



**KP TISSUE INC. AND KRUGER PRODUCTS L.P.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF RESULTS OF OPERATIONS AND FINANCIAL POSITION**

**FOR THE 3-MONTH AND 9-MONTH PERIODS ENDED SEPTEMBER 30, 2019**

**DATED NOVEMBER 6, 2019**

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The following Management's Discussion and Analysis (MD&A) dated November 6, 2019 for KP Tissue Inc. (KPT) and Kruger Products L.P. (KPLP) is intended to assist the readers in understanding the business environment, strategies, performance and risk factors relating to KPT and KPLP. It should be read in conjunction with the unaudited condensed financial statements of KPT for the 3 month periods ended September 30, 2019 and September 30, 2018, respectively, and the 9 month periods ended September 30, 2019 and September 30, 2018, respectively, and the unaudited condensed consolidated financial statements of KPLP for the 3 month periods ended September 30, 2019 (Q3 2019) and September 30, 2018 (Q3 2018), respectively, and the 9-month periods ended September 30, 2019 (YTD 2019) and September 30, 2018 (YTD 2018) respectively. The 3 month periods ended September 30, 2019 and September 30, 2018 consist of 92 days and 91 days, respectively, and the 9 month periods ended September 30, 2019 and September 30, 2018 each consist of 273 days.

## **About KP Tissue Inc.**

KPT was created to acquire, and its business is limited to holding, a limited partnership interest in KPLP, which is accounted for as an investment in an associate using the equity method of accounting. KPT currently holds a 15.2% interest in KPLP (15.4% as of September 30, 2019). The following MD&A provides discussion and analysis related to KPT to the extent necessary to understand the equity method of accounting. However, the majority of the discussion and analysis relates to KPLP and to KPT's investment in KPLP.

## **CAUTIONARY FORWARD LOOKING STATEMENT**

Certain statements in this MD&A about KPT's and KPLP's current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements or any other future events or developments constitute forward-looking statements. Forward-looking statements in this MD&A include, but are not limited to, statements regarding the projected capacity of the TAD Sherbrooke Project (as defined below), the anticipated benefits of the TAD Sherbrooke Project and the expected dates for commencement of construction and production of the TAD Sherbrooke Project; KPLP's expansion efforts in U.S. premium private label; and KPLP's future business strategy. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements. The forward-looking statements are based on certain key expectations and assumptions made by KPT or KPLP. Although KPT and KPLP believe that the expectations and assumptions on which such forward-looking information is based are reasonable, undue reliance should not be placed on the forward-looking statements since no assurance can be given that such expectations and assumptions will prove to be correct.

Many factors could cause KPLP's actual results, level of activity, performance or achievements or future events or developments (which could in turn affect the economic benefits derived from KPT's economic interest in KPLP) to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors, which are discussed in greater detail in the "Risk Factors – Risks Related to KPLP's Business" section of the KPT Annual Information Form dated March 8, 2019 available on SEDAR at [www.sedar.com](http://www.sedar.com) (the Annual Information Form): Kruger Inc.'s influence over KPLP; KPLP's reliance on Kruger Inc.; consequences of an event of insolvency relating to Kruger Inc.; risks associated with the TAD Sherbrooke Project; operational risks; Gatineau Plant land lease; significant increases in input costs; reduction in supply of fibre; increased pricing pressure and intense competition; KPLP's inability to innovate effectively; adverse economic conditions; dependence on key retail trade customers; damage to the reputation of KPLP or KPLP's brands; KPLP's sales being less than anticipated; KPLP's failure to implement its business and operating strategies; KPLP's obligation to make regular capital expenditures; KPLP's entering into unsuccessful acquisitions; KPLP's dependence on key personnel; KPLP's inability to retain its existing customers or obtain new customers; KPLP's loss of key suppliers; KPLP's failure to adequately protect its intellectual property rights; KPLP's reliance on third party intellectual property licenses; adverse litigation and other claims affecting KPLP; material expenditures due to comprehensive environmental regulation affecting KPLP's cash flow; KPLP's pension obligations are significant and can be materially higher than predicted if KPLP Management's underlying assumptions are incorrect; labour disputes adversely affecting KPLP's cost structure and KPLP's ability to run its plants; exchange rate and U.S. competitors; KPLP's inability to service all of its indebtedness; exposure to potential consumer product liability; covenant compliance; interest rate and refinancing risk; information technology; cyber-security; insurance; internal controls; and trade related.

These factors are not intended to represent a complete list of the factors that could affect KPT and/or KPLP; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein. KPT and KPLP cannot guarantee future results, levels of activity, performance, or achievements. Moreover, KPT and KPLP do not assume responsibility for the accuracy and completeness of the forward-looking statements. KPT and/or KPLP's actual results, performance or achievements could differ materially from those expressed in, or implied by, these forward-looking statements and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits that KPT and/or KPLP will derive therefrom.

To the extent any forward-looking information in this MD&A constitutes future-oriented financial information or financial outlooks within the meaning of securities laws, such information is being provided to demonstrate the potential benefits and readers are cautioned that this information may not be appropriate for any other purpose. Future-oriented financial information and financial outlooks, including expected cost-savings related to the restructuring activities, refinancing, and the installation of TAD Sherbrooke (as defined below), are, without limitation, based on the assumptions and subject to the risks set out above.

The forward-looking information contained herein is made as of the date of this MD&A and KPT and KPLP disclaim any intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise, unless required by applicable law.

## OVERVIEW

### Business Overview

KPLP is Canada's leading tissue products supplier by overall dollar and volume market share. It produces, distributes, markets and sells a wide range of disposable tissue products, including bathroom tissue, facial tissue, paper towels and napkins, for both the Consumer and the Away-From-Home (AFH) markets (in each case, as defined below). While its principal focus is on the Canadian consumer-branded tissue products market, KPLP is also a leader in the Canadian AFH market and has a considerable presence in the U.S. private label tissue market, primarily through its wholly-owned subsidiary TAD Canco Inc. and its subsidiaries. The Consumer segment consists of well recognized brands such as *Cashmere*, *Purex*, *Scotties* and *SpongeTowels* in Canada and *White Cloud* in the U.S.

KPLP is headquartered in Mississauga, Ontario and has approximately 2,500 employees across North America. KPLP's Canadian paper manufacturing facilities, consisting of three tissue plants in Québec and one plant in British Columbia, have a combined annual tissue production capacity of approximately 269,000 metric tonnes which, according to RISI data, represents approximately one-third of Canada's annual production capacity.

KPLP's U.S. manufacturing facility held in K.T.G. (USA) Inc. (KTG) and located in Memphis, Tennessee consists of two paper machines with an aggregate annual capacity of 55,000 metric tonnes, and one adjacent Through-Air-Dried (TAD) tissue machine (Memphis TAD Machine) with an aggregate annual capacity of 55,000 metric tonnes.

Pursuant to its Articles, KPT's business is limited to (i) the investment in, holding of and disposition of limited partnership interests, units, shares or other securities of KPLP and its general partner, KPGP Inc. (KPGP) (or any successor entity of either KPLP or KPGP), (ii) the acquisition of, holding, operation and disposition of any assets, liabilities, operations or business of such entities, and (iii) all activities related, incidental or ancillary to any of the foregoing. As of the date of the MD&A and following the participation by the partners in the Dividend Reinvestment Plan (DRIP) on October 15, 2019, KPT held 15.2% of the KPLP Partnership Units (KPLP Units).

### Basis of Presentation

The unaudited condensed consolidated financial statements of KPLP presented for Q3 and YTD 2019 and Q3 and YTD 2018 and the unaudited condensed financial statements of KPT presented for the 3 month and 9 month periods ended September 30, 2019 and September 30, 2018, have each been prepared in accordance with IFRS (International Financial Reporting Standards) for interim financial statements, including IAS 34, Interim Financial Reporting.

## Lease Accounting

Effective January 1, 2019, KPLP adopted IFRS 16 Leases, the new accounting standard covering lease accounting, using the full retrospective approach. Under this approach all comparative period information has been restated to reflect the adoption of IFRS 16. The following tables provide the transition effect of the adoption of IFRS 16 on the income statement and segment reporting for Q3 2018 and YTD 2018:

(C\$ millions, unless otherwise stated)	Q3 2018			YTD 2018		
	Original	Transition effect	Restated	Original	Transition effect	Restated
	\$	\$	\$	\$	\$	\$
<b>Statement of Operations Data:</b>						
Revenue	348.6	-	348.6	1,011.1	-	1,011.1
Cost of sales	(312.8)	1.4	(311.4)	(905.1)	4.0	(901.1)
Selling, general and administrative expenses	(20.6)	-	(20.6)	(63.6)	0.1	(63.5)
(Gain) loss on sale of non-financial assets	-	-	-	0.2	-	0.2
Restructuring costs, net	-	-	-	-	-	-
<b>Operating income</b>	<b>15.2</b>	<b>1.4</b>	<b>16.6</b>	<b>42.6</b>	<b>4.1</b>	<b>46.7</b>
Interest expense	(12.1)	(1.4)	(13.5)	(35.9)	(4.1)	(40.0)
Other (income) expense	0.6	-	0.6	(0.5)	-	(0.5)
<b>Income before income taxes</b>	<b>3.7</b>	<b>-</b>	<b>3.7</b>	<b>6.2</b>	<b>-</b>	<b>6.2</b>
Income taxes	0.5	-	0.5	1.2	-	1.2
<b>Net income for the period</b>	<b>4.2</b>	<b>-</b>	<b>4.2</b>	<b>7.4</b>	<b>-</b>	<b>7.4</b>

(C\$ millions, unless otherwise stated)	Q3 2018			YTD 2018		
	Original	Transition effect	Restated	Original	Transition effect	Restated
	\$	\$	\$	\$	\$	\$
<b>Segment revenue</b>						
Consumer	289.2	-	289.2	838.6	-	838.6
AFH	59.4	-	59.4	172.5	-	172.5
Total segment revenue	348.6	-	348.6	1,011.1	-	1,011.1
<b>Adjusted EBITDA</b>						
Consumer	34.1	3.2	37.3	93.2	9.4	102.6
AFH	(4.6)	1.1	(3.5)	(8.0)	2.4	(5.6)
Corporate and other costs	(1.3)	-	(1.3)	(3.2)	-	(3.2)
Total Adjusted EBITDA	28.2	4.3	32.5	82.0	11.8	93.8

### Reconciliation of Adjusted EBITDA to Net income:

<b>Adjusted EBITDA</b>	28.2	4.3	32.5	82.0	11.8	93.8
Less:						
Interest expense	12.1	1.4	13.5	35.9	4.1	40.0
Depreciation and amortization	12.8	2.9	15.7	39.2	7.7	46.9
Foreign exchange (gain) loss	(0.5)	-	(0.5)	0.1	-	0.1
Change in amortized cost of						
Partnership units liability	-	-	-	0.7	-	0.7
Change in fair value of derivatives	0.1	-	0.1	(0.3)	-	(0.3)
Loss on sale of property, plant and equipment	-	-	-	0.4	-	0.4
Gain on sale of non-financial assets	-	-	-	(0.2)	-	(0.2)
Restructuring costs, net	-	-	-	-	-	-
Income before income taxes	3.7	-	3.7	6.2	-	6.2
Income taxes	(0.5)	-	(0.5)	(1.2)	-	(1.2)
<b>Net income for the period</b>	<b>4.2</b>	<b>-</b>	<b>4.2</b>	<b>7.4</b>	<b>-</b>	<b>7.4</b>

## **Accounting Periods**

This MD&A, the unaudited condensed consolidated financial statements of KPLP and accompanying notes thereto include financial information for Q3 2019, Q3 2018, YTD 2019 and YTD 2018.

## **Financial Measures and Key Indicators**

This MD&A refers to “Adjusted EBITDA”, a measure which does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similarly titled measures presented by other companies.

“Adjusted EBITDA” is calculated by KPLP as net income (loss) before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (gain on sale) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) foreign exchange loss (gain), (viii) costs related to restructuring activities, (ix) changes in amortized cost of Partnership units liability, (x) change in fair value of derivatives, (xi) one-time consulting costs related to operational transformation initiatives, (xii) mergers and acquisitions (M&A) related costs and (xiii) loss (gain) on sale of shares. We use “Adjusted EBITDA” to evaluate the performance of our business as it reflects its ongoing profitability. This MD&A contains a reconciliation of Adjusted EBITDA to net income, the most comparable IFRS measure, on page 5.

## **Outlook**

KPLP is committed to building its consumer brands and developing innovative products for its retail and commercial customers. KPLP’s strategy is to maintain its leadership position in the Canadian market. Though the Canadian tissue market is expected to remain competitive, KPLP believes that its brands and products are well positioned for continued growth. KPLP will aim to sustain its consumer and AFH leadership position in the Canadian tissue industry by driving marketing and sales excellence, extending product lines, continuing to leverage product development and manufacturing technology to drive product superiority and cost savings, and emphasizing manufacturing quality and efficiency.

KPLP also expects to continue to grow by leveraging its TAD product capabilities in North America and focusing on the high-end private label business in the U.S. market. KPLP’s U.S. strategy also includes the expansion of the White Cloud brand to additional U.S. retailers.

## **BUSINESS HIGHLIGHTS**

### **TAD Sherbrooke Project**

On August 16, 2018, KPLP announced its plan for a capital investment of \$575 million in the Brompton area of Sherbrooke, Quebec, to build a new, state-of-the-art tissue plant featuring Canada’s largest and most modern Through-Air-Dried (TAD) paper machine along with related converting equipment and infrastructure (the TAD Sherbrooke Project). The TAD Sherbrooke Project is forecast to produce at maturity approximately 70,000 metric tonnes per annum of bathroom tissue and paper towels which will enable KPLP to increase its offering of ultra-premium and innovative tissue projects under the Cashmere, Sponge Towels and Purex brands and also enable expansion in the U.S. private label business. Construction of the new site has commenced and production is expected to start in early 2021.

As of September 30, 2019, a total of \$145.1 million had been spent on the TAD Sherbrooke Project, including financing related fees. To date the project has been financed by the \$62.5 million equity investment by KPLP into Kruger Products Sherbrooke Inc. (KPSI), the entity that will construct and operate the project, and by the \$105 million convertible debenture issued to Investissement Quebec. The project continues to be on-time and on-budget.

## RESULTS OF OPERATIONS

### Results of Operations of KPLP

(C\$ millions, unless otherwise noted)	Q3 2019	Restated Q3 2018	YTD 2019	Restated YTD 2018	\$ Change Q3 2019 vs. Q3 2018	\$ Change YTD 2019 vs. YTD 2018
<b>Statement of Operations Data:</b>						
Revenue	369.4	348.6	1,086.0	1,011.1	20.8	74.9
Cost of sales	(317.0)	(311.4)	(962.8)	(901.1)	(5.6)	(61.7)
Selling, general and administrative expenses	(25.8)	(20.6)	(73.2)	(63.5)	(5.2)	(9.7)
Gain on sale of non-financial assets	-	-	-	0.2	-	(0.2)
Restructuring costs, net	(1.6)	-	(1.9)	-	(1.6)	(1.9)
<b>Operating income</b>	<b>25.0</b>	<b>16.6</b>	<b>48.1</b>	<b>46.7</b>	<b>8.4</b>	<b>1.4</b>
Interest expense	(11.4)	(13.5)	(34.2)	(40.0)	2.1	5.8
Other income (expense)	(2.4)	0.6	(4.0)	(0.5)	(3.0)	(3.5)
<b>Income before income taxes</b>	<b>11.2</b>	<b>3.7</b>	<b>9.9</b>	<b>6.2</b>	<b>7.5</b>	<b>3.7</b>
Income taxes:						
Combined income tax rate after manufacturing and processing credits	(3.0)	(0.9)	(2.6)	(1.6)	(2.1)	(1.0)
Income tax in partners' hands	2.8	1.7	2.5	4.2	1.1	(1.7)
Other	(0.5)	(0.3)	(1.6)	(1.4)	(0.2)	(0.2)
Income taxes	(0.7)	0.5	(1.7)	1.2	(1.2)	(2.9)
<b>Net income for the period</b>	<b>10.5</b>	<b>4.2</b>	<b>8.2</b>	<b>7.4</b>	<b>6.3</b>	<b>0.8</b>

(C\$ millions, unless otherwise noted)	Q3 2019	Restated Q3 2018	YTD 2019	Restated YTD 2018	\$ Change Q3 2019 vs. Q3 2018	\$ Change YTD 2019 vs. YTD 2018
<b>Reconciliation of Adjusted EBITDA to Net income:</b>						
Net income for the period	10.5	4.2	8.2	7.4	6.3	0.8
Interest expense	11.4	13.5	34.2	40.0	(2.1)	(5.8)
Income taxes	0.7	(0.5)	1.7	(1.2)	1.2	2.9
Depreciation and amortization	15.1	15.7	44.6	46.9	(0.6)	(2.3)
Foreign exchange (gain) loss	0.5	(0.5)	(1.2)	0.1	1.0	(1.3)
Change in amortized cost of Partnership units liability	1.5	-	4.6	0.7	1.5	3.9
Change in fair value of derivatives	(0.3)	0.1	-	(0.3)	(0.4)	0.3
Loss on sale of property, plant and equipment	-	-	-	0.4	-	(0.4)
Loss on sale of shares	0.6	-	0.6	-	0.6	0.6
Gain on sale of non-financial assets	-	-	-	(0.2)	-	0.2
Restructuring costs, net	1.6	-	1.9	-	1.6	1.9
One-time consulting costs related to operational transformation initiatives	2.3	-	3.6	-	2.3	3.6
M&A related costs	0.1	-	0.8	-	0.1	0.8
<b>Adjusted EBITDA</b>	<b>44.0</b>	<b>32.5</b>	<b>99.0</b>	<b>93.8</b>	<b>11.5</b>	<b>5.2</b>

## ***Results of Operations Q3 2019 compared to Q3 2018***

### *Revenue*

Revenue was \$369.4 million in Q3 2019 compared to \$348.6 million in Q3 2018 an increase of \$20.8 million or 6.0%. The increase in revenue was primarily due to price increases across all business segments, higher sales volumes and the benefit of foreign exchange fluctuations on U.S. sales (USD average 1.32 in Q3 2019 compared to 1.31 in Q3 2018). From a geographic perspective, revenue in the U.S. increased \$11.1 million, or 9.2%, while revenue in Canada increased \$7.9 million or 3.9% and revenue in Mexico increased \$1.8 million, or 7.6%.

### *Cost of Sales*

Cost of sales was \$317.0 million in Q3 2019 compared to \$311.4 million in Q3 2018, an increase of \$5.6 million or 1.9%. Manufacturing costs increased due to several factors: increased sales volume; the cost of outsourced manufacturing due to production inefficiencies; additional maintenance costs and inflation; and the unfavourable impact of foreign exchange fluctuations on USD denominated costs (USD average 1.32 in Q3 2019 compared to 1.31 in Q3 2018). These increases were partially offset by lower pulp costs compared to Q3 2018 and the favourable impact of operational transformation initiatives in Q3 2019. Freight costs decreased primarily due to lower carrier rates compared to Q3 2018, particularly in the U.S., partially offset by higher sales volumes and the unfavourable impact of foreign exchange fluctuations. Warehousing costs increased related primarily to additional warehousing space required to manage the logistics network. As a percentage of revenue, cost of sales were 85.8% in Q3 2019 compared to 89.3% in Q3 2018.

### *Selling, General and Administrative Expenses*

Selling, general and administrative (SG&A) expenses were \$25.8 million in Q3 2019 compared to \$20.6 million in Q3 2018, an increase of \$5.2 million or 25.3%. The increase was primarily due to increased compensation related costs compared to Q3 2018, higher advertising and promotion expenses and the unfavourable impact of foreign exchange fluctuations on USD costs. As a percentage of revenue, SG&A expenses were 7.0% in Q3 2019 compared to 5.9% in Q3 2018.

### *Adjusted EBITDA*

Adjusted EBITDA was \$44.0 million in Q3 2019 compared to \$32.5 million in Q3 2018, an increase of \$11.5 million or 35.3%. The higher Adjusted EBITDA resulted primarily from the positive impact of price increases across all business segments, lower pulp costs and higher sales volumes along with the benefit from operational transformation initiatives, partially offset by unfavourable sales mix, the cost of outsourced manufacturing and maintenance costs, and higher SG&A costs.

### *Interest Expense*

Interest expense was \$11.4 million in Q3 2019 compared to \$13.5 million in Q3 2018, a decrease of \$2.1 million. The decrease was primarily due to lower interest rates related to the refinancing of KTG, partially offset by the unfavourable impact of foreign exchange.

### *Other Income (Expense)*

Other expense was \$2.4 million in Q3 2019 compared to other income of \$0.6 million in Q3 2018. Other expense in Q3 2019 was primarily related to the change in amortized cost of Partnership units liability of \$1.5 million (Q3 2018 – nil), a loss on sale of shares of \$0.6 million and a foreign exchange loss of \$0.5 million (Q3 2018 – gain of \$0.5 million), partially offset by income related to a change in the fair value of derivatives of \$0.3 million (Q3 2018 – nil).

The loss on sale of shares resulted from the sale of shares in GTM on September 20, 2019 for net proceeds of US\$5.1 million. Following the sale, KPLP will no longer recognize revenue and costs related to Mexico and will receive an annual commission in each of the next three years on sales previously associated with GTM.



### *Income Taxes*

An income tax expense of \$0.7 million was recorded in Q3 2019 compared to a recovery of \$0.5 million in Q3 2018. KPLP is not directly taxable on its Canadian business. The income tax expense in Q3 2019 resulted primarily from operating income related to the U.S. entities and the income tax recovery in Q3 2018 resulted primarily from an operating loss related to the U.S. entities. Income tax in partner's hands was a recovery of \$2.8 million in Q3 2019 compared to \$1.7 million in Q3 2018.

### *Net Income*

Net income was \$10.5 million in Q3 2019 compared to \$4.2 million in Q3 2018, an increase of \$6.3 million. The increase was primarily due higher Adjusted EBITDA of \$11.5 million as discussed above, a decrease in interest expense of \$2.1 million, lower depreciation expense of \$0.6 million, partially offset by a change in other expense of \$3.0 million, one-time consulting costs related to operational transformation initiatives of \$2.3 million, restructuring costs of \$1.6 million and higher income tax expense of \$1.2 million.

### ***Results of Operations YTD 2019 compared to YTD 2018***

#### *Revenue*

Revenue was \$1,086.0 million in YTD 2019 compared to \$1,011.1 million in YTD 2018 an increase of \$74.9 million or 7.4%. The increase in revenue was primarily due to price increases across all business segments, increased sales volume and the benefit of foreign exchange fluctuations on U.S. sales (USD average 1.33 in YTD 2019 compared to 1.29 in YTD 2018). From a geographic perspective, revenue in the U.S. increased \$39.3 million, or 11.2%, while revenue in Canada increased \$22.0 million or 3.7% and revenue in Mexico increased \$13.7 million, or 21.6%.

#### *Cost of Sales*

Cost of sales was \$962.8 million in YTD 2019 compared to \$901.1 million in YTD 2018, an increase of \$61.7 million or 6.9%. Manufacturing costs increased due to several factors: increased sales volume; the unfavourable impact of foreign exchange fluctuations on USD denominated costs (USD average 1.33 in YTD 2019 compared to 1.29 in YTD 2018); the cost of outsourced manufacturing resulting from capacity related challenges and increased costs due to production inefficiencies; and additional maintenance costs and inflation. Pulp costs were essentially flat compared to YTD 2018. Freight costs increased primarily due to higher volume, the geographic mix of sales, and the unfavourable impact of foreign exchange fluctuations, partially offset by lower carrier rates in YTD 2019 compared to YTD 2018. Warehousing costs increased related primarily to additional warehousing space required to manage the logistics network. As a percentage of revenue, cost of sales were 88.7% in YTD 2019 compared to 89.1% in YTD 2018.

#### *Selling, General and Administrative Expenses*

SG&A expenses were \$73.2 million in YTD 2019 compared to \$63.5 million in YTD 2018, an increase of \$9.7 million or 15.2%. The increase was primarily due to increased compensation related costs compared to YTD 2018, M&A costs, higher advertising and promotion expenses, and the unfavourable impact of foreign exchange fluctuations on USD costs. As a percentage of revenue, SG&A expenses were 6.7% in YTD 2019 compared to 6.3% in YTD 2018.

#### *Adjusted EBITDA*

Adjusted EBITDA was \$99.0 million in YTD 2019 compared to \$93.8 million in YTD 2018, an increase of \$5.2 million or 5.6%. The increase was primarily due to price increases across all business segments and higher sales volumes, partially offset by unfavourable sales mix, the cost of outsourced manufacturing and maintenance costs, higher SG&A costs and the unfavourable impact of foreign exchange fluctuations.

### *Interest Expense*

Interest expense was \$34.2 million in YTD 2019 compared to \$39.9 million in YTD 2018, a decrease of \$5.7 million. The decrease was primarily due to lower interest rates related to the refinancing of KTG, partially offset by the unfavourable impact of foreign exchange and higher debt levels during the first half of 2019 (excluding debt related to the TAD Sherbrooke Project).

### *Other Income (Expense)*

Other expense was \$4.0 million in YTD 2019 compared to \$0.5 million in YTD 2018. Other expense in YTD 2019 was primarily related to the change in amortized cost of Partnership units liability of \$4.6 million (YTD 2018 – increase of \$0.7 million) and a loss on sale of shares of \$0.6 million, partially offset by a foreign exchange gain of \$1.2 million (YTD 2018 – loss of \$0.1 million).

### *Income Taxes*

An income tax expense of \$1.7 million was recorded in YTD 2019 compared to a recovery of \$1.2 million in YTD 2018. KPLP is not directly taxable on its Canadian business. The income tax expense in Q3 2019 resulted primarily from operating income related to the U.S. entities and the income tax recovery in Q3 2018 resulted primarily from an operating loss related to the U.S. entities. Income tax in partner's hands was a recovery of \$2.5 million in YTD 2019 compared to \$4.2 million in YTD 2018.

### *Net Income*

Net income was \$8.2 million in YTD 2019 compared to \$7.4 million in YTD 2018, an increase of \$0.8 million. The increase was primarily due to higher Adjusted EBITDA of \$5.2 million as discussed above, a decrease in interest expense of \$5.8 million and lower depreciation expense of \$2.3 million, partially offset by a change in other expense of \$3.5 million, one-time consulting costs related to operational transformation initiatives of \$3.6 million, restructuring costs of \$1.9 million, higher income tax expense of \$2.9 million and M&A costs of \$0.8 million.

## **Results of Operations of KPT**

	<b>3-month period ended September 30, 2019</b>	<b>3-month period ended September 30, 2018</b>	<b>9-month period ended September 30, 2019</b>	<b>9-month period ended September 30, 2018</b>
<b>(C\$ millions, unless otherwise noted)</b>				
<b>Statement of Operations Data:</b>				
Share of income (loss)	1.6	0.7	1.3	1.2
Depreciation of fair value increments	(1.4)	(1.5)	(4.3)	(4.4)
<b>Equity loss</b>	0.2	(0.8)	(3.0)	(3.2)
Dilution gain	0.1	0.1	0.4	0.2
<b>Loss before income taxes</b>	0.3	(0.7)	(2.6)	(3.0)
Income taxes:				
Current tax expense	(0.2)	(0.1)	(0.2)	(0.2)
Deferred tax (expense) recovery	(0.5)	-	(2.1)	0.2
Income taxes	(0.7)	(0.1)	(2.3)	-
<b>Net loss for the period</b>	<b>(0.4)</b>	<b>(0.8)</b>	<b>(4.9)</b>	<b>(3.0)</b>
<b>Basic loss per share (dollars)</b>	<b>(0.04)</b>	<b>(0.09)</b>	<b>(0.52)</b>	<b>(0.32)</b>

The financial information presented above is based on KPT's interest in KPLP for the 3 month and 9 month periods ended September 30, 2019 and September 30, 2018, respectively. The share of income relates to KPT's share of income of KPLP. Refer to Results of Operations of KPLP above for an explanation of the results. The depreciation of fair value

increments relates to adjustments to the carrying amount of certain assets of KPLP on its acquisition by KPT. Refer to note 5 in KPT's financial statements for additional information.

The current income tax expense (recovery) is based on KPT's share of the taxable income (loss) of KPLP for the same periods. The deferred tax expense (recovery) is a result of changes in the temporary differences of KPLP's assets and liabilities since acquisition and the difference between the accounting and tax basis for KPT's investment in KPLP. Refer to note 6 in KPT's financial statements for additional information.

Pursuant to the Tax Distribution as defined in the Partnership Agreement, KPLP would typically declare a Tax Distribution on February 28, 2019, related to taxes owing resulting from the taxable income of KPT for Fiscal 2018. However, KPT incurred a loss for tax purposes for Fiscal 2018 and as a result no Tax Distribution was declared on February 28, 2019. The excess advances over the Tax Distribution were \$1.7 million. Of that amount, \$0.1 million was used to pay the monthly tax instalment on behalf of KPT and is repayable to KPLP on or before March 31, 2020. The remaining \$1.6 million was repaid to KPLP by Kruger Inc. and KPGP during YTD 2019. The advances are non-interest bearing and non-recourse in nature and will be settled when the Tax Distribution is declared annually.

## SEGMENT INFORMATION

### Segment Operating Income

Segment operating income is the earnings (loss) for each such segment before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (gain on sale) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) foreign exchange loss (gain), (viii) costs related to restructuring activities, (ix) changes in amortized cost of Partnership units liability, (x) change in fair value of derivatives, (xi) one-time consulting costs related to operational transformation initiatives, (xii) mergers and acquisitions (M&A) related costs and (xiii) loss (gain) on sale of shares. "Consumer Segment Adjusted EBITDA", "AFH Segment Adjusted EBITDA", and "Other Segment Adjusted EBITDA" means in each case the Segment operating income for the referring respective segment of KPLP.

### Segment Results

(C\$ millions, unless otherwise noted)	Restated		Restated		Q3 2019 vs. Q3 2018		YTD 2019 vs. YTD 2018	
	Q3 2019	Q3 2018	YTD 2019	YTD 2018	\$ Change	% Change	\$ Change	% Change
<b>Segment Revenue</b>								
Consumer	305.1	289.2	900.9	838.6	15.9	5.5%	62.3	7.4%
AFH	64.3	59.4	185.1	172.5	4.9	8.2%	12.6	7.3%
Total segment revenue	<u>369.4</u>	<u>348.6</u>	<u>1,086.0</u>	<u>1,011.1</u>	<u>20.8</u>	<u>6.0%</u>	<u>74.9</u>	<u>7.4%</u>
<b>Adjusted EBITDA</b>								
Consumer	46.0	37.3	111.3	102.6	8.7		8.7	
AFH	(1.9)	(3.5)	(11.5)	(5.6)	1.6		(5.9)	
Corporate and other costs	(0.1)	(1.3)	(0.8)	(3.2)	1.2		2.4	
Total Adjusted EBITDA	<u>44.0</u>	<u>32.5</u>	<u>99.0</u>	<u>93.8</u>	<u>11.5</u>		<u>5.2</u>	

### Consumer Segment

#### Q3 2019 compared to Q3 2018

Consumer segment revenue was \$305.1 million in Q3 2019 compared to \$289.2 million in Q3 2018, an increase of \$15.9 million or 5.5%. The increase in revenue was primarily due to price increases in Canada and the U.S., higher sales volume in Canada and Mexico and favourable foreign exchange fluctuations on U.S. sales (USD average 1.32 in Q3 2019 compared to 1.31 in Q3 2018). Consumer segment revenue increased in the U.S., Canada and Mexico.

Consumer Segment Adjusted EBITDA was \$46.0 million in Q3 2019 compared to \$37.3 million in Q3 2018, an increase of \$8.7 million. The increase was primarily due to the price increases in Canada and the U.S., higher sales volume and lower fibre and freight costs, partially offset by the unfavourable impact of sales mix, increased warehousing costs and higher SG&A expenses.

*YTD 2019 compared to YTD 2018*

Consumer segment revenue was \$900.9 million in YTD 2019 compared to \$838.6 million in YTD 2018, an increase of \$62.3 million or 7.4%. The increase in revenue was primarily due to price increases in Canada and the U.S., increased sales volume in the U.S. and Mexico and favourable foreign exchange fluctuations on U.S. sales (USD average 1.33 in YTD 2019 compared to 1.29 in YTD 2018). Consumer segment revenue increased in the U.S., Canada and Mexico.

Consumer Segment Adjusted EBITDA was \$111.3 million in YTD 2019 compared to \$102.6 million in YTD 2018, an increase of \$8.7 million. Higher sales volume, price increases in Canada and the U.S. and lower freight costs were partially offset by the unfavourable impact of sales mix and higher warehousing and SG&A expenses.

***AFH Segment***

*Q3 2019 compared to Q3 2018*

AFH segment revenue was \$64.3 million in Q3 2019 compared to \$59.4 million in Q3 2018, an increase of \$4.9 million or 8.2%. The increase was primarily due to higher sales volume, selling price increases and the favourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.32 in Q3 2019 compared to 1.31 in Q3 2018). AFH segment revenue increased in both the U.S. and Canada.

AFH Segment Adjusted EBITDA was a loss of \$1.9 million in Q3 2019 compared to a loss of \$3.5 million in Q3 2018, an improvement of \$1.6 million. The improvement was primarily due to higher sales volume, the benefit from price increases and lower fibre costs, partially offset by higher outsourced paper and freight costs resulting from production inefficiencies, and higher warehousing and SG&A costs.

*YTD 2019 compared to YTD 2018*

AFH segment revenue was \$185.1 million in YTD 2019 compared to \$172.5 million in YTD 2018, an increase of \$12.6 million or 7.3%. The increase was primarily due to higher sales volume, selling price increases and the favourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.33 in YTD 2019 compared to 1.29 in YTD 2018). AFH segment revenue increased in the U.S. and Canada.

AFH Segment Adjusted EBITDA was a loss of \$11.5 million in YTD 2019 compared to a loss of \$5.6 million in YTD 2018, a decrease of \$5.9 million. The decrease was primarily due to higher outsourced paper and freight costs resulting from production inefficiencies, the unfavourable impact of mix and higher warehousing and SG&A costs, partially offset by higher sales volume, the benefit from price increases and lower fibre costs.

***Corporate and Other Costs***

*Q3 2019 compared to Q3 2018*

Corporate and other costs previously included revenue and profit (loss) associated with the sales of parent rolls and recycled fibre, which were considered an "Other" segment. Any associated profit (loss) is now included in Consumer or AFH segments as appropriate. Corporate and other costs currently includes certain overhead costs and timing adjustments for certain manufacturing costs included in inventory not allocated to the Consumer and AFH segments.

Corporate and other costs were \$0.1 million in Q3 2019 compared to \$1.3 million in Q3 2018, a decrease of \$1.2 million, as the timing adjustments in inventory essentially offset the overhead costs.

## *YTD 2019 compared to YTD 2018*

Corporate and other costs previously included revenue and profit (loss) associated with the sales of parent rolls and recycled fibre, which were considered an “Other” segment. Any associated profit (loss) is now included in Consumer or AFH segments as appropriate. Corporate and other costs currently includes certain overhead costs and timing adjustments for certain manufacturing costs included in inventory not allocated to the Consumer and AFH segments.

Corporate and other costs were \$0.8 million in YTD 2019 compared to \$3.2 million in YTD 2018, a decrease of \$2.4 million, as the timing adjustments in inventory partially offset the overhead costs.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Overview**

KPLP’s principal uses of funds are for operating costs, working capital, capital expenditures and pension contributions (together, the Funding Requirements). To date, KPLP has met the Funding Requirements by using cash generated from operating activities and the Dividend Reinvestment Plan and borrowings under its various debt facilities. The registered defined benefit pension plans (RDBPP) sponsored by KPLP are currently in a solvency deficiency position, requiring KPLP to make funding contributions over the next ten years. KPLP Management believes that cash generated from operations and the Dividend Reinvestment Plan, together with amounts available under the various debt facilities will be sufficient to meet its future Funding Requirements. However, KPLP’s ability to meet future Funding Requirements and its ability to make scheduled payments of interest and principal on its debt facilities and to satisfy any of its other present or future debt obligations will depend on its future operating performance, which will be affected by general economic, financial and other factors including factors beyond its control. KPLP Management reviews investment opportunities in the normal course of its business and may, if suitable opportunities arise, make selected investments to implement KPLP’s business strategy. Historically, the funding for any such investments has come from cash flow from operations and/or additional debt.

On September 19, 2019, KPLP entered into a second supplemental credit agreement to the sixth amended and restated credit agreement (the Senior Credit Agreement) related to its revolving credit facility (the Senior Credit Facility). The maturity date of the Senior Credit Facility was also amended to September 19, 2023.

The Senior Credit Facility was increased to \$250.0 million from \$200.0 million, which increased the total borrowing capacity by \$50.0 million. The Senior Credit Agreement requires the Restricted Credit Parties to comply with certain financial covenants. The financial covenants are calculated on an Adjusted Consolidated Basis (as defined in the Senior Credit Agreement) such that the Unrestricted Credit Parties are accounted for as investments but not consolidated. As such, the Unrestricted Subsidiaries’ EBITDA are not included in such calculations. KPLP is no longer required to maintain the Ratio of Total Net Funded Debt to EBITDA.

KPLP shall maintain on an adjusted consolidated basis and quarterly financial basis:

Ratio of Senior Secured Net Funded Debt to EBITDA not greater than:

- i) 3.00 to 1.00 until December 31, 2018, inclusively;
- ii) 3.25 to 1.00 from January 1, 2019 to March 31, 2019;
- iii) 3.75 to 1.00 from April 1, 2019 to September 30, 2019;
- iv) 3.50 to 1.00 from October 1, 2019 to June 30, 2020;
- v) 3.25 to 1.00 from July 1, 2020 to September 30, 2020; and
- vi) 3.00 to 1.00 thereafter;

Interest Coverage Ratio of at least 3.00 to 1.00.

In connection with the amendments above, Kruger Inc. has agreed to increase its participation in the dividend reinvestment plan (DRIP) from 75% to 100% until December 31, 2020, which is expected to reduce the net distribution.

As of September 30, 2019, KPLP was in compliance with all of its financial covenants under all of its outstanding credit facilities. As of September 30, 2019, KPLP had drawn \$125.0 million from the \$250.0 million committed amount under the Senior Credit Facility, and had \$21.0 million of letters of credit outstanding, resulting in \$104.0 million available from the credit line. As of September 30, 2019, KPLP had total liquidity of \$186.4 million (December 31, 2018 - \$178.7 million) representing cash and cash equivalents and availability under the credit line. Total liquidity of \$186.4 million includes \$32.2 million of cash and cash equivalents held by KPSI and committed to the TAD Sherbrooke Project.

As it pertains to capital expenditures, approximately \$25 million annually relate to maintenance projects and the remaining expenditures are focused on growth projects aimed at reducing costs and offsetting annual inflation, or increasing production capacity. Regular growth projects focused on performance improvement generally have a 3 to 4 year payback. Capital expenditures were \$117.4 million in YTD 2019, including \$96.7 million related to the TAD Sherbrooke Project (including interest capitalized during construction). Capital expenditures are expected to be approximately \$215 million to \$235 million in fiscal 2019, primarily driven by the TAD Sherbrooke Project expenditures of \$190 million to \$200 million.

The tissue industry is generally characterized by high sales volume and rapid turnover of inventories and accounts receivable. In general, accounts receivable and inventories are readily convertible into cash. Investment in working capital may be affected by fluctuations in the prices of pulp and other supply costs, vendor terms and timing of collection of accounts receivable. The Partnership participates in a factoring program to assist in managing working capital. Under the program, the Partnership derecognizes certain receivables upon sale.

## Cash Flows

(C\$ millions, unless otherwise stated)	YTD 2019	Restated YTD 2018	\$ Change
			YTD 2019 vs. YTD 2018
Net cash flows from (used in) operating activities	56.5	54.7	1.8
Net cash flows used in investing activities	(114.1)	(35.4)	(78.7)
Net cash flows from (used in) financing activities	(28.3)	7.5	(35.8)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	(1.6)	0.3	(1.9)
Increase (decrease) in cash and cash equivalents	(87.5)	27.1	(114.6)
Beginning cash and cash equivalents, net	169.9	(0.2)	170.1
Ending cash and cash equivalents, net	82.4	26.9	55.5
Bank indebtedness	-	-	-
Ending cash and cash equivalents	82.4	26.9	55.5

### *Net Cash Flows from Operating Activities*

Net cash from operating activities was \$56.5 million in YTD 2019 compared to \$54.7 million in YTD 2018. Cash from operating activities in YTD 2019 was primarily driven by Adjusted EBITDA of \$99.0 million (YTD 2018 – \$93.8 million), partially offset by an increase in working capital of \$33.0 million (YTD 2018 – \$34.6 million), funding of pension and post-retirement benefit plans of \$11.6 million (YTD 2018 – \$12.3 million), income tax payments of \$2.4 million (YTD 2018 – \$1.9 million) and provisions paid of \$0.9 million (YTD 2018 – \$0.2 million).

### *Net Cash Flows used in Investing Activities*

Net cash used in investing activities was \$114.1 million in YTD 2019 compared to \$35.4 million in YTD 2018. Cash used in investing activities related to capital expenditures of \$117.4 million (including \$96.7 million for the TAD Sherbrooke Project and \$20.7 million for the existing business) in YTD 2019 compared to \$35.7 million in YTD 2018. This was partially offset by proceeds on sale of shares of \$3.3 million.

### ***Net Cash Flows from (used in) Financing Activities***

Net cash used in financing activities was \$28.3 million in YTD 2019 compared to cash from financing activities of \$7.5 million in YTD 2018. Net cash used in financing activities in YTD 2019 was primarily due to interest paid of \$20.0 million (YTD 2018 –\$25.7 million), lease payments of \$12.6 million (YTD 2018 –\$11.8 million), and distributions, advances paid (net of DRIP proceeds) of \$9.0 million (YTD 2018 –\$18.4 million) and payment of deferred financing fees of \$1.3 million (YTD 2018 –\$4.1 million), partially offset by net proceeds from debt of \$14.6 million (YTD 2018 –\$67.5 million).

### **Contractual Obligations**

KPLP's contractual obligations consist of long-term debt (principal repayments and interest payments), right-of-use leases for the rental of property, equipment and automobiles, partnership units liability and pensions. Refer to the contractual obligations disclosed in the 2018 Annual MD&A.

KPLP's cash pension contribution for defined benefit pension arrangements in YTD 2019 was \$9.5 million, while its post-retirement benefits contribution was \$2.1 million. In addition, as of September 30, 2019, KPLP had \$19.5 million of letters of credit related to pensions outstanding. Pension and post-retirement contributions for fiscal 2019 are expected to be \$17.5 million.

KPLP concluded a new land lease for its Gatineau tissue plant that commences in March 2028 and permits KPLP to secure the site until March 2053.

As of September 30, 2019, KPLP had no foreign exchange swaps or forwards outstanding.

KPLP holds interest rate swaps, contracted to fix the interest rate on a notional amount of \$100.0 million at September 30, 2019 (December 31, 2018 – \$100.0 million). The interest rate swaps will mature in the first quarter of 2020.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

### **Currency Risk**

Currency risk is the risk that KPLP's earnings may fluctuate due to changes in Canadian to U.S. dollar exchange rates, as the financial results are reported in Canadian dollars. KPLP sells certain of its products in U.S. dollars at prevailing U.S. dollar prices. The currency exposure is more than offset by U.S. dollar costs and expenses and the U.S. dollar denominated debt. KPLP is generally a net buyer of U.S. dollars.

As of September 30, 2019, KPLP had net liabilities denominated in U.S. dollars of \$21.0 million (December 31, 2018 – \$31.7 million). Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the result on net income before tax in Q3 2019 would have been an increase (decrease) of \$1.1 million (December 31, 2018 – \$1.6 million).

From time to time, KPLP uses derivative financial instruments to manage foreign currency risk. Foreign exchange swaps and foreign exchange forwards are used to manage U.S. dollar borrowings. As of September 30, 2019, KPLP had no foreign exchange swaps or forwards outstanding.

### **Interest Rate Risk**

KPLP's interest rate risk arises from its variable rate debt related to the revolving credit facility. As of September 30, 2019, KPLP had variable rate debts of \$123.1 million (December 31, 2018 – \$109.0 million). This facility bears interest at a base rate of Canadian prime rate, U.S. base rate, banker's acceptance rates or LIBOR plus the applicable margins. The applicable margin on the loan ranges between 0.20% and 3.50%.

A 100 basis point increase (decrease) in the market rate of interest would result in a decrease (increase) in net income before tax of \$1.2 million.

From time to time, KPLP uses interest rate swaps to manage part of its exposure to movements in interest rates on its credit facilities. KPLP holds interest rate swaps, contracted to fix the interest rate on a notional amount of \$100.0 million at September 30, 2019 (December 31, 2018 – \$100 million). The interest rate swaps will mature in the first quarter of 2020.

### **Credit Risk**

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. KPLP's financial instruments exposed to credit risk as of September 30, 2019 included cash and cash equivalents, trade and other receivables, receivables from related parties and advances to partners. KPLP places its cash and cash equivalents with financial institutions of high creditworthiness.

KPLP sells its products to a variety of customers under certain credit terms and therefore is exposed to credit risks. Normal trade receivables are due within 30 days from the invoice date and amounts in excess of 90 days past the invoice date are considered delinquent. KPLP routinely assesses the financial strength of its customers and mitigates against identified exposure primarily by lowering credit limits with high risk accounts. KPLP's customers are well established companies and accordingly, KPLP has experienced limited financial loss with respect to credit risk. As a result, KPLP believes that its exposure to credit risk is limited.

### **Liquidity Risk**

The purpose of liquidity risk management is to maintain sufficient cash and cash equivalents and to ensure KPLP has sufficient authorized credit facilities to maintain liquidity and meet its future obligations as they come due.

On September 19, 2019, KPLP entered into a second supplemental credit agreement to the sixth amended and restated credit agreement (the Senior Credit Agreement) related to its revolving credit facility (the Senior Credit Facility). The maturity date of the Senior Credit Facility was amended to September 19, 2023. The Senior Credit Facility was increased to \$250.0 million from \$200.0 million, which increased the total borrowing capacity by \$50.0 million.

As of September 30, 2019, KPLP had drawn \$125.0 million from the \$250.0 million committed amount under the Senior Credit Facility, and had \$21.0 million of letters of credit outstanding, resulting in \$104.0 million available from the credit line. As of September 30, 2019, KPLP had total liquidity of \$186.4 million (December 31, 2018 - \$178.7 million) representing cash and cash equivalents and availability under the credit line. Total liquidity of \$186.4 million includes \$32.2 million of cash and cash equivalents held by KPSI and committed to the TAD Sherbrooke Project. KPLP prepares projections to ensure it has sufficient funds to fulfill its obligations.

The ability to pay its obligations relies on KPLP collecting its trade receivables in a timely manner and by maintaining sufficient cash and cash equivalents in excess of anticipated needs. KPLP's trade and other payables of \$192.8 million as of September 30, 2019 (December 31, 2018 –\$238.9 million) are all due for payment within twelve months of the dates of the consolidated statements of financial position.

### **Commodity Price Risk**

Commodity price risk is the risk that future cash flows associated with purchasing required raw materials will fluctuate due to changes in commodity prices, which can be affected by foreign exchange and other trade related risks. KPLP is subject to commodity price fluctuations since KPLP's main raw material is fibre, which changes price due to market conditions, and therefore can result in periodic earnings volatility in the short term. Historically, the industry has generally been able to mitigate its exposure to commodity price risk over the medium term by passing increases in its supply costs onto its customers through incremental price increases, depending on the supply and demand balance. The ability to eventually pass through the full amount of pulp cost increases can be impacted by the competitive market situation. There can be no assurance that the historical ability to pass through increases in costs will continue to occur in the future. From time to time, KPLP enters into futures contracts to manage its commodity risk. No such contracts were outstanding as of September 30, 2019.



## **TRANSACTIONS WITH RELATED PARTIES**

Kruger Inc. provides certain management and support services to KPLP, including corporate management and administrative support; accounting and tax support; corporate financing support; corporate treasury support; benefits and human resources support; corporate legal and secretarial, corporate insurance; corporate procurement support; and corporate engineering support. Such services are provided pursuant to a Management Services Agreement, the terms of which have been in place since 2012 and are currently under review. During YTD 2019, management fees of \$3.3 million (YTD 2018 - \$3.3 million) were paid to Kruger Inc. for management services provided to KPLP.

Kruger Inc. is also providing certain management and support services related to the TAD Sherbrooke Project including project management services, and engineering, construction, accounting and corporate finance support services.

KPLP also leases warehouses located in Laval, Québec and Vancouver, British Columbia from an entity of which an affiliate of Kruger Inc. is a 50% owner.

KPLP purchases certain supplies and services from Kruger Inc. and its affiliates, including fibre and small quantities of pulp and packaging. These transactions generally take place on arm's-length terms. KPLP also has the ability to procure these goods and services from third party suppliers.

Sales of goods to Kruger Inc. for YTD 2019 were \$0.1 million (YTD 2018 - \$0.4 million). Sales of goods to subsidiaries of Kruger Inc. for YTD 2019 were \$0.1 million (YTD 2018 - \$0.1 million). Goods are sold based on the price lists in force and terms that would be available to third parties.

Purchases of goods and services from Kruger Inc. for YTD 2019 were \$4.3 million (YTD 2018 - \$5.4 million). Purchases of goods and services from subsidiaries of Kruger Inc. for YTD 2019 were \$31.1 million (YTD 2018 - \$25.9 million). Goods are purchased from Kruger Inc. and related parties under normal commercial terms and conditions. These purchases of goods and services are included within cost of sales and SG&A expenses.

## **OFF BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS**

KPLP has entered into right-of-use lease commitments related to land, buildings, IT services, vehicles and other machines and equipment. Contractual obligations including these right-of-use leases are described in the "Contractual Obligations" subsection under the "Liquidity and Capital Resources" section of the 2018 MD&A available on SEDAR at [www.sedar.com](http://www.sedar.com).

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the consolidated financial statements is in accordance with IFRS, which requires KPLP Management to make estimates and assumptions that affect the reported amounts and disclosures made in the KPLP and KPT financial statements and accompanying notes. KPLP Management continually evaluates the estimates and assumptions it uses. These estimates and assumptions are based on KPLP Management's historical experience, best knowledge of current events and conditions and activities that KPLP and KPT may undertake in the future. Actual results could differ materially from these estimates. The estimates and assumptions described in this section depend upon subjective or complex judgment that may be uncertain and changes in these estimates and assumptions could materially impact the financial statements.

### **Pension and Post-Retirement Benefit Obligations**

The cost and accrued benefit plan obligations of KPLP's pension plans, consisting of the RDBPP, supplementary retirement arrangements and the Annuity Arrangement and other benefit plans are accrued based on actuarial valuations that are dependent on assumptions determined by KPLP Management. These assumptions include the discount rate, the expected growth rate of health care costs, the rate of compensation increase, retirement ages and mortality rates. These assumptions are reviewed quarterly by KPLP Management and KPLP's actuaries. The discount rate (based on market rates) and the expected growth rate in health care costs represent the most significant assumptions.

## **Partnership Units**

The Limited Partnership Agreement requires KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. KPLP determined that it was appropriate to reclassify a portion of its equity to Partnership units liability, since the Tax Distribution represents a contractual obligation to deliver cash and, as such, meets the definition of a financial liability for accounting purposes under IFRS.

The liability is based on management's best estimate of the net present value of expected future Tax Distributions, which are made on a pro rata basis based on taxes payable by KPT, which results from KPT's taxable income from its partnership interest in KPLP. KPLP updates the net present value of the liability annually and records any resulting change in other income (expense). The net present value of the liability is based on a number of assumptions including estimates of taxable income and tax rates, as well as discount rates, growth rates, forecasted Adjusted EBITDA, future commodity prices and foreign exchange rates. Taxable income can differ significantly from accounting income as a result of both timing and permanent tax differences based on enacted tax legislation and therefore changes in the Partnership units obligation are not necessarily indicative of a change in the expected future profitability of KPLP.

As of September 30, 2019, \$121.2 million was recorded as a liability in respect of this obligation (December 31, 2018 - \$116.5 million). The Partnership units liability was adjusted during YTD 2019 to reflect the Tax Distribution required to meet KPT's taxes payable. The change in amortized cost of Partnership units liability of \$4.6 million recorded during YTD 2019 (YTD 2018 - \$0.7 million) has been included in Other income (expense).

## **Equity Method of Accounting**

The equity method of accounting is being applied by KPT as it relates to its investment in KPLP. The conclusion to account for an investment using the equity method, particularly when the percentage of ownership is below 20%, is based on an assessment of several facts and circumstances and ultimately requires significant judgment in reaching a conclusion. Management has reviewed the agreements and made an assessment of the rights of KPT. Based on KPT having three of nine seats on the board of directors of KPGP, management has concluded that KPT has the ability to exercise significant influence over KPLP.

## **Impairment Tests**

KPLP performs an annual impairment test for goodwill and indefinite lived trademarks. KPT is required to perform an impairment test on its investment in KPLP if there is objective evidence that the investment may be impaired. Under IFRS, KPT and KPLP did not perform an impairment test at September 30, 2019, as there were no events or changes in circumstances to indicate that the assets may be impaired.

## **Income Taxes**

The Partnership computes its income taxes in each jurisdiction in which its subsidiaries operate. Estimation of income taxes includes evaluating the recoverability of the deferred tax assets based on an assessment of the ability to use the underlying tax deductions and credits against future taxable income. The assessment requires an estimate of future taxable income compared to the net operating loss carry forwards and U.S. State tax credits. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period. During the 9-month period ended September 30, 2019, the Partnership reassessed its ability to utilize the U.S. state tax credits. As a result of this reassessment, a reversal of \$5.0 million of the U.S. state tax credits was recorded during YTD 2019 (YTD 2018 – \$1.1 million).

KPT has not recognized at the date of acquisition the deferred tax assets and liabilities related to the differences between the accounting and tax basis of KPLP's assets and liabilities. Accordingly, KPT is tracking temporary differences that are subject to the initial recognition exemption and recognizes newly created temporary differences as they arise. The determination of the temporary differences that are subject to the initial recognition exemption requires significant judgment. KPT has not recognized the deferred tax asset related to its Investment in KPLP.

## Lease liabilities

KPLP leases are for land, buildings, equipment and motor vehicles. KPLP has included renewal options in the measurement of lease liabilities when it is reasonably certain to exercise the renewal option.

Interest expense on lease liabilities for YTD 2019 was \$4.0 million (YTD 2018 - \$4.1 million). The expense relating to variable lease payments not included in the measurement of lease liabilities for YTD 2019 was \$3.9 million (YTD 2018 - \$3.9 million). These expenses include variable lease payments for operating costs, property taxes and insurance. The expenses relating to leases of low value assets for YTD 2019 was \$0.2 million (YTD 2018 - \$0.2 million), and expenses relating to short-term leases were not significant.

## ACCOUNTING CHANGES AND FUTURE ACCOUNTING STANDARDS

### Accounting Standards Implemented for the Period Ended September 30, 2019

- (i) IAS 19, Employee Benefits. In February 2018, the IASB issued an amendment in connection with defined benefit plans and accounting for plan amendments, settlements or curtailments. The mandatory effective date was for annual periods beginning on or after January 1, 2019. The amended standard had no impact on the unaudited condensed consolidated financial statements.
- (ii) IAS 23, Borrowing Costs. In December 2017, the IASB issued Annual Improvements to IFRS Standards 2015-2017 Cycle, which includes an amendment to IAS 23, Borrowing Costs. The amendment clarifies borrowing costs eligible for capitalization. The mandatory effective date was for annual periods beginning on or after January 1, 2019. The amended standard had no impact on the unaudited condensed consolidated financial statements.
- (iii) IAS 28, Interests in Associates and Joint Ventures. In February 2018, the IASB issued an amendment to clarify that an entity applies IFRS 9, including its impairment requirements, to long term interests in an associate or joint venture to which the equity method is not applied. The mandatory effective date was for annual periods beginning on or after January 1, 2019. The amended standard had no impact on the unaudited condensed consolidated financial statements.
- (iv) Effective January 1, 2019, KPLP applied IFRS 16 Leases, using the full retrospective approach. Under this approach all comparative information has been restated to reflect adoption of IFRS 16 and an opening statement of financial position as at the beginning of the earliest comparative period is presented. Impacts on the income statement, statement of other comprehensive income (loss), cash flow statement and statement of financial position are disclosed in note 19 in the unaudited condensed consolidated financial statements.

IFRS 16 establishes principles on how to recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all major leases. IFRS 16 superseded the current lease recognition guidance including IAS 17 Leases and the related interpretations when it became effective.

The primary changes to lease accounting as a result of IFRS 16 include the following:

- The definition of a lease has changed under the new standard. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Previously, KPLP determined at contract inception whether an arrangement is or contains a lease under IFRIC 4;
- Under IFRS 16, the lessee recognizes a right-of-use asset and a lease liability upon lease commencement for leases with a lease term of greater than one year. The right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs incurred by the lessee. Subsequent measurement is determined based on the nature of the underlying asset. The lease liability is initially measured at the present value of the lease payments payable over the lease term and discounted at the implied lease rate. If the

implied lease rate cannot be readily determined, the lessee uses its incremental borrowing rate. Subsequent re-measurement is required under specific circumstances.

Previously, KPLP classified leases as operating or finance leases based on its assessment of whether the lease transferred significantly all of the risks and rewards incidental to ownership of the underlying asset to the Partnership;

- IFRS 16 provides detailed guidance on determining the lease term when KPLP has an option to extend the lease; and
- The new standard includes extensive disclosure requirements that differ from previous requirements.

At inception of a contract, KPLP assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

KPLP recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated to the earlier of the end of their useful life or the lease term using the straight-line method as this most closely reflects the expected pattern of consumption of the future economic benefits as follows:

Land	25 years
Buildings	1 to 34 years
Equipment	1 to 10 years
Motor vehicles	1 to 4 years

The lease term includes periods covered by an option to extend if the Partnership is reasonably certain to exercise that option.

In addition, the right-of-use asset may be periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Partnership's incremental borrowing rate. Generally, KPLP uses its incremental borrowing rate as the discount rate. Variable lease payments that do not depend on an index or rate are not included in the measurement of the lease liability.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in KPLP's estimate of the amount expected to be payable under a residual value guarantee, or if KPLP changes its assessment of whether it will exercise a purchase, extension or termination option.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

KPLP has elected to present right-of-use assets separately from Property, Plant and Equipment and lease liabilities are presented under current and non-current liabilities in the statement of financial position.

At the inception of the lease, KPLP records the right-of-use asset based on the corresponding lease liability over the term of the lease. Right-of-use assets of \$94.2 million and lease obligations of \$115.1 million were recorded as of January 1, 2019, adjusted for \$2.8 million of lease payments made at or before January 1, 2019, with a \$23.7 million net impact on the deficit. When measuring lease liabilities, KPLP discounted lease payments using its incremental borrowing rate at the lease commencement date. The weighted-average rate applied is 4.63% at September 30, 2019.

Payments to suppliers includes payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liabilities. Interest paid includes cash payments for the interest portion of lease liabilities.

In applying IFRS 16 for the first time, KPLP has used the following practical expedients permitted by the standard:

- KPLP adopted the recognition exemptions permitted for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The lease payments associated with these leases are recognized as an expense on a straight-line basis over the lease term.
- KPLP has applied the practical expedient whereby KPLP is not required to reassess which transactions are leases on the date of initial application, as previously assessed under IAS 17 and IFRIC 4. KPLP applied the definition of a lease under IFRS 16 to contracts entered into or changed on or after January 1, 2019.
- KPLP has applied the practical expedient whereby certain classes of underlying assets are not required to separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components within the contract as a single lease component.

The application of IFRS 16 requires significant judgements and certain key estimations to be made.

Critical judgements required in the application of IFRS 16 include the following:

- Identifying whether a contract (or part of a contract) includes a lease;
- Determining whether it is reasonably certain that an extension or termination option will be exercised;
- Determining whether variable payments are in-substance fixed;
- Establishing whether there are multiple leases in an arrangement; and
- Determining the stand-alone selling price of lease and non-lease components.

Key sources of estimation uncertainty in the application of IFRS 16 include the following:

- Estimating the lease term;
- Determining the appropriate rate to discount lease payments; and
- Assessing whether a right-of-use asset is impaired.

### **Future Accounting Standards**

The impact of new standards, amendments to standards and interpretations that have been issued but not yet effective for financial periods beginning on or after January 1, 2020 and have not been early adopted have been discussed in the annual audited consolidated financial statements for the year ended December 31, 2018, except for the following

The impact of new standards, amendments to standards and interpretations effective for annual periods beginning on or after January 1, 2020, that have not been early adopted were discussed in the 2018 Annual MD&A, except for the following:

- (i) IAS 1 and IAS 8, Definition of Material. In October 2018, the IASB issued amendments to the definition of material in IAS 1 and IAS 8 and provide guidance to improve consistency in the application of the concept whenever it is used. The mandatory effective date would be annual periods beginning on or after January 1, 2020, with early adoption permitted. The amended standards are not expected to have an impact on the unaudited condensed consolidated financial statements

- (ii) IFRS 3, Definition of a Business. In October 2018, the IASB issued an amendment that revises the definition of a business. The amendment aims to resolve the difficulties that arise when an entity determines whether it has acquired a business or a group of assets. The mandatory effective date would be annual periods beginning on or after January 1, 2020, with early adoption permitted. The amended standard is not expected to have an impact on the unaudited condensed consolidated financial statements.
- (iii) IFRS 9/IAS 39 and IFRS 7, Interest Rate Benchmark Reform (Phase 1). In September 2019, the IASB issued amendments that provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform and require certain related disclosures. The mandatory effective date would be annual periods beginning on or after January 1, 2020, with early adoption permitted. The amended standards are not expected to have an impact on the unaudited condensed consolidated financial statements.

### SELECTED QUARTERLY FINANCIAL INFORMATION

The following table provides selected financial information for KPT and KPLP:

(C\$ millions, unless otherwise stated)	<u>September 30, 2019</u>	<u>Restated December 31, 2018</u>
<b>KPT Financial Information</b>		
Total assets	83.1	101.6
Total liabilities	5.4	5.6
<b>KPLP Financial Information</b>		
Total assets	1,576.4	1,596.3
Total liabilities	1,287.8	1,229.5

The following table summarizes quarterly financial results for KPLP for the last eight quarters:

(C\$ millions, unless otherwise stated)	2019			2018 (Restated)				2017 (Restated)
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Number of days in the period</b>	92	91	90	92	91	91	91	98
Revenue	369.4	365.7	351.0	359.5	348.6	338.8	323.7	340.0
Net income (loss) for the period	10.5	0.9	(3.2)	38.0	4.2	1.6	1.6	(18.0)
<b>Reconciliation of Net income (loss) to Adjusted EBITDA</b>								
<b>Net income (loss)</b>	10.5	0.9	(3.2)	38.0	4.2	1.6	1.6	(18.0)
Interest expense	11.4	11.4	11.3	13.5	13.5	13.8	12.7	11.8
Income taxes	0.7	1.1	(0.2)	(2.0)	(0.5)	0.4	(1.1)	7.8
Depreciation and amortization	15.1	15.1	14.8	16.2	15.8	15.6	15.4	16.1
Foreign exchange (gain) loss	0.5	(1.0)	(0.7)	2.0	(0.5)	(0.2)	(0.2)	0.9
Change in amortized cost of Partnership units liability	1.5	1.5	1.5	(42.6)	-	(2.0)	2.7	18.9
Change in fair value of derivatives	(0.3)	0.3	-	(0.8)	-	1.4	(0.6)	0.4
Loss on sale of property, plant and equipment	-	-	-	0.2	-	-	0.4	-
Loss on sale of shares	0.6	-	-	-	-	-	-	-
Gain on sale of non-financial assets	-	-	-	-	-	-	(0.2)	-
Restructuring costs, net	1.6	0.2	0.1	-	-	-	-	-
One-time consulting costs related to operational transformation initiatives	2.3	1.3	-	-	-	-	-	-
M&A related costs	0.1	0.7	-	-	-	-	-	-
<b>Adjusted EBITDA</b>	<b>44.0</b>	<b>31.5</b>	<b>23.6</b>	<b>24.5</b>	<b>32.5</b>	<b>30.6</b>	<b>30.7</b>	<b>37.9</b>

The quarterly information for 2018 and 2017 above has been retrospectively restated for the adoption of IFRS 16, Leases.

## SHARE INFORMATION

KPT's authorized share capital consists of an unlimited number of Common Shares. As of November 6, 2019, there were 9,626,152 Common Shares issued and outstanding. Pursuant to the Exchange Agreement, Kruger has the right to exchange KPLP Units it holds from time to time for Common Shares on the basis of one KPLP Unit for one Common Share, subject to adjustment as set out in the Exchange Agreement. If Kruger were to exchange all KPLP Units held by it as of November 6, 2019 for Common Shares, it would hold approximately 84.8% of the issued and outstanding Common Shares. As of November 6, 2019, there were no potentially dilutive instruments outstanding.

Pursuant to the Limited Partnership Agreement, KPLP may issue an unlimited number of KPLP Units. As of November 6, 2019, there were 63,293,136 KPLP Units issued and outstanding.

## RISK FACTORS

For a detailed description of risk factors associated with KPT and KPLP, refer to the "Risk Factors" section of the 2018 Annual Information Form dated March 8, 2019 available on SEDAR at [www.sedar.com](http://www.sedar.com). KPLP Management is not aware of any significant changes to the risk factors associated with KPT and KPLP from those disclosed at that time.

## CONTROLS AND PROCEDURES

### *Disclosure Controls and Procedures and Internal Control over Financial Reporting*

Disclosure controls and procedures within KPT and KPLP (collectively, the Corporations) have been designed to provide reasonable assurance that all relevant information is identified to its Chief Executive Officer (CEO), its Chief

Financial Officer (CFO) and its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, under the supervision of, and with the participation of the Corporations' CEO and CFO, to provide reasonable assurance regarding the reliability of the Corporations' financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

In the Corporations' 2018 filings, the Corporations' CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporations' disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting.

In the Corporations' Q3 2019 filings, the Corporations' CEO and CFO certified, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design of the Corporations' disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporations' Audit Committees reviewed this MD&A and the unaudited condensed financial statements and notes of KPT and the unaudited condensed consolidated financial statements and notes of KPLP, and the Corporations' Boards of Directors approved these documents prior to their release.

#### ***Changes in Internal Controls over Financial Reporting***

There have been no changes to the Corporations' internal controls over financial reporting during Q3 2019 that have materially affected, or are reasonably expected to materially affect, its internal controls over financial reporting.

#### **ADDITIONAL INFORMATION**

Additional information relating to KPT and KPLP, including the Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).