



K·BRO

## MANAGEMENT'S DISCUSSION & ANALYSIS



## **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 unaudited interim Condensed Consolidated Financial Statements of K-Bro Linen Inc. ("the Corporation") for the nine months ended September 30, 2020 and the audited Consolidated Financial Statements, as well as the MD&A, for the year ended December 31, 2019. The Corporation and its wholly-owned subsidiaries, including K-Bro Linen Systems Inc., are collectively referred to as "K-Bro" in this MD&A.

Management is responsible for the information contained in this MD&A and its consistency with information presented to the Audit Committee and Board of Directors. All information in this document has been reviewed and approved by the Audit Committee and Board of Directors. This review was performed by management with information available as of November 10, 2020.

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, Quebec, Saskatchewan and the United Kingdom (the "UK"); (ix) the availability of future financing; (x) textile demand; (xi) the adverse impact of the COVID-19 pandemic on the Corporation, which has been significant to date and which we believe will continue to be significant for the short-term; and (xii) foreign currency risk. 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; (iv) foreign exchange rates; (v) the level of capital expenditures and (vi) the expected impact of the COVID-19 pandemic on the Corporation. 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 new customers, calculation of costs, including one-time costs impacting the quarterly financial results, anticipated future capital spending and statements with respect to future expectations on margins and volume growth, as well as statements related to the impact of the COVID-19 pandemic on the Corporation.

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 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 six UK sites located in Cupar, Perth, Newcastle, Livingston 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 linen, workwear and clean room garment services. Other types of processors in Fishers' industry in the UK include publicly traded companies, 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 has historically exhibited the following characteristics and trends:

*Generally Stable Industry with Moderate Cyclicity* – 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 five to ten years), while contracts in the hospitality sector usually range from two to five years. We note that the ongoing COVID-19 pandemic has introduced atypical instability in both the healthcare and the hospitality sectors which is inconsistent with the historical characteristics of and trends in K-Bro's industry. The continued spread of COVID-19 throughout Canada and the UK, at least in the short-term, is expected to have a significant negative impact on the Corporation's business.

*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' customers include 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 greater than 250 rooms) have historically generated between 0.5 million and 3 million pounds of linen per year. Most healthcare customers have historically generated between 0.5 million pounds of linen per year for a hospital and up to approximately 40 million pounds of linen per year for a Canadian healthcare region. We note that the ongoing COVID-19 pandemic has introduced atypical instability in both the healthcare and the hospitality sectors which is inconsistent with such historical linen generation trends. As COVID-19 continues to spread throughout Canada and the UK, at least in the short-term, we expect significant reductions in linen volume generation by our customers in the hospitality segment, primarily as a result of decreased willingness and ability of the general population to travel to and within Canada and the UK during the course of the

outbreak. In addition, as hospitals have prepared for potential surges in COVID-19-related occupancy, in Q1 and early Q2 we saw a decline in healthcare volumes as a result of cancelled elective surgeries and decreased occupancy rates. As Q2 and Q3 progressed, we have seen a gradual return to more typical healthcare levels however we cannot predict with certainty how a second wave of COVID-19 will impact overall volumes.

## SELECTED QUARTERLY FINANCIAL INFORMATION

(In reporting currency \$ Canadian)

(thousands, except percentages and per share amounts)	Three Months Ended September 30,										
	Canadian Division		UK Division	2020 <sup>(5)</sup>	Canadian Division		UK Division	2019 <sup>(4)</sup>	Canadian Division		UK Division
	2020	2020	2019		2019	2018	2018		2018		
Revenue	\$ 43,045	\$ 8,394	\$ 51,439	\$ 49,491	\$ 18,351	\$ 67,842	\$ 46,872	\$ 17,100	\$ 63,972		
EBITDA <sup>(1)</sup>	12,046	673	12,719	10,423	4,194	14,617	5,114	3,196	8,310		
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	10,609	176	10,785	8,925	3,361	12,286	5,114	3,196	8,310		
Net earnings (loss)	4,404	(962)	3,442	2,893	1,776	4,669	200	1,686	1,886		
Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	4,422	(879)	3,543	2,919	1,817	4,736	200	1,686	1,886		
<i>Net earnings (loss) per share:</i>											
Basic	\$ 0.417	\$ (0.091)	\$ 0.326	\$ 0.275	\$ 0.169	\$ 0.444	\$ 0.019	\$ 0.161	\$ 0.180		
Diluted	\$ 0.413	\$ (0.090)	\$ 0.323	\$ 0.273	\$ 0.168	\$ 0.441	\$ 0.019	\$ 0.160	\$ 0.179		
<i>Adjusted net earnings (loss) without adoption of IFRS 16 per share:</i>											
Basic	\$ 0.419	\$ (0.083)	\$ 0.335	\$ 0.278	\$ 0.173	\$ 0.451	\$ 0.019	\$ 0.161	\$ 0.180		
Diluted	\$ 0.415	\$ (0.082)	\$ 0.332	\$ 0.276	\$ 0.172	\$ 0.447	\$ 0.019	\$ 0.160	\$ 0.179		
Total assets			\$ 338,591			\$ 353,021			\$ 316,968		
Long-term debt (excludes lease liabilities)			59,325			66,070			67,045		
<i>Weighted average number of shares outstanding:</i>											
Basic			10,562,663			10,510,915			10,470,255		
Diluted			10,666,540			10,584,300			10,540,278		

(thousands, except percentages and per share amounts)	Nine Months Ended September 30,										
	Canadian Division		UK Division	2020 <sup>(5)</sup>	Canadian Division		UK Division	2019 <sup>(4)</sup>	Canadian Division		UK Division
	2020	2020	2019		2019	2018	2018		2018		
Revenue	\$ 122,109	\$ 24,125	\$ 146,234	\$ 140,623	\$ 48,895	\$ 189,518	\$ 134,822	\$ 45,272	\$ 180,094		
EBITDA <sup>(1)</sup>	26,414	103	26,517	27,106	9,365	36,471	16,532	6,430	22,962		
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	27,597	(2,145)	25,452	22,769	6,808	29,577	16,532	6,430	22,962		
Net earnings (loss)	6,392	(4,745)	1,647	6,027	2,684	8,711	2,669	2,448	5,117		
Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	10,767	(4,947)	5,820	6,162	2,769	8,931	2,669	2,448	5,117		
<i>Net earnings (loss) per share:</i>											
Basic	\$ 0.606	\$ (0.450)	\$ 0.156	\$ 0.574	\$ 0.256	\$ 0.829	\$ 0.255	\$ 0.234	\$ 0.489		
Diluted	\$ 0.601	\$ (0.446)	\$ 0.155	\$ 0.571	\$ 0.254	\$ 0.825	\$ 0.254	\$ 0.233	\$ 0.487		
<i>Adjusted net earnings (loss) without adoption of IFRS 16 per share:</i>											
Basic	\$ 1.020	\$ (0.469)	\$ 0.552	\$ 0.587	\$ 0.264	\$ 0.850	\$ 0.255	\$ 0.234	\$ 0.489		
Diluted	\$ 1.013	\$ (0.465)	\$ 0.547	\$ 0.583	\$ 0.262	\$ 0.844	\$ 0.254	\$ 0.232	\$ 0.487		
Total assets			\$ 338,591			\$ 353,021			\$ 316,968		
Long-term debt (excludes lease liabilities)			59,325			66,070			67,045		
<i>Weighted average number of shares outstanding:</i>											
Basic			10,551,230			10,503,778			10,462,091		
Diluted			10,631,404			10,561,812			10,513,782		

- (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 without adoption of IFRS 16 (as defined below) is defined as EBITDA (defined above) with the exclusion of IFRS 16, and 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 without adoption of IFRS 16 is defined as net earnings with the exclusion of IFRS 16, and 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) Effective January 1, 2019, the Corporation has adopted IFRS 16 Leases ("IFRS 16") using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16. To enable the comparability of previous periods, the Corporation has provided the 2020 and 2019 figures for both EBITDA and net earnings without adoption of IFRS 16 as separate line items.
- (5) Q1 2020 includes an adjustment of \$5.5 million for an impairment related charge to the Canadian Division, and is excluded in adjusted EBITDA and adjusted net earnings (loss).

## SUMMARY OF INTERIM RESULTS, AND KEY EVENTS

### Financial Growth

Net earnings for the third quarter of 2020 was \$3.4 million or \$0.33 per share (basic). Cash used in operating activities for the third quarter of 2020 was \$0.5 million and distributable cash flow was \$11.1 million. As a result of the COVID-19 pandemic, consolidated hospitality revenue for the three months ended September 30, 2020 decreased by 62.7% over the comparable 2019 period. This is partially offset by an increase of 12.6% in consolidated healthcare revenue for an overall decrease in consolidated revenue of 24.2%.

EBITDA (see “Terminology”) decreased in the third quarter to \$12.7 million from \$14.6 million in 2019, which is a decrease of 13.0%. On a consolidated basis, the Corporation’s EBITDA margin increased from 21.5% in 2019 to 24.7% in 2020. For the Canadian division, EBITDA margin increased to 28.0% from 21.1% for the comparative quarter of 2020. For the UK division, EBITDA margin decreased to 8.0% from 22.9% for the comparative quarter of 2020.

On a consolidated basis, adjusted EBITDA and margin without the adoption of IFRS 16 for the third quarter of 2020 was \$10.8 million and 21.0%, compared to \$12.3 million and 18.1% respectively in the same comparative period of 2019. The changes in adjusted EBITDA and adjusted EBITDA margin relate primarily to effects of COVID-19, which include government assistance received during the quarter.

For the Canadian division, the Corporation, for the months of April, May, and July through September was eligible for the Canadian Emergency Wage Subsidy (“CEWS”) that was announced by the Federal Government in response to the COVID-19 pandemic on March 27, 2020. The CEWS program, which subsidizes a percentage of employee wages (subject to certain caps) is designed for eligible Canadian employers whose businesses have been impacted by the COVID-19 pandemic and is intended to help employers rehire previously laid off workers, retain existing employees, and assist Canadian businesses through the pandemic. The CEWS program allowed the Corporation to preserve a significant number of jobs. As a result, during the third quarter of 2020 the Company recognized \$2.1 million of wage subsidy which has been netted against the respective source of the expense. This includes an allocation to wages and benefits of \$1.8 million, delivery of \$0.2 million, and corporate costs of \$0.1 million. Without the benefit of this wage subsidy, the Canadian operations would have taken available alternative actions. Year to date, the Corporation has recognized \$7.7 million of the wage subsidy which has been netted against the respective source of the expense.

For the UK division, the Corporation was eligible for the Coronavirus Job Retention Scheme (“CJRS”) which was introduced by the UK government on March 20, 2020 to pay approximately 80% of salaries for employees (subject to certain caps) who are furloughed. As a result, during the third quarter of 2020 the Company recognized £0.7 million (\$1.1 million) of wage subsidy which has been netted against the respective source of the expense. This includes an allocation to wages and benefits of £0.4 million (\$0.6 million), delivery of £0.2 million (\$0.3million), and corporate costs of £0.1 million (\$0.2 million). Year to date, the Corporation has recognized £2.7 million (\$4.6 million) which has been netted against the respective source of the expense. During the third quarter, the terms of the CJRS required that companies share in the cost of the program and as a result the impact to EBITDA during the quarter and year to date was a cost of £26k (\$45k) which represents the UK division’s contribution for hours and certain benefits. For greater clarity, until July 2020 the UK division received an equivalent amount from the government that is then paid to furloughed employees netting to no impact on EBITDA however starting in August 2020 the UK division was required to make contributions for hours and certain benefits.

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

In 2019, management completed its strategy in its Toronto and Vancouver markets that it believes will position K-Bro for long-term growth in its healthcare and hospitality businesses. The strategy included capital investments to build large, efficient, state-of-the-art facilities with meaningful additional capacity in Toronto and Vancouver. In addition, K-Bro has made investments to upgrade one of its existing Vancouver plants to create a more efficient facility with meaningful additional capacity.

The construction and/or upgrade of three of our large facilities enables us to bid on a significant amount of additional business, but created margin pressure through 2017, 2018 and Q1 2019 as K-Bro incurred significant one-time and transition costs associated with these large investments. Management believes that the one-time and transition costs incurred will position K-Bro to achieve more long-term growth and a lower cost structure in the future and that K-Bro will ultimately return to normalized margins upon resolution of the COVID-19 pandemic, as more specifically discussed below.

As disclosed above, the continued spread of COVID-19 throughout Canada and the UK, at least in the short-term, is expected to have a significant negative impact on the amount of volume processed by the Corporation. Dependent on the duration of the pandemic, management believes that the Corporation's capital investments in Vancouver and Toronto could position the Corporation to profitably grow the business, for example as hotel occupancy rates rebound upon resolution of the public health crisis.

## **Key events in our markets are summarized below.**

### ***British Columbia Contract Award***

On September 1, 2020 the Corporation was awarded a five-year extension to provide healthcare laundry and linen services to part of the Lower Mainland. The contract extends the existing relationship between the Corporation and Business Initiatives & Support Services (BISS) for Vancouver Coastal Health, Fraser Health, Providence Health Care and Provincial Health Services Authority.

### ***Revolving Credit Facility***

During the second quarter of 2020, the Corporation completed an amendment to its existing revolving credit facility which made changes to certain terms and conditions within the agreement in consideration of the ongoing COVID-19 pandemic and the impact to the Corporation's operations. Key changes included:

- An increased Funded Debt to EBITDA covenant for the period of September 30, 2020 to June 30, 2021 which gradually allows for a maximum Funded Debt to EBITDA ratio of 4.5x for Q4 2020 and Q1 2021 including certain one-time add backs to EBITDA.
- A reduction to the Fixed Charge Covenant for the period of September 30, 2020 to June 30, 2021 which reduces to a maximum of 1.1x.
- A restriction on any further dividend increases during the covenant relief period of July 1, 2020 to June 30, 2021.

### ***UK Acquisition***

On July 19, 2019, the Corporation signed a share purchase agreement to acquire all the assets of a Scotland-incorporated private laundry and linen services company operating in Aberdeen. This acquisition was completed in September 2019 for a total consideration of £775k plus a working capital adjustment. For accounting purposes, the transaction has been treated as an asset acquisition, whereby

the net working capital was recorded at closing, and the customer contracts acquired have been recorded as an intangible asset for £883k representing the total purchase price of £775k and associated transaction costs of £88k.

### ***Capital Investment Plan***

For fiscal 2020, K-Bro had previously anticipated capital spending to be approximately \$5.0 million on a consolidated basis. However, in light of the current public health crisis, the Corporation's planned capital spending for fiscal 2020 is expected to be approximately \$3.0 million, as a result of the deferral of the Corporation's plan to implement an enterprise-wide operating system. This guidance includes both strategic and maintenance capital requirements to support existing base business in both Canada and the UK and does not take into account amounts accrued in 2019 that were paid in 2020.

### ***Alberta Contract Award***

On March 1, 2020, the Corporation was awarded a one-year extension to provide laundry and linen services to Alberta Health Services Calgary. The contract extends the existing relationship between the Corporation and Alberta Health Services Calgary.

### ***Loss of Whitbread Group Contract***

Subsequent to the 2019 fiscal year, the Corporation was unsuccessful in renewing its UK contract with the Whitbread Group. The associated volume was phased out of the relevant plant over the first two quarters of 2020. For the year ended December 31, 2019, this contract accounted for approximately 14% of Fishers' overall revenue.

### ***COVID-19 Pandemic***

The ongoing COVID-19 pandemic has caused world governments to institute travel restrictions, impacting travel both in and out of Canada and the UK. This has had and is expected to continue to have a significant adverse impact on the Corporation's hospitality business, the duration of which we are unable to predict with any degree of accuracy. Since mid-March, we have seen significantly reduced hotel occupancy rates compared to historical levels. Demand for both business and leisure airline travel has declined significantly on a global basis, and airlines are responding by cancelling international and domestic flights. Accordingly, hospitality volumes in all of our Canadian and UK markets have slowed to historically low levels. While we saw improvement in the Corporation's hospitality business in Q3 resulting from increased domestic tourism, we expect Q4 to decline given the higher proportion of business travel typical in this quarter. In addition to this, in late Q1 and into Q2 we saw decreases in our healthcare business as a result of hospitals and health authorities taking measures to prepare for anticipated surges in COVID-19-related occupancy (i.e., cancellation of elective surgeries). As Q2 and Q3 progressed, we saw a return to more normal healthcare levels however we cannot predict with certainty how a second wave of COVID-19 will impact overall volumes. The following table depicts the impact on the Corporation's revenue to date.



Month	Healthcare Revenue Change (2020 compared to 2019)	Hospitality Revenue Change (2020 compared to 2019)	Consolidated Revenue Change (2020 compared to 2019)
January	3%	7%	5%
February	5%	7%	6%
March	0%	-27%	-12%
<b>Q1 2020 compared to Q1 2019 (Jan to March)</b>	<b>3%</b>	<b>-6%</b>	<b>-1%</b>
April	-8%	-94%	-45%
May	2%	-92%	-39%
June	9%	-90%	-40%
<b>Q2 2020 compared to Q2 2019 (April to June)</b>	<b>1%</b>	<b>-92%</b>	<b>-41%</b>
July	13%	-76%	-29%
August	12%	-59%	-23%
September	12%	-53%	-20%
<b>Q3 2020 compared to Q3 2019 (July to September)</b>	<b>12%</b>	<b>-63%</b>	<b>-24%</b>
October - Estimate	12%	-60%	-20%

Although the Corporation has developed and implemented measures to mitigate the effects of the COVID-19 pandemic which include, temporary restructuring through consolidating operations, reducing headcount, reducing certain capital expenditures and accessing available government assistance programs, earnings will continue to be particularly affected if we continue to experience reductions in travel and reduced hospitality and healthcare occupancy rates. The extent of such negative effects on our business and our financial and operational performance will depend on future developments, including the duration, spread and severity of the outbreak, the duration and geographic scope of related travel advisories and restrictions and the extent of the impact of the COVID-19 pandemic on overall demand for personal and business travel, all of which are highly uncertain and cannot be predicted with any degree of accuracy. As hotels are continuing to experience significantly reduced occupancy rates for an extended period, our 2020 consolidated results of operations will continue to be significantly impacted. Additionally, our suppliers or other third parties we rely upon may experience delays or shortages, which could have an adverse effect on our business prospects and results of operations.

As an ongoing risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, and continues to be offset through the Corporation's business continuity plan and other mitigating measures. Any estimate of the length and severity of these developments is therefore subject to significant uncertainty, and, accordingly, estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Corporation's operations, financial results and condition in future periods are also subject to significant uncertainty.

Therefore, uncertainty about judgments, estimates and assumptions made by management during the preparation of the Corporation's interim condensed consolidated financial statements related to potential impacts of the COVID-19 pandemic on revenue, expenses, assets, liabilities, and note disclosures could result in a material adjustment to the carrying value of the assets or liabilities affected.

### **Impairment of Assets**

Based on management's review, the original assessment at March 31, 2020 remains appropriate in that no additional impairment amounts are determined to be required, with the exception of CGU's already deemed to be impaired. Management had previously assessed the impairment indicators that existed at March 31, 2020, specifically, five CGUs that rely primarily on hospitality revenues due to the significant impact that COVID-19 had on the hospitality industry. The recoverable amounts of these specific CGUs were recalculated using the value in use method by applying probability weightings to capture the increased risk and uncertainty arising from COVID-19.

Management's probability weighted approach was evaluated based off an equally weighted probability of a one year downturn in sales to the worst case of a two year downturn in sales. The scenarios estimated a decline of 70% for year 1 and 50% for year 2, with sales returning to normalized levels thereafter with sales growth estimates used between 2% to 3%. At March 31, 2020, an impairment loss of \$5,516k was recognized for three CGUs in the Canadian division, of which \$3,177k was allocated to goodwill and \$2,339k was allocated to PP&E.

During the nine month period ended September 30, 2020, EBITDA before impairment of PP&E was \$32,033k (2019 - \$36,471k).

CGU (thousands)	Allocated to Goodwill	Allocated to PP&E	Total impairment recorded	Recoverable Amount
Montreal	\$ 823	\$ -	\$ 823	\$ 2,485
Quebec	654	2,339	2,993	1,917
Victoria	1,700	-	1,700	5,433
	\$ 3,177	\$ 2,339	\$ 5,516	\$ 9,835

The recoverable amount of the UK Division and Vancouver 2 CGUs was estimated to be £67,234k and \$24,008k as at March 31, 2020 which exceeded the carrying amount of both of the CGUs. No impairment was therefore required for either of these CGUs.

The key assumptions in calculating the recoverable amount of the five CGU's where impairment calculations were as follows:

	March 31 2020
Long-term growth rate %	2.0% to 3.0%
Pre-tax discount rate %	10.5% to 12.5%

For Vancouver 2 and the UK Division, in addition to the key assumptions noted above, management has also evaluated other reasonable changes in estimates and assumptions, and did not identify any other instances at March 31, 2020, that could cause the carrying amount of these CGUs to exceed the recoverable amount.

There were no other CGUs as at September 30, 2020 showing further signs of impairment, that were not already considered at March 31, 2020, and as such we have not updated any of the other impairment calculations. The Corporation will continue to carefully monitor the situation as it pertains to COVID-19 and further consider if there are new, or additional indicators, that exist during the year.

With the ongoing development of the COVID-19 pandemic, the length and severity of these developments is therefore subject to significant uncertainty, and accordingly may materially and adversely affect assumptions used in the consideration of the impairment of assets, impact whether a CGU has been impaired, and may change prior recorded impairment amounts.

## OUTLOOK

While the COVID-19 pandemic will have a significant negative impact on our hospitality revenue, management believes the prospects for the Corporation's healthcare business remains strong in the medium-to-long-term. By providing integral laundry and linen processing services to the hospitality and healthcare sectors, the Corporation has been designated an "essential" service in the jurisdictions in which it operates, which has allowed the Corporation's facilities to remain open and continue "normal" operations. This has mitigated some of the more dramatic financial and operational impacts experienced by many other businesses in other industries. In addition, management believes that the financial flexibility provided by our strong balance sheet will enable us to operate without disruption to our business model while maintaining our ability to service the healthcare and hospitality sectors in our Canadian and UK markets. Given the uncertainties regarding the general economic environment and the potential impact of a second wave of COVID-19 it is difficult to provide revenue guidance; however we do anticipate a consolidated adjusted EBITDA margin before the adoption of IFRS 16 in the range of 12% to 16% for the year. For further information about the impact of the COVID-19 pandemic on our business, see the "Summary of Interim Results, and Key Events".

## RESULTS OF OPERATIONS

### 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 in the long term. The following outlines our results on a period-to-period comparative basis in each of these areas:

		Three Months Ended September 30,					
(thousands, except percentages and per share amounts)		Canadian	UK		Canadian	UK	
Category	Indicator	Division	Division	2020	Division	Division	2019 <sup>(5)</sup>
		2020	2020		2019	2019	
Growth	EBITDA <sup>(1)</sup>	15.6%	-84.0%	-13.0%	103.8%	31.2%	75.9%
	Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	18.9%	-94.8%	-12.2%	74.5%	5.2%	47.8%
	Revenue	-13.0%	-54.3%	-24.2%	5.6%	7.3%	6.0%
	Distributable cash flow <sup>(4)</sup>			26.0%			20.6%
Profitability	EBITDA <sup>(1)</sup>	\$ 12,046	\$ 673	\$ 12,719	\$ 10,423	\$ 4,194	\$ 14,617
	EBITDA margin	28.0%	8.0%	24.7%	21.1%	22.9%	21.5%
	Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	\$ 10,609	\$ 176	\$ 10,785	\$ 8,925	\$ 3,361	\$ 12,286
	Adjusted EBITDA margin without adoption of IFRS 16	24.6%	2.1%	21.0%	18.0%	18.3%	18.1%
	Net earnings (loss)	\$ 4,404	\$ (962)	\$ 3,442	\$ 2,893	\$ 1,776	\$ 4,669
	Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	\$ 4,422	\$ (879)	\$ 3,543	\$ 2,919	\$ 1,817	\$ 4,736
Stability	Debt to total capital <sup>(7)</sup>			23.9%			25.9%
	Unutilized line of credit			\$ 39,525			\$ 32,780
	Cash on hand			\$ 998			\$ 4,362
	Payout ratio			29.0%			36.3%
	Dividends declared per share			\$ 0.300			\$ 0.300
Cost containment	Wages and benefits	31.9%	38.4%	33.0%	41.1%	34.1%	39.2%
	Utilities	5.1%	7.9%	5.5%	5.1%	8.5%	6.1%
	Expenses included in EBITDA	72.0%	92.0%	75.3%	78.9%	77.1%	78.5%

		Nine Months Ended September 30,					
(thousands, except percentages and per share amounts)		Canadian	UK		Canadian	UK	
Category	Indicator	Division	Division	2020 <sup>(4)</sup>	Division	Division	2019 <sup>(5)</sup>
		2020	2020		2019	2019	
Growth	EBITDA <sup>(1)</sup>	-2.6%	-98.9%	-27.3%	64.0%	45.6%	58.8%
	Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	21.2%	-131.5%	-13.9%	37.7%	5.9%	28.8%
	Revenue	-13.2%	-50.7%	-22.8%	4.3%	8.0%	5.2%
	Distributable cash flow <sup>(4)</sup>			8.1%			19.0%
Profitability	EBITDA <sup>(1)</sup>	\$ 26,414	\$ 103	\$ 26,517	\$ 27,106	\$ 9,365	\$ 36,471
	EBITDA margin	21.6%	0.4%	18.1%	19.3%	19.2%	19.2%
	Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	\$ 27,597	\$ (2,145)	\$ 25,452	\$ 22,769	\$ 6,808	\$ 29,577
	Adjusted EBITDA margin without adoption of IFRS 16	22.6%	-8.9%	17.4%	16.2%	13.9%	15.6%
	Net earnings (loss)	\$ 6,392	\$ (4,745)	\$ 1,647	\$ 6,027	\$ 2,684	\$ 8,711
	Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	\$ 10,767	\$ (4,947)	\$ 5,820	\$ 6,162	\$ 2,769	\$ 8,931
Stability	Debt to total capital <sup>(7)</sup>			23.9%			25.9%
	Unutilized line of credit			\$ 39,525			\$ 32,780
	Cash on hand			\$ 998			\$ 4,362
	Payout ratio			39.3%			42.2%
	Dividends declared per share			\$ 0.900			\$ 0.900
Cost containment	Wages and benefits	33.1%	42.9%	34.7%	41.0%	35.2%	39.5%
	Utilities	5.3%	8.7%	5.8%	5.8%	8.9%	6.6%
	Expenses included in EBITDA	78.4%	99.6%	81.9%	80.7%	80.8%	80.8%

(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 without adoption of IFRS 16 is defined as EBITDA (defined above) with the exclusion of IFRS 16, and 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 without adoption of IFRS 16 is defined as net earnings with the exclusion of IFRS 16, and 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) Effective January 1, 2019, distributable cash flow includes the addition of principal elements of lease payments. This accounts for the change in accounting policies and the adoption of IFRS 16, where now the principal elements of lease payments flow through financing outflows opposed to operating cash flows.

(5) Effective January 1, 2019, the Corporation has adopted IFRS 16 using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16. To enable the comparability of previous periods, the Corporation has provided the 2020 and 2019 figures for both EBITDA and net earnings without adoption of IFRS 16 as separate line items.

(6) Q1 2020 includes an adjustment of \$5.5 million for an impairment related charge to the Canadian Division, and is included in adjusted EBITDA and adjusted net earnings (loss).

(7) Debt to total capital is defined by management as the total long term debt (excludes lease liabilities) divided by the Corporation's total capital. See "Terminology".

## Quarterly Financial Information - Consolidated

Historically, the Corporation's financial and operating results, particularly in respect of Fishers, 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.

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

Quarterly Financial Information - Consolidated (thousands, except percentages and per share amounts)	2020 <sup>(5)</sup>				2019 <sup>(4)</sup>			2018
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Healthcare revenue	39,071	35,103	35,048	35,482	34,710	34,729	34,103	34,469
Hospitality revenue	12,368	2,417	22,227	27,410	33,132	29,164	23,680	24,971
Total revenue	51,439	37,520	57,275	62,892	67,842	63,893	57,783	59,440
Expenses included in EBITDA	38,720	27,465	53,532	51,790	53,225	51,154	48,668	52,821
EBITDA <sup>(1)</sup>	12,719	10,055	3,743	11,102	14,617	12,739	9,115	6,619
EBITDA as a % of revenue (EBITDA margin)	24.7%	26.8%	6.5%	17.7%	21.5%	19.9%	15.8%	11.1%
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	10,785	7,558	7,109	9,116	12,286	10,488	6,803	6,619
Adjusted EBITDA without adoption of IFRS 16 as a % of revenue	21.0%	20.1%	12.4%	14.5%	18.1%	16.4%	11.8%	11.1%
Depreciation and amortization	6,840	6,853	7,081	7,011	7,059	6,979	6,916	5,252
Finance expense	1,141	791	1,193	1,213	1,510	1,566	1,513	866
Earnings (loss) before income taxes	4,738	2,411	(4,531)	2,878	6,048	4,194	686	501
Income tax expense (recovery)	1,296	798	(1,123)	683	1,379	647	191	(551)
Net earnings (loss)	3,442	1,613	(3,408)	2,195	4,669	3,547	495	1,052
Net earnings (loss) as a % of revenue	6.7%	4.3%	-6.0%	3.5%	6.9%	5.6%	0.9%	1.8%
Basic earnings (loss) per share	0.326	0.153	(0.323)	0.209	0.444	0.338	0.047	0.100
Diluted earnings (loss) per share	0.323	0.152	(0.322)	0.207	0.441	0.336	0.047	0.100
Adjusted net earnings without adoption of IFRS 16 <sup>(3)</sup>	3,543	1,292	985	2,408	4,736	3,637	558	1,052
Basic adjusted earnings without adoption of IFRS 16 per share	0.335	0.122	0.093	0.229	0.451	0.346	0.053	0.100
Diluted adjusted earnings without adoption of IFRS 16 per share	0.332	0.122	0.093	0.227	0.447	0.344	0.053	0.100
Total assets	338,591	330,372	336,127	352,059	353,021	361,018	360,563	322,229
Total long-term financial liabilities	113,278	108,207	106,621	116,455	119,102	129,862	123,049	87,831
Funds provided by (used in) operations	(504)	6,289	11,588	11,555	19,816	2,875	9,670	7,799
Long-term debt (excludes lease liabilities)	59,325	56,416	54,693	62,494	66,070	75,952	67,444	70,203
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 without adoption of IFRS 16 is defined as EBITDA (defined above) with the exclusion of IFRS 16, and 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 without adoption of IFRS 16 is defined as net earnings with the exclusion of IFRS 16, and 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) Effective January 1, 2019, the Corporation has adopted IFRS 16 using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16. To enable the comparability of previous periods, the Corporation has provided the 2020 and 2019 figures for both EBITDA and net earnings without adoption of IFRS 16 as separate line items.
- (5) Q1 2020 includes an adjustment of \$5.5 million for an impairment related charge to the Canadian Division, and is excluded in adjusted EBITDA and adjusted net earnings (loss).

## Quarterly Financial Information – Canadian Division

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

Quarterly Financial Information - Canadian Division (thousands, except percentages and per share amounts)	Q3	2020 <sup>(5)</sup>			2019 <sup>(4)</sup>			2018
		Q2	Q1	Q4	Q3	Q2	Q1	Q4
Healthcare revenue	37,417	33,598	33,395	33,839	33,224	33,122	32,435	32,912
Hospitality revenue	5,628	1,755	10,316	12,162	16,267	13,477	12,098	12,155
Total revenue	43,045	35,353	43,711	46,001	49,491	46,599	44,533	45,067
Expenses included in EBITDA	30,999	23,779	40,917	37,264	39,068	37,300	37,149	40,229
EBITDA <sup>(1)</sup>	12,046	11,574	2,794	8,737	10,423	9,299	7,384	4,838
EBITDA as a % of revenue (EBITDA margin)	28.0%	32.7%	6.4%	19.0%	21.1%	20.0%	16.6%	10.7%
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	10,609	10,140	6,848	7,283	8,925	7,884	5,960	4,838
Adjusted EBITDA without adoption of IFRS 16 as a % of revenue	24.6%	28.7%	15.7%	15.8%	18.0%	16.9%	13.4%	10.7%
Net earnings (loss)	4,404	4,460	(2,472)	1,760	2,893	2,403	731	32
Net earnings (loss) as a % of revenue	10.2%	12.6%	-5.7%	3.8%	5.8%	5.2%	1.6%	0.1%
Basic earnings (loss) per share	0.417	0.423	(0.235)	0.167	0.275	0.229	0.070	0.003
Diluted earnings (loss) per share	0.413	0.420	(0.233)	0.166	0.273	0.228	0.069	0.003
Adjusted net earnings without adoption of IFRS 16 <sup>(3)</sup>	4,422	4,482	1,863	1,835	2,919	2,456	787	32
Basic adjusted earnings without adoption of IFRS 16 per share	0.419	0.425	0.177	0.174	0.278	0.234	0.075	0.003
Diluted adjusted earnings without adoption of IFRS 16 per share	0.415	0.422	0.176	0.173	0.276	0.233	0.075	0.003

- (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 without adoption of IFRS 16 is defined as EBITDA (defined above) with the exclusion of IFRS 16, and 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 without adoption of IFRS 16 is defined as net earnings with the exclusion of IFRS 16, and 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) Effective January 1, 2019, the Corporation has adopted IFRS 16 using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16. To enable the comparability of previous periods, the Corporation has provided the 2020 and 2019 figures for both EBITDA and net earnings without adoption of IFRS 16 as separate line items.
- (5) Q1 2020 includes an adjustment of \$5.5 million for an impairment related charge to the Canadian Division, and is excluded in adjusted EBITDA and adjusted net earnings (loss).

## Quarterly Financial Information – UK Division

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

Quarterly Financial Information - UK Division (in reporting currency Canadian \$) (thousands, except percentages and per share amounts)	2020				2019 <sup>(4)</sup>			2018
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Healthcare revenue	1,654	1,505	1,653	1,643	1,486	1,607	1,668	1,557
Hospitality revenue	6,740	662	11,911	15,248	16,865	15,687	11,582	12,816
Total revenue	8,394	2,167	13,564	16,891	18,351	17,294	13,250	14,373
Expenses included in EBITDA	7,721	3,686	12,615	14,526	14,157	13,854	11,519	12,592
EBITDA <sup>(1)</sup>	673	(1,519)	949	2,365	4,194	3,440	1,731	1,781
EBITDA as a % of revenue (EBITDA margin)	8.0%	-70.1%	7.0%	14.0%	22.9%	19.9%	13.1%	12.4%
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	176	(2,582)	261	1,833	3,361	2,604	843	1,781
Adjusted EBITDA without adoption of IFRS 16 as a % of revenue	2.1%	-119.2%	1.9%	10.9%	18.3%	15.1%	6.4%	12.4%
Net earnings (loss)	(962)	(2,847)	(936)	435	1,776	1,144	(236)	1,020
Net earnings (loss) as a % of revenue	-11.5%	-131.4%	-6.9%	2.6%	9.7%	6.6%	-1.8%	7.1%
Basic earnings (loss) per share	(0.091)	(0.270)	(0.089)	0.041	0.169	0.109	(0.022)	0.097
Diluted earnings (loss) per share	(0.090)	(0.268)	(0.088)	0.041	0.168	0.108	(0.022)	0.097
Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	(879)	(3,190)	(878)	573	1,817	1,181	(229)	1,020
Basic adjusted earnings (loss) without adoption of IFRS 16 per share	(0.083)	(0.302)	(0.083)	0.054	0.173	0.112	(0.022)	0.097
Diluted adjusted earnings (loss) without adoption of IFRS 16 per share	(0.082)	(0.300)	(0.083)	0.054	0.172	0.112	(0.022)	0.097

Quarterly Financial Information - UK Division (in local currency Sterling £) (thousands, except percentages and per share amounts)	2020				2019 <sup>(4)</sup>			2018
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Healthcare revenue	961	875	962	966	913	935	963	917
Hospitality revenue	3,916	385	6,931	8,967	10,359	9,126	6,689	7,550
Total revenue	4,877	1,260	7,893	9,933	11,272	10,061	7,652	8,467
Expenses included in EBITDA	4,487	2,140	7,343	8,543	8,696	8,058	6,654	7,413
EBITDA <sup>(1)</sup>	390	(880)	550	1,390	2,576	2,003	998	1,054
EBITDA as a % of revenue (EBITDA margin)	8.0%	-69.8%	7.0%	14.0%	22.9%	19.9%	13.1%	12.4%
Adjusted EBITDA without adoption of IFRS 16 <sup>(2)</sup>	102	(1,499)	150	1,077	2,065	1,517	485	1,054
Adjusted EBITDA without adoption of IFRS 16 as a % of revenue	2.1%	-119.0%	1.9%	10.9%	18.3%	15.1%	6.4%	12.4%
Net earnings (loss)	(559)	(1,653)	(546)	254	1,091	668	(138)	600
Net earnings (loss) as a % of revenue	-11.5%	-131.2%	-6.9%	2.6%	9.7%	6.6%	-1.8%	7.1%
Basic earnings (loss) per share	(0.053)	(0.157)	(0.052)	0.024	0.104	0.064	(0.013)	0.057
Diluted earnings (loss) per share	(0.052)	(0.156)	(0.052)	0.024	0.103	0.063	(0.013)	0.057
Adjusted net earnings (loss) without adoption of IFRS 16 <sup>(3)</sup>	(510)	(1,853)	(512)	336	1,115	690	(134)	600
Basic adjusted earnings (loss) without adoption of IFRS 16 per share	(0.048)	(0.176)	(0.049)	0.032	0.106	0.066	(0.013)	0.057
Diluted adjusted earnings (loss) without adoption of IFRS 16 per share	(0.048)	(0.174)	(0.048)	0.032	0.105	0.065	(0.013)	0.057

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- (2) Adjusted EBITDA without adoption of IFRS 16 is defined as EBITDA (defined above) with the exclusion of IFRS 16, and 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 without adoption of IFRS 16 is defined as net earnings with the exclusion of IFRS 16, and 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) Effective January 1, 2019, the Corporation has adopted IFRS 16 using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16. To enable the comparability of previous periods, the Corporation has provided the 2020 and 2019 figures for both EBITDA and net earnings without adoption of IFRS 16 as separate line items.

## Revenue, Earnings and EBITDA

As a result of the COVID-19 pandemic, consolidated hospitality revenue for the three months ended September 30, 2020 decreased 62.7% over the comparable 2019 period. This is partially offset by an increase of 12.6% in consolidated healthcare revenue for an overall decrease in consolidated revenue of 24.2%. On a year-to-date basis, consolidated revenue decreased by 22.8% to \$146.2 million compared to \$189.5 million in the comparative period of 2019. This decrease was primarily due to the significant reduction in hospitality revenue related to the COVID-19 pandemic. In 2020 year to date, approximately 74.7% of K-Bro's consolidated revenue was generated from healthcare institutions, which is higher compared to 54.6% in 2019. This was primarily related to the COVID-19 pandemic's effect on the hospitality segment, as described above.

Consolidated EBITDA in the third quarter of 2020 decreased by \$1.9 million to \$12.7 million compared to \$14.6 million in the comparative period of 2019, and margin increased by 3.2% to 24.7%. On a year-to-date basis, consolidated EBITDA decreased by \$10.0 million to \$26.5 million compared to \$36.5 million in the comparative period of 2019, and margin decreased by 1.1% to 18.1%. The impairment of assets represents \$5.5 million and accounts for 3.8% of the decrease in EBITDA margin on a year-to-date basis. On an adjusted basis for the quarter, without the adoption of IFRS 16 and impairment of assets, EBITDA decreased by 12.2% to \$10.8 million with an adjusted EBITDA margin of 21.0%. The reduction in the adjusted EBITDA and increase in adjusted EBITDA margin can be attributed to the reduced hospitality volume as a result of the COVID-19 pandemic offset by government assistance received in the quarter for the Canadian division in the amount of \$2.1 million. Government assistance was also received from the UK division in the amount of £0.7 million (\$1.1 million) during the third quarter which has been netted against the respective source of the expense. During the third quarter, the terms of the CJRS required that companies share in the cost of the program and as a result the impact to EBITDA during the quarter and year to date was a cost of £26k (\$45k) which represents the UK division's contribution for hours and certain benefits. For greater clarity, until July 2020 the UK division received an equivalent amount from the government that is then paid to furloughed employees netting to no impact on EBITDA however starting in August 2020 the UK division was required to make contributions for hours and certain benefits.

Net earnings in the third quarter of 2020 decreased by \$1.3 million to \$3.4 million compared to \$4.7 million in the comparative period of 2019, and as a percentage of revenue decreased by 0.2% to 6.7%. On a year-to-date basis, net earnings decreased by \$7.1 million to \$1.6 million compared to \$8.7 million in the comparative period of 2019, and as a percentage of revenue decreased by 3.5% to 1.1%. The change in net earnings is primarily related to the flow through items in EBITDA discussed above, offset by lower depreciation, lower finance costs related to the revolving credit facility, and offset by a lower income tax expense.

## Operating Expenses

Wages and benefits in the third quarter of 2020 decreased by \$9.6 million to \$17.0 million compared to \$26.6 million in the comparative period of 2019, and as a percentage of revenue decreased by 6.2% to 33.0%. On a year-to-date basis, wages and benefits decreased by \$24.2 million to \$50.7 million compared to \$74.9 million in the comparative period of 2019, and as a percentage of revenue decreased by 4.8% to 34.7%. The decrease as a percentage of revenue is primarily related to \$7.7 million government assistance received in the Canadian division, improvements in labour efficiencies, offset by escalating minimum wage rates and restructuring costs of \$1.4 million related to COVID-19.

Linen in the third quarter of 2020 decreased by \$0.7 million to \$6.4 million compared to \$7.1 million in the comparative period of 2019, and as a percentage of revenue increased by 1.9% to 12.4%. On a year-to-date basis, linen decreased by \$2.2 million to \$18.3 million compared to \$20.5 million in the comparative period of 2019, and as a percentage of revenue increased by 1.7% to 12.5%. The increase as a percentage



of revenue is primarily related to the higher proportion of healthcare revenue, and flow through of customer setup costs from prior periods.

Utilities in the third quarter of 2020 decreased by \$1.3 million to \$2.8 million compared to \$4.1 million in the comparative period of 2019, and as a percentage of revenue decreased by 0.6% to 5.5%. On a year-to-date basis, utilities decreased by \$4.0 million to \$8.5 million compared to \$12.5 million in the comparative period of 2019, and as a percentage of revenue decreased by 0.8% to 5.8%. The decrease as a percentage of revenue is primarily related to lower utility costs in British Columbia as a result of a temporary natural gas supply shortage during the first quarter of 2019, lower commodity costs, and operational measures to offset the impact of COVID-19.

Delivery in the third quarter of 2020 decreased by \$2.0 million to \$5.1 million compared to \$7.1 million in the comparative period of 2019, and as a percentage of revenue decreased by 0.5% to 10.0%. On a year-to-date basis, delivery decreased by \$5.6 million to \$15.7 million compared to \$21.3 million in the comparative period of 2019, and as a percentage of revenue decreased by 0.5% to 10.7%. The decrease as a percentage of revenue is primarily related to government assistance received, in addition to management's efforts to offset the impact of COVID-19 in the delivery operations of each plant through temporary reductions in the delivery labour force, logistics and delivery route optimizations, offset by fixed costs which remain constant regardless of the reduction in volume resulting from the COVID-19 pandemic and price increases from renewals of outsourced freight contracts.

Occupancy costs in the third quarter of 2020 decreased by \$0.2 million to \$0.9 million compared to \$1.1 million in the comparative period of 2019, and as a percentage of revenue increased by 0.2% to 1.8%. On a year-to-date basis, occupancy costs decreased by \$0.7 million to \$2.6 million compared to \$3.3 million in the comparative period of 2019, and as a percentage of revenue remained relatively constant at 1.8%. This includes fixed costs that remain constant regardless of the reduction in volume resulting from the COVID-19 pandemic, offset by rent concessions received in certain plants in the UK in the amount of \$0.5 million recorded in the second quarter of 2020.

Materials and supplies in the third quarter of 2020 decreased by \$0.4 million to \$1.9 million compared to \$2.3 million in the comparative period of 2019, and as a percentage of revenue increased by 0.3% to 3.7%. On a year-to-date basis, materials and supplies decreased by \$0.8 million to \$5.2 million compared to \$6.0 million in the comparative period of 2019, and as a percentage of revenue increased by 0.4% to 3.6%. The increase as a percentage of revenue is primarily related to additional personal protective equipment required as a result of the COVID-19 pandemic and one-time cost recoveries in 2019.

Repairs and maintenance in the third quarter of 2020 decreased by \$0.4 million to \$1.8 million compared to \$2.2 million in the comparative period of 2019, and as a percentage of revenue increased by 0.2% to 3.5%. On a year-to-date basis, repairs and maintenance decreased by \$1.1 million to \$5.4 million compared to \$6.5 million in the comparative period of 2019, and as a percentage of revenue increased by 0.3% to 3.7%. The increase as a percentage of revenue is primarily related to fixed costs that remain constant regardless of the reduction in volume resulting from the COVID-19 pandemic and timing of maintenance activities.

Corporate costs in the third quarter of 2020 increased by \$0.1 million to \$2.8 million compared to \$2.7 million in the comparative period of 2019, and as a percentage of revenue increased by 1.5% to 5.4%. On a year-to-date basis, corporate costs decreased by \$0.3 million to \$7.8 million compared to \$8.1 million in the comparative period of 2019, and as a percentage of revenue increased by 1.0% to 5.3%. The increase as a percentage of revenue is primarily related to a provision for bad debt expense of \$0.5 million, restructuring costs of \$0.5 million, the timing of initiatives to support the Corporation's growth and business strategies across the plants, and offset by government assistance received.

Depreciation of property, plant and equipment and amortization of intangible assets represents the expense related to the appropriate matching of the Corporation's long-term assets to the estimated useful life and period of economic benefit of those assets.

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

During Q3 2020, cash used in operating activities was \$0.5 million compared to cash generated by operating activities of \$19.8 million in Q3 2019. On a year-to-date basis, cash generated by operating activities was \$17.4 million compared to \$32.4 million in 2019. 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 impact of COVID-19, particularly timing of collection of healthcare receivables which have been delayed due to the pandemic. Management believes the unutilized balance of \$39.5 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.

During Q3 2020, cash used in financing activities was \$1.7 million compared to \$14.9 million in Q3 2019. On a year-to-date basis, cash used in financing activities was \$17.3 million compared to \$18.8 million in 2019. Financing activities consisted of net repayment of the revolving credit facility, dividends paid to Shareholders and principal elements of lease payments.

During Q3 2020, cash used in investing activities was \$0.0 million compared to \$4.3 million in Q3 2019. On a year-to-date basis, cash used in investing activities was \$4.3 million compared to \$11.9 million in 2019.

### Contractual Obligations

Payments due under contractual obligations for the next five years and thereafter are as follows:

(thousands)	Payments due by Period				
	Total	Remainder of 2020	2021 to 2022	2023 to 2024	Subsequent
Long-term debt	\$ 59,325	-	59,325	-	-
Lease liabilities	\$ 62,117	3,672	15,593	12,269	30,583
Utility commitments	\$ 7,143	1,616	5,527	-	-
Linen purchase obligations	\$ 4,108	4,108	-	-	-
Property, plant and equipment commitments	\$ 258	258	-	-	-

The lease liabilities are secured by automotive equipment and plants and are more fully described in the Corporation's audited annual consolidated financial statements for the year ended December 31, 2019. 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

	Nine Months Ended September 30, 2020	Years Ended December 31, 2019
<i>(thousands, except percentages)</i>		
Cash and cash equivalents	\$ (998)	\$ (5,301)
Long-term debt (excludes lease liabilities)	59,325	62,494
Shareholders' equity	189,576	196,051
<b>Total capital</b>	<b>\$ 247,903</b>	<b>\$ 253,244</b>
Debt to total capital (see <i>Terminology</i> for definition)	<b>23.9%</b>	24.7%

For the quarter ended September 30, 2020, the Corporation had a debt to total capital of 23.9%, unused revolving credit facility of \$39.5 million and has not incurred any events of default under the terms of its credit facility.

As at September 30, 2020, the Corporation had net working capital of \$43.1 million compared to its working capital position of \$31.0 million at December 31, 2019. The increase in working capital is primarily attributable to timing differences related to cash receipts from customers, particularly timing of collection of healthcare receivables which have been delayed due to the pandemic, cash settlement of new plant equipment, deposits related to the acquisition of equipment related across the plants, income tax payments, and a decrease in cash and cash equivalents.

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 raise capital through equity issuances in the market or increase its borrowing capacity, if necessary, to provide for capital spending and to sustain its property, plant and equipment.

## DIVIDENDS

Fiscal Period	Payment Date	# of Shares outstanding	2020		2019	
			Amount per Share	Total Amount (1)(3)(5)	Amount per Share	Total Amount (2)(4)(6)
January	February 14	10,604,029	\$ 0.10000	\$ 1,060	\$ 0.10000	\$ 1,056
February	March 13	10,604,029	0.10000	1,060	0.10000	1,056
March	April 15	10,604,029	0.10000	1,060	0.10000	1,056
Q1			\$ 0.30000	\$ 3,181	\$ 0.30000	\$ 3,168
April	May 15	10,604,029	\$ 0.10000	\$ 1,060	\$ 0.10000	\$ 1,056
May	June 15	10,676,889	0.10000	1,068	0.10000	1,060
June	July 15	10,676,889	0.10000	1,068	0.10000	1,060
Q2			\$ 0.30000	\$ 3,196	\$ 0.30000	\$ 3,177
July	August 14	10,676,889	\$ 0.10000	\$ 1,068	\$ 0.10000	\$ 1,060
August	September 15	10,676,889	0.10000	1,068	0.10000	1,060
September	October 15	10,676,889	0.10000	1,068	0.10000	1,060
Q3			\$ 0.30000	\$ 3,203	\$ 0.30000	\$ 3,181
YTD			\$ 0.90000	\$ 9,580	\$ 0.90000	\$ 9,526

- (1) The total amount of dividends declared was \$0.10000 per share for a total of \$1,060,438 per month for January - March 2020; when rounded in thousands, \$3,181 of dividends were declared in Q1 2020.
- (2) The total amount of dividends declared was \$0.10000 per share for a total of \$1,055,994 per month for January - March 2019; when rounded in thousands, \$3,168 of dividends were declared in Q1 2019.
- (3) The total amount of dividends declared was \$0.10000 per share for a total of \$1,060,438 for April 2020, \$1,067,689 for May 2020, and \$1,067,689 for June 2020. When rounded in thousands, \$3,181 of dividends were declared in Q2 2020.
- (4) The total amount of dividends declared was \$0.10000 per share for a total of \$1,055,994 for April 2019, \$1,060,403 for May 2019, and \$1,060,438 for June 2019. When rounded in thousands, \$3,177 of dividends were declared in Q2 2019.
- (5) The total amount of dividends declared was \$0.10000 per share for a total of \$1,067,689 per month for July - September 2020; when rounded in thousands, \$3,203 of dividends were declared in Q3 2020.
- (6) The total amount of dividends declared was \$0.10000 per share for a total of \$1,060,438 per month for July - September 2019; when rounded in thousands, \$3,181 of dividends were declared in Q3 2019.

For the three months ended September 30, 2020, the Corporation declared a \$0.300 per Common Share dividend compared to \$1.036 per Common Share of Distributable Cash Flow (see "Terminology") and actual payout ratio of 29.0%. On a year-to-date basis, the Corporation declared a \$0.900 per Common Share dividend compared to \$2.294 per Common Share of Distributable Cash Flow and actual payout ratio of 39.3%.

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 Board of Directors. 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 15<sup>th</sup> 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 \$000s 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)	2020				2019 <sup>(4)</sup>			2018
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
Cash (used in) provided by operating activities	\$ (504)	\$ 6,289	\$ 11,588	\$ 11,555	\$ 19,816	\$ 2,875	\$ 9,670	\$ 7,799
<i>Deduct (add):</i>								
Net changes in non-cash working capital items <sup>(1)</sup>	(13,724)	(2,926)	3,011	1,534	7,463	(8,615)	1,484	1,082
Share-based compensation expense	693	189	507	404	427	439	540	380
Maintenance capital expenditures <sup>(2)</sup>	35	280	328	1,072	1,352	1,143	374	526
Principal elements of lease payments <sup>(5)</sup>	1,442	1,487	1,666	1,501	1,806	1,736	1,648	-
Distributable cash flow <sup>(5)</sup>	\$ 11,050	\$ 7,259	\$ 6,076	\$ 7,044	\$ 8,768	\$ 8,172	\$ 5,624	\$ 5,811
Dividends declared	3,203	3,196	3,181	3,181	3,181	3,177	3,168	3,168
Dividends declared per share	0.300	0.300	0.300	0.300	0.300	0.300	0.300	0.300
Payout ratio <sup>(3)</sup>	29.0%	44.0%	52.4%	45.2%	36.3%	38.9%	56.3%	54.5%
Weighted average shares outstanding during the period, basic	10,563	10,551	10,539	10,521	10,511	10,504	10,497	10,479
Weighted average shares outstanding during the period, diluted	10,667	10,627	10,591	10,588	10,584	10,558	10,546	10,525
<b>Trailing-twelve months ("TTM")</b>								
Distributable cash flow	31,429	29,147	30,060	29,608	28,375	26,879	25,190	24,765
Dividends	12,761	12,739	12,720	12,707	12,694	12,681	12,667	12,651
Payout ratio <sup>(3)</sup>	40.6%	43.7%	42.3%	42.9%	44.7%	47.2%	50.3%	51.1%

- (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.
- (4) Effective January 1, 2019, the Corporation has adopted IFRS 16 using the modified retrospective method but has not restated comparatives for the prior periods, as permitted under the specific transitional provisions of IFRS 16.
- (5) Effective January 1, 2019, distributable cash flow includes the addition of principal elements of lease payments. This accounts for the change in accounting policies and the adoption of IFRS 16, where now the principal elements of lease payments flow through financing outflows opposed to operating cash flows.

## **OUTSTANDING SHARES**

As at September 30, and November 10, 2020, the Corporation had 10,676,889 Common Shares outstanding. Basic and diluted weighted average number of Common Shares outstanding for the three months ended September 30, 2020 were 10,562,663 and 10,666,540, respectively (10,510,915 and 10,584,300, respectively, for the comparative 2019 interim periods).

In accordance with the Corporation's Long Term Incentive ("LTI") plan and in conjunction with the performance of the Corporation in the 2019 fiscal year, on April 24, 2020 the Compensation, Nominating and Corporate Governance Committee approved LTI compensation of \$1.8 million (2019 – \$1.7 million) to be paid as Common Shares issued from treasury. As at September 30, 2020, the value of the Common Shares held by the LTI custodian was \$3.2 million (December 31, 2019 – \$2.7 million) which was comprised of 114,225 in unvested Common Shares (December 31, 2019 – 64,924) with a nil aggregate cost (December 31, 2019 – \$nil).

As at November 10, 2020 there were 10,676,889 Common Shares issued and outstanding including 114,225 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 member of the Board of Directors. The amounts charged are recorded at their exchange amounts and are on arm's length terms. For the three month period ended September 30, 2020, the Corporation incurred fees totaling \$34,500 compared to \$34,500 for the same period of fiscal 2019. For the nine months ended September 30, 2020, the Corporation incurred such fees totaling \$103,500 compared to \$103,500 for the same period of fiscal 2019.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the financial statements, in conformity with IFRS, requires K-Bro to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Management regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances. This involves varying degrees of judgment and uncertainty and, therefore, amounts currently reported in the financial statements could differ in the future. Further to those areas discussed in the Corporation's 2019 audited financial statements and annual MD&A, determining the lease term and incremental borrowing rates under IFRS 16 requires critical judgments as well as assumptions that have been incorporated into any asset impairment testing models.

The ongoing COVID-19 pandemic has caused world governments to institute travel restrictions both in and out of and within Canada and the UK, which has had, and is expected to continue to have, a significant adverse impact on the Corporation's hospitality business, the duration of which we are unable to predict with any degree of accuracy.

The extent of such negative effects on our hospitality business and our financial and operational performance will depend on future developments, including the duration, spread and severity of the outbreak, the duration and geographic scope of related travel advisories and restrictions and the extent of the impact of COVID-19 on overall demand for personal and business travel, all of which are highly uncertain and cannot be predicted with any degree of accuracy. As hotels continue to experience significantly reduced occupancy rates for an extended period, our 2020 consolidated results of operations will be significantly impacted. The extent to which the outbreak affects our

earnings will depend on the length of time the hospitality industry continues to experience reduced occupancy rates. Earnings will continue to be particularly affected if we continue to experience reductions in travel and reduced hospitality occupancy rates. Additionally, our suppliers or other third parties we rely upon may experience delays or shortages, which could have an adverse effect on our business prospects and results of operations.

As an ongoing risk, the duration and full financial effect of the COVID-19 pandemic is unknown at this time, and continues to be offset through the Corporation's business continuity plan and other mitigating measures. Any estimate of the length and severity of these developments is therefore subject to significant uncertainty, and accordingly estimates of the extent to which the COVID-19 pandemic may materially and adversely affect the Corporation's operations, financial results and condition in future periods are also subject to significant uncertainty.

Based on impairment indicators that existed at March 31, 2020 as a result of the COVID-19 pandemic, management has assessed the impairment of assets based off facts and circumstances which suggest that the carrying amount in certain CGUs may exceed its recoverable amount, refer to note 12 in the unaudited interim Condensed Consolidated Financial Statements for further detail.

Uncertainty about judgments, estimates and assumptions made by management during the preparation of the Corporation's interim condensed consolidated financial statements related to potential impacts of the COVID-19 outbreak on revenue, expenses, assets, liabilities, and note disclosures could result in a material adjustment to the carrying value of the asset or liability affected.

## **TERMINOLOGY**

### **EBITDA**

K-Bro reports EBITDA (Earnings before interest, taxes, depreciation and amortization) as a key measure used by management to evaluate performance. EBITDA is utilized to measure compliance with debt covenants and to make decisions related to dividends to Shareholders. We believe EBITDA assists investors to assess 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.

(thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020 <sup>(1)</sup>	2019
Net earnings	\$ 3,442	\$ 4,669	\$ 1,647	\$ 8,711
Add:				
Income tax expense	1,296	1,379	971	2,217
Finance expense	1,141	1,510	3,125	4,589
Depreciation of property, plant and equipment	5,885	6,314	17,891	18,652
Amortization of intangible assets	955	745	2,883	2,302
<b>EBITDA</b>	<b>\$ 12,719</b>	<b>\$ 14,617</b>	<b>\$ 26,517</b>	<b>\$ 36,471</b>

(1) Q1 2020 includes an adjustment of \$5.5 million for an impairment related charge to the Canadian Division.

## Non-GAAP Measures

### Adjusted EBITDA without adoption of IFRS 16

Adjusted EBITDA without adoption of IFRS 16 is a measure which has been reported in order to assist in the comparison of historical EBITDA to current results. "Adjusted EBITDA" without adoption of IFRS 16 is defined as EBITDA (defined above) with the exclusion of IFRS 16, and certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations.

(thousands)	Three Months Ended September 30,					
	Canadian Division 2020	UK Division 2020	2020	Canadian Division 2019	UK Division 2019	2019
EBITDA	\$ 12,046	\$ 673	\$ 12,719	\$ 10,423	\$ 4,194	\$ 14,617
Add back IFRS 16 Adjustments:						
Delivery	(332)	(321)	(653)	(401)	(525)	(926)
Occupancy costs	(1,105)	(176)	(1,281)	(1,096)	(307)	(1,403)
EBITDA without adoption of IFRS 16	\$ 10,609	\$ 176	\$ 10,785	\$ 8,926	\$ 3,362	\$ 12,288
Add back non-reoccurring items:						
Impairment of assets	-	-	-	-	-	-
<b>Adjusted EBITDA without adoption of IFRS 16</b>	<b>\$ 10,609</b>	<b>\$ 176</b>	<b>\$ 10,785</b>	<b>\$ 8,926</b>	<b>\$ 3,362</b>	<b>\$ 12,288</b>

(thousands)	Nine Months Ended September 30,					
	Canadian Division 2020	UK Division 2020	2020	Canadian Division 2019	UK Division 2019	2019
EBITDA	\$ 26,414	\$ 103	\$ 26,517	\$ 27,106	\$ 9,365	\$ 36,471
Add back IFRS 16 Adjustments:						
Delivery	(1,019)	(1,141)	(2,160)	(1,048)	(1,641)	(2,689)
Occupancy costs	(3,314)	(1,107)	(4,421)	(3,288)	(915)	(4,203)
EBITDA without adoption of IFRS 16	\$ 22,081	\$ (2,145)	\$ 19,936	\$ 22,770	\$ 6,809	\$ 29,579
Add back non-reoccurring items:						
Impairment of assets	5,516	-	5,516	-	-	-
<b>Adjusted EBITDA without adoption of IFRS 16</b>	<b>\$ 27,597</b>	<b>\$ (2,145)</b>	<b>\$ 25,452</b>	<b>\$ 22,770</b>	<b>\$ 6,809</b>	<b>\$ 29,579</b>



## Adjusted net earnings without adoption of IFRS 16 and adjusted net earnings without adoption of IFRS 16 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 IFRS 16, and certain material items that are unusual in nature, infrequently occurring or not considered part of our core operations.

Three Months Ended September 30,						
(thousands)	Canadian Division 2020	UK Division 2020	2020	Canadian Division 2019	UK Division 2019	2019
Net earnings (loss)	\$ 4,404	\$ (962)	\$ 3,442	\$ 2,893	\$ 1,776	\$ 4,669
<i>Add back IFRS 16 Adjustments:</i>						
Delivery	(332)	(321)	(653)	(401)	(525)	(926)
Occupancy costs	(1,105)	(176)	(1,281)	(1,096)	(307)	(1,403)
Depreciation of property, plant and equipment	1,096	503	1,599	1,119	769	1,888
Finance expense	364	95	459	415	113	528
Income tax expense	(5)	(18)	(23)	(11)	(9)	(20)
Net earnings (loss) without adoption of IFRS 16	\$ 4,422	\$ (879)	\$ 3,543	\$ 2,919	\$ 1,817	\$ 4,736
<i>Add back non-reoccurring items (net of income taxes):</i>						
Impairment of assets	-	-	-	-	-	-
<b>Adjusted net earnings (loss) without adoption of IFRS 16</b>	<b>\$ 4,422</b>	<b>\$ (879)</b>	<b>\$ 3,543</b>	<b>\$ 2,919</b>	<b>\$ 1,817</b>	<b>\$ 4,736</b>
Weighted average number of shares outstanding:						
Basic	10,562,663	10,562,663	10,562,663	10,510,915	10,510,915	10,510,915
Diluted	10,666,540	10,666,540	10,666,540	10,584,300	10,584,300	10,584,300
Adjusted net earnings (loss) without adoption of IFRS 16 per share:						
Basic	\$0.419	(\$0.083)	\$0.335	\$0.275	\$0.169	\$0.451
Diluted	\$0.415	(\$0.082)	\$0.332	\$0.273	\$0.168	\$0.447

Nine Months Ended September 30,						
(thousands)	Canadian Division 2020	UK Division 2020	2020	Canadian Division 2019	UK Division 2019	2019
Net earnings (loss)	\$ 6,392	\$ (4,745)	\$ 1,647	\$ 6,027	\$ 2,684	\$ 8,711
<i>Add back IFRS 16 Adjustments:</i>						
Delivery	(1,019)	(1,141)	(2,160)	(1,048)	(1,641)	(2,689)
Occupancy costs	\$ (3,314)	\$ (1,107)	(4,421)	(3,288)	(915)	(4,203)
Depreciation of property, plant and equipment	\$ 3,300	\$ 1,704	5,004	3,291	2,306	5,597
Finance expense	\$ 1,121	\$ 301	1,422	1,229	353	1,582
Income tax expense	\$ (22)	\$ 41	19	(49)	(18)	(67)
Net earnings (loss) without adoption of IFRS 16	\$ 6,458	\$ (4,947)	\$ 1,511	\$ 6,162	\$ 2,769	\$ 8,931
<i>Add back non-reoccurring items (net of income taxes):</i>						
Impairment of assets	4,309	-	4,309	-	-	-
<b>Adjusted net earnings (loss) without adoption of IFRS 16</b>	<b>\$ 10,767</b>	<b>\$ (4,947)</b>	<b>\$ 5,820</b>	<b>\$ 6,162</b>	<b>\$ 2,769</b>	<b>\$ 8,931</b>
Weighted average number of shares outstanding:						
Basic	10,551,230	10,551,230	10,551,230	10,503,778	10,503,778	10,503,778
Diluted	10,631,404	10,631,404	10,631,404	10,561,812	10,561,812	10,561,812
Adjusted net earnings (loss) without adoption of IFRS 16 per share:						
Basic	\$1.020	(\$0.469)	\$0.552	\$0.574	\$0.256	\$0.850
Diluted	\$1.013	(\$0.465)	\$0.547	\$0.571	\$0.254	\$0.846

## **Distributable Cash Flow**

Distributable cash flow is a measure used by management to evaluate the Corporation's 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 should 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, maintenance capital expenditures and principal elements of lease payments.

## **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 Capital**

"Debt to total capital" is defined by management as the total long-term debt (excludes lease liabilities) divided by the Corporation's total capital. This is a measure used by investors to assess the Corporation's financial structure.

Distributable cash flow, payout ratio, debt to total capital 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 September 30, 2020, the Corporation has not entered into any off balance sheet arrangements.

## **UPDATES TO SIGNIFICANT ACCOUNTING POLICIES**

### **(a) IFRS 16 Leases – COVID-19 Related Rent Concessions**

New or amended standards became applicable for the current reporting period, and the Corporation changed its accounting policies with adjustments on a prospective basis as a result of adopting the amendment to IFRS 16 Leases on June 1, 2020.

IFRS 16, Leases was amended and is effective for annual reporting periods beginning on or after June 1, 2020. The changes to IFRS 16, Leases, pertain to COVID-19 Related Rent Concessions, which:

1. provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification;

2. require lessees that apply the exemption to account for COVID-19-related rent concessions as if they were not lease modifications; require lessees that apply the exemption to disclose that fact; and
3. require lessees to apply the exemption retrospectively in accordance with IAS 8, but not require them to restate prior period figures.

The main change from the proposal in the exposure draft is that the IASB had proposed that the practical expedient should only be available for lease payments originally due in 2020. However, after having considered the feedback to the exposure draft, the IASB decided to extend this period to June 2021 to also capture rent concessions granted now and lasting for 12 months.

The Corporation has elected to apply the exemption and has treated COVID-19 rent related concessions received as if they were not lease modifications. As such, changes in lease payments that do not arise from a lease modification are accounted for as variable lease payments, in which the Corporation recognizes the variable lease payments in profit or loss in the respective period in which the event or condition that triggers those payments occurs.

For the nine month period ended September 30, 2020, a rent concession for the unconditional forgiveness of debt of \$464 was recognized as a negative variable lease payment included in the Corporation's consolidated statements of earnings and comprehensive income as an offset to occupancy costs and treated as a forgiveness of lease liabilities, with a non-cash impact to the principal elements of lease payments included in financing activities within the Corporation's consolidated statements of cash flow.

**(b) Government Grants**

For the nine month period ended September 30, 2020, the Corporation adopted the use of IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance, which outlines how to account for government grants and other assistance. The standard outlines that government grants are recognised in profit or loss on a systematic basis over the periods in which the entity recognizes expenses for the related costs for which the grants are intended to compensate, which in the case of grants related to assets requires setting up the grant as deferred income or deducting it from the carrying amount of the asset.

The Corporation received government assistance for both their Canadian and UK division, under the following government programs:

- I. The Canada Emergency Wage Subsidy ("CEWS") program was introduced by the Government of Canada on March 27, 2020, reimbursing eligible employers who have experienced the required reduction in revenue for a portion of salaries paid out to employees during the pandemic. During the nine months ended September 30, 2020, the Corporation submitted claims of \$7,690 under the CEWS program, with the majority of the amounts received with only \$556 outstanding in receivables on the Corporation's consolidated balance sheet at September 30, 2020. The Corporation will continue to evaluate its eligibility under the CEWS program through the balance of 2020.
- II. The Coronavirus Job Retention Scheme ("CJRS") was introduced by the UK government on March 20, 2020, and provides eligible employers the ability to access support to continue paying part of their employees' salary for those employees that would otherwise have been laid off during the crisis. During the nine months ended September 30, 2020, the Corporation submitted claims of £2,650 (\$4,560) under the CJRS program with the majority of the amounts received with only £50 (\$87) outstanding in

receivables on the Corporation's consolidated balance sheet at September 30, 2020. The Corporation will continue to evaluate its eligibility under the CJRS program through the balance of 2020.

In accordance with IAS 20 Accounting for Government Grants and Disclosure of Government Assistance, the government grants have been recognized on the Corporation's consolidated statements for the nine months ended September 30, 2020 as an offset to operating expenses of \$12,250 which includes, wages and benefits of \$9,125, delivery of \$2,044, and corporate costs of \$1,081.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

New standards, interpretations, or amendments that have been issued, or are not yet effective, have not been further described or early adopted, where no material impact is expected on the Corporation's consolidated financial statements.

## **CRITICAL RISKS AND UNCERTAINTIES**

As at September 30, 2020 there are no material changes in the Corporation's risks or risk management activities since December 31, 2019, other than in respect of the impact of the COVID-19 pandemic which is discussed in detail in this MD&A and accompanying unaudited consolidated interim financial statements. The Corporation's results of operations, business prospects, financial condition, cash dividends to Shareholders and the trading price of the 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 Common Shares, see "Risk Factors – Risks Related to K-Bro and the Laundry and Linen Industry" detailed in the Corporation's Annual Information Form that is available at [www.sedar.com](http://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.

### **Internal Controls over Financial Reporting**

There were no changes in internal controls over financial reporting ("ICFR") during the three month period ended September 30, 2020 that materially affected, or are reasonably likely to materially affect, the Corporation's ICFR.

The Corporation's CEO and CFO have determined that there is not a material weakness in the design of disclosure controls and procedures and internal controls over financial reporting which existed as at September 30, 2020.

A discussion of the internal controls over financial reporting can be found under the MD&A that accompany the audited consolidated financial statements for the year ended December 31, 2019.

A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instance of fraud, if any, have been detected. These inherent limitations include, amongst other items: (i) that managements' assumptions and judgments could ultimately prove to be incorrect under varying conditions and circumstances; or, (ii) the impact of isolated errors.

Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential (future) conditions.

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Additional information regarding K-Bro including required securities filings are available on our website at [www.k-brolinen.com](http://www.k-brolinen.com) and on the Canadian Securities Administrators' website at [www.sedar.com](http://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](http://www.k-brolinen.com) et sur le site Web des autorités canadiennes en valeurs mobilières au [www.sedar.com](http://www.sedar.com), le site Web du Système électronique de données, d'analyse et de recherche (« SEDAR »).