mixed measurement model and establishes three primary measurement categories for financial assets: amortized cost, fair value through OCI and fair value through P&L. IFRS 9 is to be applied prospectively and is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. The Corporation has determined the adoption of the standard will not have a material impact to the consolidated financial statements.

- IFRS 16, Leases, was issued in January 2016 and applies to annual reporting periods beginning on or after January 1, 2019. IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. The Corporation is in the process of evaluating the impact that IFRS 16

may have on the financial statements. The standard will affect primarily the accounting for the Corporation's operating leases. The Corporation has not yet determined to what extent these commitments will result in the recognition of assets and liabilities for future payments and how this will affect EBITDA, net earnings and classification of cash flows.

- On June 20, 2016 the IASB issued an amendment to IFRS 2 "Share-based Payment" addressing three classification and measurement issues. The amendment clarifies the measurement basis for cash-settled, share based payments and the accounting for modifications that change an award from cash-settled to equity settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly-equity settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share based payment and pay that amount to the tax authority. The amendments are effective for periods beginning on or after January 1, 2018. The Corporation has determined the adoption of the standard will not have a material impact to the consolidated financial statements.

## FINANCIAL INSTRUMENTS

K-Bro's financial instruments at December 31, 2017 consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable 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 the Corporation to manage cash flow risk against the volatility in interest rates on its long-term debt and foreign exchange rates on its equipment purchase commitments. The Corporation typically does not utilize derivative financial instruments for trading or speculative purposes. The Corporation has a 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, the Corporation may enter into interest rate swaps, forward contracts on foreign currency, utilities and textiles or option contracts. The Corporation has entered into several electrical and natural gas contracts at December 31, 2017. The Corporation has examined the terms of the natural gas and electricity contracts and has determined that these contracts will be physically settled and as such are not considered to be financial instruments.

## CRITICAL RISKS AND UNCERTAINTIES

As at December 31, 2017, there are no material changes in the Corporation's risks or risk management activities since December 31, 2016. The Corporation's results of operations, business prospects, financial condition, cash dividends to Shareholders and the trading price of the Corporation's Common 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 under the Corporation's profile 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 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, 2017, 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, 2017 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, 2017, subject to the limitation on scope of design as discussed below, 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.

### Limitation on Scope of Design

K-Bro has limited the scope of design of DCP and our Internal Controls over Financial Reporting (ICFR) to exclude controls, policies and procedures of Fishers acquired on November 27, 2017. The scope limitation is in accordance with section 3.3(1)(b) of NI 52-109 which allows an issuer to limit its design of ICFR to exclude controls, policies and procedures of a business that the issuer acquired not more than 365 days before the end of the fiscal period.

| **Fishers** (millions) | **As at December 31, 2017** |
|---|---|
| Current assets | **$ 27.9** |
| Non-current assets | **42.0** |
| Current liabilities | **11.3** |
| Non-current liabilities | **4.0** |

| **Fishers** (millions) | **Year ended December 31, 2017** |
|---|---|
| Revenue | **$ 4.7** |
| Expense | **(7.6)** |
| Income from operations | **$ (2.9)** |

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 »).