



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 6-MONTH PERIODS ENDED JUNE 30, 2020

DATED AUGUST 5, 2020

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The following Management's Discussion and Analysis (MD&A) dated August 5, 2020 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 June 30, 2020 and June 30, 2019, respectively, and the 6-month periods ended June 30, 2020 and June 30, 2019, respectively, and the unaudited condensed consolidated financial statements of KPLP for the 3-month periods ended June 30, 2020 (Q2 2020) and June 30, 2019 (Q2 2019), respectively, and the 6-month periods ended June 30, 2020 (YTD 2020) and June 30, 2019 (YTD 2019), respectively.

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 14.8% interest in KPLP (14.8% as of June 30, 2020). 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 30, 2020 available on SEDAR at 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; 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; trade related; and risk related to COVID-19.

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. 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 Canada and the United States. 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 273,500 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 its wholly owned subsidiary K.T.G. (USA) Inc. (KTG), 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 July 15, 2020, KPT held 14.8% of the KPLP Partnership Units (KPLP Units).

Basis of Presentation

The unaudited condensed consolidated financial statements of KPLP presented for Q2 2020 and YTD 2020 and Q2 2019 and YTD 2019 and the unaudited condensed financial statements of KPT presented for the 3-month and 6-month periods ended June 30, 2020 and June 30, 2019, respectively, have each been prepared in accordance with IFRS (International Financial Reporting Standards) for interim financial statements, including IAS 34, Interim Financial Reporting.

Accounting Periods

This MD&A includes financial information for the 3-month and 6-month periods ended June 30, 2020 (Q2 2020 and YTD 2020) and June 30, 2019 (Q2 2019 and YTD 2019), respectively.

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) consulting costs related to operational transformation initiatives, (xii) corporate development 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 (loss), 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 Canada and the United States (refer to Business Highlights, TAD Sherbrooke Project) 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.

COVID-19

In March 2020, the World Health Organization characterized the outbreak of the novel strain of coronavirus, specifically identified as “COVID-19”, as a global pandemic. This has resulted in local governments enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposed quarantine periods and social distancing, have caused material disruption to businesses in the United States of America and Canada resulting in an economic slowdown. Equity markets have experienced significant volatility and weakness and the local governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. There is significant uncertainty as to the likely effects of this outbreak.

KPLP’s priorities during the COVID-19 pandemic are to first protect the health and safety of our employees, while increasing the availability of our products, which are essential to consumers each and every day. We are leveraging our employees’ talents and our resources to help society meet and overcome the current challenges from this pandemic. Since the Company sells products that help consumers with their daily hygiene and cleaning needs, the COVID-19 pandemic has not had a negative impact on our results in the 3-month and 6-month periods ended June 30, 2020. In fact, during the 3-month and 6-month periods ended June 30, 2020, we experienced a significant increase in demand and consumption of our product categories caused in part by changing consumer habits and pantry loading, contributing to increases in net sales. In the future, the pandemic may cause reduced demand for our products if it results in a recessionary global economic environment. It could also lead to volatility in consumer access to our products due to government actions impacting our ability to produce and ship products or impacting consumers’ movements and access to our products. We believe that over the long term there will continue to be strong demand for our products. However, the timing and extent of demand recovery in our North American markets, the timing and impact of potential consumer pantry destocking in North American markets, and product demand trends caused by future economic trends are unclear. Accordingly, there may be heightened volatility in net sales and resulting earnings during and subsequent to the duration of the pandemic. Our retail customers are also being impacted by the pandemic. Their success in addressing the issues and maintaining their operations could impact consumer access to, and as a result, sales of our products.

Our ability to continue to operate without any significant negative impacts will in part depend on our ability to protect our employees and our supply chain. The Company has endeavored to follow recommended actions of government and health authorities to protect our employees, with particular measures in place for those working in our plants and distribution

facilities. We have also worked closely with local and national officials to keep our manufacturing facilities open due to the essential nature of our products.

For the 3-month and 6-month periods ended June 30, 2020, the pandemic has not materially impacted our operations or demand for our products and, as a result, has also not negatively impacted the Company's liquidity position. We continue to generate operating cash flows to meet our short-term liquidity needs. We have also not observed any material impairments of our assets or a significant change in the fair value of assets due to the COVID-19 pandemic. However, uncertainty resulting from the pandemic could result in an unforeseen disruption to our supply chain (for example a closure of a key manufacturing or distribution facility or the inability of a key supplier or transportation supplier to source and transport materials) that could impact our operations.

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 forecasted 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 June 30, 2020, a total of \$346.8 million had been spent on the TAD Sherbrooke Project, including financing related costs. To date, the project has been financed by a \$107.5 million equity investment by KPLP into Kruger Products Sherbrooke Inc. (KPSI), the entity that will construct and operate the project, a \$105 million convertible debenture issued to Investissement Quebec (IQ) and amounts drawn on the TAD Sherbrooke Project Facility, as follows:

- (i) US\$76.5 million on the US\$188 million term loan facility (December 31, 2019 – US\$10.3 million);
- (ii) \$45.2 million on the \$111 million term loan facility (December 31, 2019 – \$6.1 million); and
- (iii) nil on the \$12.5 million revolving loan facility (December 31, 2019 – \$7.0 million)

Project work was temporarily suspended on March 23, 2020 in response to emergency measures enacted by the province of Quebec in response to the COVID-19 pandemic, and restarted during the week of April 20, 2020. The COVID-19 outbreak could result in further delays and cost overruns to the project in future periods.

In response to the uncertainty resulting from the COVID-19 pandemic, certain terms of the AgCredit Agreement were amended to provide greater flexibility related to the TAD Sherbrooke Project. On April 20, 2020, the Partnership entered into the first amendment to the AgCredit agreement (the First Amendment to the AgCredit Agreement), with an effective date of March 23, 2020.

RESULTS OF OPERATIONS

Results of Operations of KPLP

(C\$ millions, unless otherwise noted)	Q2 2020	Q2 2019	YTD 2020	YTD 2019	\$ Change	\$ Change
					Q2 2020 vs. Q2 2019	YTD 2020 vs. YTD 2019
Statement of Operations Data:						
Revenue	386.8	365.7	761.9	716.6	21.1	45.3
Cost of sales	(310.0)	(325.8)	(624.5)	(645.8)	15.8	21.3
Selling, general and administrative expenses	(30.5)	(25.4)	(60.2)	(47.4)	(5.1)	(12.8)
Restructuring costs, net	(0.5)	(0.2)	(1.2)	(0.3)	(0.3)	(0.9)
Operating income	45.8	14.3	76.0	23.1	31.5	52.9
Interest expense	(11.3)	(11.4)	(21.9)	(22.7)	0.1	0.8
Other income (expense)	3.2	(0.9)	(8.1)	(1.8)	4.1	(6.3)
Income (loss) before income taxes	37.7	2.0	46.0	(1.4)	35.7	47.4
Income taxes:						
Combined income tax rate after manufacturing and processing credits	(9.8)	(0.5)	(12.0)	0.4	(9.3)	(12.4)
Income tax in partners' hands	5.7	0.4	7.8	(0.3)	5.3	8.1
Other	(4.7)	(1.0)	(4.5)	(1.0)	(3.7)	(3.5)
Income taxes	(8.8)	(1.1)	(8.7)	(0.9)	(7.7)	(7.8)
Net income (loss)	28.9	0.9	37.3	(2.3)	28.0	39.6

(C\$ millions, unless otherwise noted)	Q2 2020	Q2 2019	YTD 2020	YTD 2019	\$ Change	\$ Change
					Q2 2020 vs. Q2 2019	YTD 2020 vs. YTD 2019
Reconciliation of Adjusted EBITDA to Net income (loss):						
Net income (loss)	28.9	0.9	37.3	(2.3)	28.0	39.6
Interest expense	11.3	11.4	21.9	22.7	(0.1)	(0.8)
Income taxes	8.8	1.1	8.7	0.9	7.7	7.8
Depreciation and amortization	17.0	15.1	33.8	29.7	1.9	4.1
Foreign exchange (gain) loss	(5.8)	(1.0)	3.5	(1.7)	(4.8)	5.2
Change in amortized cost of Partnership units liability	2.5	1.5	5.0	3.1	1.0	1.9
Change in fair value of derivatives	-	0.3	(0.4)	0.3	(0.3)	(0.7)
Loss on sale of property, plant and equipment	-	-	0.1	-	-	0.1
Restructuring costs, net	0.5	0.2	1.2	0.3	0.3	0.9
Consulting costs related to operational transformation initiatives	1.2	1.3	4.3	1.3	(0.1)	3.0
Corporate development related costs	-	0.7	-	0.7	(0.7)	(0.7)
Adjusted EBITDA	64.4	31.5	115.4	55.0	32.9	60.4

Results of Operations Q2 2020 compared to Q2 2019

Revenue

Revenue was \$386.8 million in Q2 2020 compared to \$365.7 million in Q2 2019, an increase of \$21.1 million or 5.8%. The increase in revenue was primarily due to significant volume increases in the Consumer business segment in Canada and the U.S., resulting primarily from COVID-19 buying activity and the favourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.39 in Q2 2020 compared to 1.34 in Q2 2019). The increases were partially offset by lower volume in the AFH segment resulting from the ongoing impacts from COVID-19, Consumer segment selling prices moderating lower in response to lower pulp prices, and no volume from Mexico as a result of the share sale at the end of Q3 2019.

Mexico revenue was \$25.4 million in Q2 2019. From a geographic perspective, revenue in Canada increased \$10.3 million or 4.9%, while revenue in the U.S. increased \$36.3 million, or 27.5%.

Cost of Sales

Cost of sales was \$310.0 million in Q2 2020 compared to \$325.8 million in Q2 2019, a decrease of \$15.8 million or 4.8%. Manufacturing costs decreased compared to Q2 2019 primarily due to lower pulp costs, operational transformation initiatives (“OpEx”) which increased production efficiency and reduced outsourcing costs, and the COVID-19 transition to a reduced sku production environment. These cost decreases were partially offset by the unfavourable impact of foreign exchange fluctuations (USD average 1.39 in Q2 2020 compared to 1.34 in Q2 2019), inflation and additional overhead costs, in part due to precautions taken in our manufacturing facilities as a result of COVID-19. Freight costs decreased compared to Q2 2019 primarily due to a more favourable sales mix, despite higher volume and some increased complexity associated with shipping products in the current environment. Warehousing costs increased compared to Q2 2019 related primarily to additional handling costs required to manage the increased demand. As a percentage of revenue, cost of sales was 80.2% in Q2 2020 compared to 89.1% in Q2 2019.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$30.5 million in Q2 2020 compared to \$25.4 million in Q2 2019, an increase of \$5.1 million or 20.2%. The increase compared to Q2 2019 was primarily due to higher compensation and personnel related costs, higher selling expenses due to increased volume, increased investment in marketing to support the brands, and increased spending on Information Technology. As a percentage of revenue, SG&A expenses were 7.9% in Q2 2020 compared to 6.9% in Q2 2019.

Adjusted EBITDA

Adjusted EBITDA was \$64.4 million in Q2 2020 compared to \$31.5 million in Q2 2019, an increase of \$32.9 million or 104.6%. The increase was primarily due to higher sales volume, the favourable impact of lower pulp prices and lower manufacturing costs compared to Q2 2019 as described above and favourable freight costs. The increases were partially offset by higher maintenance, warehousing and SG&A costs.

Interest Expense

Interest expense was \$11.3 million in Q2 2020 compared to \$11.4 million in Q2 2019, a decrease of \$0.1 million. The decrease was primarily due to lower interest rates, partially offset by the unfavourable impact of foreign exchange.

Other Income (Expense)

Other income was \$3.2 million in Q2 2020 compared to other expense of \$0.9 million in Q2 2019. Other income in Q2 2020 was primarily related to a foreign exchange gain on USD denominated debt of \$5.8 million (Q2 2019 – gain of \$1.0 million), partially offset by a loss resulting from the change in amortized cost of Partnership units liability of \$2.5 million (Q2 2019 – loss of \$1.5 million). There was also a loss resulting from a change in fair value of derivatives of \$0.3 million in Q2 2019.

Income Taxes

An income tax expense of \$8.8 million was recorded in Q2 2020 compared to \$1.1 million in Q2 2019. KPLP is not directly taxable on its Canadian business. The income tax expense resulted primarily from operating income related to the U.S. entities and was primarily deferred tax. Income tax in partner’s hands was a recovery of \$5.7 million in Q2 2020 compared to \$0.4 million in Q2 2019.

Net Income

Net income was \$28.9 million in Q2 2020 compared to \$0.9 million in Q2 2019, an increase of \$28.0 million. The increase was primarily due to higher Adjusted EBITDA of \$32.9 million as discussed above, an increase in other income of \$4.1 million and a decrease in corporate development related costs of \$0.7 million, partially offset by higher income tax

expense of \$7.7 million, an increase in depreciation expense of \$1.9 million and an increase in the change in amortized cost of Partnership units liability of \$1.0 million.

Results of Operations YTD 2020 compared to YTD 2019

Revenue

Revenue was \$761.9 million in YTD 2020 compared to \$716.6 million in YTD 2019, an increase of \$45.3 million or 6.3%. The increase in revenue was primarily due to significant volume increases in the Consumer business segment in Canada and the U.S. resulting primarily from COVID-19 buying activity, the impact of favourable sales mix and the favourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.36 in YTD 2020 compared to 1.33 in YTD 2019). The increases were partially offset by lower volume in the AFH segment resulting from the impact from COVID-19 in Q2 2020, Consumer segment selling prices moderating lower in response to lower pulp prices, and no volume from Mexico as a result of the share sale at the end of Q3 2019. Mexico revenue was \$51.5 million in YTD 2019. From a geographic perspective, revenue in Canada increased \$43.0 million or 10.6%, while revenue in the U.S. increased \$53.8 million, or 20.7%.

Cost of Sales

Cost of sales was \$624.5 million in YTD 2020 compared to \$645.8 million in YTD 2019, a decrease of \$21.3 million or 3.3%. Manufacturing costs decreased compared to YTD 2019 primarily due to lower pulp costs, operational transformation initiatives (“OpEx”) which increased production efficiency and reduced outsourcing costs, and the COVID-19 transition to a reduced sku production environment. These decreases were partially offset by the unfavourable impact of foreign exchange fluctuations (USD average 1.36 in YTD 2020 compared to 1.33 in YTD 2019), inflation and additional overhead costs, in part due to precautions taken in our manufacturing facilities as a result of COVID-19. Freight costs were essentially flat compared to YTD 2019, as the impact of higher volume and somewhat increased complexity associated with shipping products in the current environment were offset by improved customer mix. Warehousing costs increased compared to YTD 2019 related primarily to increased handling costs to manage the higher volume. As a percentage of revenue, cost of sales was 82.0% in YTD 2020 compared to 90.1% in YTD 2019.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$60.2 million in YTD 2020 compared to \$47.4 million in YTD 2019, an increase of \$12.8 million or 27.0%. The increase was primarily due to higher compensation and personnel related costs compared to YTD 2019, higher selling expenses due to increased volume, investment in marketing to support the brands, and increased spending on Information Technology. As a percentage of revenue, SG&A expenses were 7.9% in YTD 2020 compared to 6.6% in YTD 2019.

Adjusted EBITDA

Adjusted EBITDA was \$115.4 million in YTD 2020 compared to \$55.0 million in YTD 2019, an increase of \$60.4 million or 109.6%. The increase was primarily due to higher sales volume and favourable sales mix, the favourable impact of lower pulp prices and lower manufacturing costs compared to YTD 2019 as described above. The increases were partially offset by higher maintenance, warehousing and SG&A costs.

Interest Expense

Interest expense was \$21.9 million in YTD 2020 compared to \$22.7 million in YTD 2019, a decrease of \$0.8 million. The decrease was primarily due to lower interest rates, partially offset by the unfavourable impact of foreign exchange.

Other Expense

Other expense was \$8.1 million in YTD 2020 compared to \$1.8 million in YTD 2019. Other expense in YTD 2020 was primarily related to a foreign exchange loss on USD denominated debt of \$3.5 million (YTD 2019 – gain of \$1.7 million)

and a loss resulting from the change in amortized cost of Partnership units liability of \$5.0 million (YTD 2019 – loss of \$3.1 million), partially offset by a gain on change in fair value of derivatives of \$0.4 million (YTD 2019 – loss of \$0.3 million).

Income Taxes

An income tax expense of \$8.7 million was recorded in YTD 2020 compared to \$0.9 million in YTD 2019. KPLP is not directly taxable on its Canadian business. The income tax expense resulted primarily from operating income related to the U.S. entities. Income tax in partner’s hands was a recovery of \$7.8 million in YTD 2020 compared to expense of \$0.3 million in YTD 2019.

Net Income (Loss)

Net income was \$37.3 million in YTD 2020 compared to a net loss of \$2.3 million in YTD 2019, an increase of \$39.6 million. The increase was primarily due to higher Adjusted EBITDA of \$60.4 million as discussed above and lower interest expense in YTD 2020 compared to YTD 2019 of \$0.8 million, partially offset by higher income tax expense of \$7.8 million, an increase in other expense of \$6.3 million, an increase in depreciation expense of \$4.1 million, higher consulting costs related to operational transformation initiatives and corporate development related costs of \$2.3 million, and an increase in restructuring costs of \$0.9 million.

Results of Operations of KPT

<i>(C\$ millions, unless otherwise noted)</i>	3-month period ended June 30, 2020	3-month period ended June 30, 2019	6-month period ended June 30, 2020	6-month period ended June 30, 2019
Statement of Operations Data:				
Share of income (loss)	4.3	0.1	5.6	(0.3)
Depreciation of fair value increments	(1.4)	(1.4)	(2.8)	(2.9)
Equity income (loss)	2.9	(1.3)	2.8	(3.2)
Dilution gain	0.3	0.1	0.5	0.2
Income (loss) before income taxes	3.2	(1.2)	3.3	(3.0)
Income taxes:				
Current tax expense	(0.9)	-	(1.6)	-
Deferred tax expense	(2.4)	(1.4)	(0.1)	(1.5)
Income taxes	(3.3)	(1.4)	(1.7)	(1.5)
Net income (loss)	(0.1)	(2.6)	1.6	(4.5)
Basic earnings (loss) per share (dollars)	(0.01)	(0.27)	0.16	(0.48)

The financial information presented above is based on KPT’s interest in KPLP for Q2 2020 and YTD 2020 and Q2 2019 and YTD 2019. 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 4 in KPT’s financial statements for additional information.

The current income tax expense is based on KPT’s share of the taxable income (loss) of KPLP for the same periods. The deferred tax expense 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 5 in KPT’s financial statements for additional information.

Pursuant to the Tax Distribution as defined in the Partnership Agreement, on February 28, 2020, KPLP declared a Tax Distribution of \$5.1 million, of which \$0.1 million was used to settle the outstanding advance to KPT as of December 31, 2019. During the 6-month period ended June 30, 2020, pursuant to the Tax Distribution as defined in the Partnership Agreement, KPLP made advances to its partners of \$2.3 million, of which \$0.4 million was used to pay the monthly tax instalment on behalf of KPT and the remaining was advanced to Kruger Inc. and KPGP. The advances are non-interest bearing and non-recourse in nature and are 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) consulting costs related to operational transformation initiatives, (xii) corporate development related costs and (xiii) loss (gain) on sale of shares. “Consumer Segment Adjusted EBITDA” and “AFH 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)	Q2 2020	Q2 2019	YTD 2020	YTD 2019	Q2 2020 vs Q2 2019		YTD 2020 vs YTD 2019	
					\$ Change	% Change	\$ Change	% Change
Segment Revenue								
Consumer	338.3	299.7	651.5	595.8	38.6	12.9%	55.7	9.3%
AFH	48.5	66.0	110.4	120.8	(17.5)	-26.5%	(10.4)	-8.6%
Total segment revenue	<u>386.8</u>	<u>365.7</u>	<u>761.9</u>	<u>716.6</u>	<u>21.1</u>	<u>5.8%</u>	<u>45.3</u>	<u>6.3%</u>
Adjusted EBITDA								
Consumer	69.6	35.4	123.9	65.4	34.2		58.5	
AFH	(2.1)	(3.0)	(3.1)	(9.6)	0.9		6.5	
Corporate and other costs	(3.1)	(0.9)	(5.4)	(0.8)	(2.2)		(4.6)	
Total Adjusted EBITDA	<u>64.4</u>	<u>31.5</u>	<u>115.4</u>	<u>55.0</u>	<u>32.9</u>		<u>60.4</u>	

Consumer Segment

Q2 2020 compared to Q2 2019

Consumer segment revenue was \$338.3 million in Q2 2020 compared to \$299.7 million in Q2 2019, an increase of \$38.6 million or 12.9%. The increase in revenue was primarily due to higher sales volume in Canada and the U.S. resulting primarily from COVID-19 buying activity and the favourable impact of foreign exchange fluctuations on U.S. sales, significantly offset by no volume from Mexico as a result of the share sale at the end of Q3 2019, and also selling prices moderating lower in Canada and the U.S. in response to lower pulp prices. Mexico revenue was \$25.4 million in Q2 2019. Consumer segment revenue increased in both Canada and the U.S.

Consumer Segment Adjusted EBITDA was \$69.6 million in Q2 2020 compared to \$35.4 million in Q2 2019, an increase of \$34.2 million. The increase in Adjusted EBITDA was primarily due to higher sales volume in both Canada and the U.S. and lower pulp costs along with operational transformation initiatives (“OpEx”), which increased production efficiency and reduced outsourcing costs, and the COVID-19 transition to a reduced sku production environment. Freight expense was lower in Q2 2020 compared to Q2 2019 due primarily to favourable customer mix. The increases were partially offset by additional maintenance costs, and higher warehousing and SG&A expenses.

YTD 2020 compared to YTD 2019

Consumer segment revenue was \$651.5 million in YTD 2020 compared to \$595.8 million in YTD 2019, an increase of \$55.7 million or 9.3%. The increase in revenue was primarily due to higher sales volume in Canada and the U.S. resulting primarily from COVID-19 buying activity, the impact of favourable sales mix, and the favourable impact of foreign exchange fluctuations on U.S. sales, significantly offset by no volume from Mexico as a result of the share sale at the end of Q3 2019, and selling prices moderating lower in Canada and the U.S. in response to lower pulp prices. Mexico revenue was \$51.5 million in YTD 2019. Consumer segment revenue increased in both Canada and the U.S.

Consumer Segment Adjusted EBITDA was \$123.9 million in YTD 2020 compared to \$65.4 million in YTD 2019, an increase of \$58.5 million. Higher sales volume in both Canada and the U.S. and lower pulp costs along with operational transformation initiatives (“OpEx”) which increased production efficiency and reduced outsourcing costs, and the COVID-19 transition to a reduced sku production environment, were partially offset by additional maintenance costs, and higher warehousing and SG&A expenses.

AFH Segment

Q2 2020 compared to Q2 2019

AFH segment revenue was \$48.5 million in Q2 2020 compared to \$66.0 million in Q2 2019, a decrease of \$17.5 million or 26.5%. The decrease was primarily due to lower sales volume as a result of the negative impact of COVID-19 on AFH customer buying activity. AFH segment revenue decreased in both the U.S. and Canada.

AFH Segment Adjusted EBITDA was a loss of \$2.1 million in Q2 2020 compared to a loss of \$3.0 million in Q2 2019, an improvement of \$0.9 million. The improvement was primarily due to lower pulp prices and lower outsourced manufacturing and improved production efficiency compared to Q2 2019, partially offset by lower sales volume, additional maintenance costs and higher freight, warehousing and SG&A costs.

YTD 2020 compared to YTD 2019

AFH segment revenue was \$110.4 million in YTD 2020 compared to \$120.8 million in YTD 2019, a decrease of \$10.4 million or 8.6%. The decrease was primarily due to lower sales volume as a result of the negative impact of COVID-19 on buying activity in Q2 2020, partially offset by price increases implemented during the second half of 2019. AFH segment revenue decreased in Canada compared to YTD 2019, and increased in the U.S compared to the same period.

AFH Segment Adjusted EBITDA was a loss of \$3.1 million in YTD 2020 compared to a loss of \$9.6 million in YTD 2019, an improvement of \$6.5 million. The improvement was primarily due to lower pulp prices and lower outsourced manufacturing and improved production efficiency compared to Q2 2019, partially offset by lower sales volume, additional maintenance costs and higher freight, warehousing and SG&A costs.

Corporate and Other Costs

Q2 2020 compared to Q2 2019

Corporate and other costs include certain overhead costs, timing adjustments for certain manufacturing costs included in inventory not allocated to the Consumer and AFH segments and start-up costs related to the TAD Sherbrooke Project.

Corporate and other costs were a loss of \$3.1 million in Q2 2020 compared to a loss of \$0.9 million in Q2 2019, an increase of \$2.2 million resulting primarily from the recognition of certain manufacturing costs from inventory due to significantly lower inventory levels as of June 30, 2020.

YTD 2020 compared to YTD 2019

Corporate and other costs include certain overhead costs, timing adjustments for certain manufacturing costs included in inventory not allocated to the Consumer and AFH segments and start-up costs related to the TAD Sherbrooke Project.

Corporate and other costs were a loss of \$5.4 million in YTD 2020 compared to a loss of \$0.8 million in YTD 2019, an increase of \$4.6 million resulting primarily from the recognition of certain manufacturing costs from inventory due to significantly lower inventory levels as of June 30, 2020.

LIQUIDITY AND CAPITAL RESOURCES

Overview

KPLP's principal uses of funds are for operating costs, working capital, capital expenditures, pension contributions and Tax and Partnership Unit distributions (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.

The Senior Credit Agreement requires the Restricted Credit Parties to comply with certain financial covenants related to its revolving credit facility (the Senior Credit Facility). The financial covenants were amended by a consent letter dated as of May 27, 2020. 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 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 March 31, 2020; and
- (v) 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 reduced its participation in the dividend reinvestment plan (DRIP) from 100% to 50% starting April 1, 2020 (accelerated from October 1, 2020), which is expected to increase the net distribution.

As of June 30, 2020, KPLP was in compliance with all of its financial covenants under all of its outstanding credit facilities. As of June 30, 2020, KPLP had drawn \$65.0 million from the \$250.0 million committed amount under the Senior Credit Facility, and had \$19.6 million of letters of credit outstanding, resulting in \$165.4 million available from the credit line, subject to covenant limitations. As of June 30, 2020, KPLP had total liquidity of \$271.7 million (December 31, 2019 - \$216.8 million) representing cash and cash equivalents and availability under the Senior Credit Facility within the covenant limitations. In addition, \$37.8 million (December 31, 2019 - \$16.4 million) of cash and cash equivalents were held by KPSI and committed to the TAD Sherbrooke Project.

As it pertains to capital expenditures, approximately \$25.0 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 \$145.3 million in YTD 2020, including \$136.2 million related to the TAD Sherbrooke Project (including interest capitalized during construction). The TAD Sherbrooke Project also had \$33.8 million of accrued and unpaid capital spending as of June 30, 2020. Capital expenditures are expected to be approximately \$350.0 million to \$385.0 million in fiscal 2020, primarily driven by the TAD Sherbrooke Project expenditures of \$330.0 million to \$350.0 million. The total level of capital spending may be impacted by potential disruptions resulting from COVID-19 at each manufacturing plant.

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. KPLP participates in a factoring program to assist in managing working capital. Under the program, KPLP derecognizes certain receivables upon sale.

Cash Flows

(C\$ millions, unless otherwise stated)	YTD 2020	YTD 2019	\$ Change
			YTD 2020 vs. YTD 2019
Net cash flows from operating activities	137.1	4.6	132.5
Net cash flows used in investing activities	(144.3)	(57.3)	(87.0)
Net cash flows from (used in) financing activities	56.4	(0.2)	56.6
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	1.9	(1.5)	3.4
Increase (decrease) in cash and cash equivalents	51.1	(54.4)	105.5
Beginning cash and cash equivalents, net	93.1	169.9	(76.8)
Ending cash and cash equivalents, net	144.2	115.5	28.7
Bank indebtedness	-	9.9	(9.9)
Ending cash and cash equivalents	144.2	125.4	18.8

Net Cash Flows from Operating Activities

Net cash from operating activities was \$137.1 million in YTD 2020 compared to \$4.6 million in YTD 2019. Cash from operating activities in YTD 2020 was primarily driven by Adjusted EBITDA of \$115.4 million (YTD 2019 – \$55.0 million) and a decrease in working capital of \$26.0 million (YTD 2019 – increase of \$44.8 million), partially offset by funding of pension and post-retirement benefit plans of \$7.9 million (YTD 2019 – \$7.2 million) and provisions paid of \$1.9 million (YTD 2019 - \$0.5 million).

Net Cash Flows used in Investing Activities

Net cash used in investing activities was \$144.3 million in YTD 2020 compared to \$57.3 million in YTD 2019. Cash used in investing activities related to capital expenditures of \$145.3 million (including \$136.2 million for the TAD Sherbrooke Project and \$9.1 million for the existing business) in YTD 2020 compared to \$57.3 million (including \$43.7 million for the TAD Sherbrooke Project and \$13.6 million for the existing business) in YTD 2019. This was partially offset by the final proceeds due on sale of shares of \$1.0 million in Q1 2020.

Net Cash Flows from (used in) Financing Activities

Net cash from financing activities was \$56.4 million in YTD 2020 compared to cash used in financing activities of \$0.2 million in YTD 2019. Net cash from financing activities in YTD 2020 was primarily due to net proceeds from debt of \$98.6 million (YTD 2019 –\$27.9 million), partially offset by interest paid of \$21.6 million (YTD 2019 –\$13.9 million), lease payments of \$9.9 million (YTD 2019 –\$8.3 million), distributions and advances paid (net of DRIP proceeds) of \$10.2 million (YTD 2019 –\$5.5 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 motor vehicles, partnership units liability and pensions.

As of June 30, 2020, KPLP had \$113.2 million (December 31, 2019 – \$151.1 million) commitments related to the TAD Sherbrooke Project.

KPLP's cash pension contribution for defined benefit pension arrangements in YTD 2020 was \$6.7 million, while its post-retirement benefits contribution was \$1.2 million. In addition, as of June 30, 2020, KPLP had \$19.2 million of letters of credit related to pensions outstanding. Pension and post-retirement contributions for fiscal 2020 are expected to be \$15.9 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 June 30, 2020, KPLP had no foreign exchange swaps outstanding and foreign exchange forwards outstanding of nil (December 31, 2019 – \$23.7 million).

As of December 31, 2019, the Partnership held interest rate swaps, contracted to fix the interest rate on a notional amount of \$100.0 million. The interest rate swaps matured during the 3-month period ended March 31, 2020.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

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 June 30, 2020 included cash and cash equivalents, trade and other receivables and receivables from related parties. 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 generally limited. However, the risk and uncertainties associated with the COVID-19 pandemic have increased that risk, which is being closely managed.

On November 16, 2018, KPLP entered into a factoring arrangement with the Bank of Nova Scotia, pursuant to a Receivables Purchase Agreement. As a result, KPLP sells to the Bank of Nova Scotia eligible trade receivables owing by certain key customers with a facility limit of \$50 million. Eligible trade receivables are sold on a non-recourse basis. KPLP receives 95% of customer invoices sold net of a dilution factor. The dilution factor is an estimate of rebates accrued for each customer in respect of the customer invoice. KPLP is restricted from selling or pledging these trade receivables. The factoring arrangement bears interest at a floating interest rate based on CDOR plus applicable margin. KPLP is committed to a two year term, renewable for additional one year periods. As eligible trade receivables are sold, KPLP removes the factored receivables from the consolidated statement of financial position, recognizes the proceeds received as consideration for the transfer and records a loss on factoring, which is included in interest expense in the consolidated statement of comprehensive income (loss). Cash flows from the factoring arrangement are presented as operating activities in the consolidated statement of cash flows.

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 June 30, 2020, KPLP had net liabilities denominated in U.S. dollars of \$71.7 million (June 30, 2019 – \$35.3 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 Q2 2020 would have been an increase (decrease) of \$3.6 million (Q2 2019 – \$1.8 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 June 30, 2020, KPLP had no foreign exchange swaps outstanding and foreign exchange forwards outstanding of nil (December 31, 2019 – \$23.7 million).

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.

As of June 30, 2020, KPLP had drawn \$65.0 million from the \$250 million committed amount under the Senior Credit Facility entered into on April 24, 2018, as amended by a first supplemental credit agreement dated November 19, 2018 and a second supplemental credit agreement dated September 19, 2019, maturing in September 2023. KPLP had \$19.6 million of letters of credit outstanding, resulting in \$165.4 million available from the credit line, subject to covenant limitations. As of June 30, 2020, KPLP had total liquidity of \$271.7 million (December 31, 2019 - \$216.8 million) representing cash and cash equivalents and availability under the Senior Credit Facility within the covenant limitations. In addition, \$37.8 million (December 31, 2019 - \$16.4 million) of cash and cash equivalents were 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. The risks and uncertainties associated with the COVID-19 pandemic have increased the credit risk associated with trade receivables and such risk is being closely managed. KPLP's trade and other payables of \$254.8 million as of June 30, 2020 (December 31, 2019 –\$242.4 million) are all due for payment within twelve months of the dates of the consolidated statements of financial position.

Interest Rate Risk

KPLP's interest rate risk arises from its variable rate debt related to the Senior Credit Facility and certain credit facilities made available as part of the TAD Sherbrooke Project Facility. As of June 30, 2020, KPLP had variable rate debts of \$106.6 million (December 31, 2019 – \$99.4 million). The Senior Credit 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 loans ranges between 0.20% and 3.50%. The \$111 million term loan made available as part of the TAD Sherbrooke Project Facility bears interest at a floating interest rate based on CDOR plus an applicable margin. The revolving loans of US\$10 million and \$12.5 million made available as part of the TAD Sherbrooke Project Facility also bear interest at floating interest rates.

A 100 basis point increase (decrease) in the market rate of interest would result in a decrease (increase) in net income before tax of \$1.1 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. As of December 31, 2019, the Partnership held interest rate swaps, contracted to fix the interest rate on a notional amount of \$100.0 million. The interest rate swaps matured during the 3-month period ended March 31, 2020.

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 June 30, 2020 and June 30, 2019.

TRANSACTIONS WITH RELATED PARTIES

KPLP and Kruger are parties to a Third Amended and Restated Management Services Agreement dated as of November 15, 2019 with effect as of January 1, 2020 (the “Management Services Agreement”) pursuant to which Kruger provides certain management and support services to KPLP, including corporate management support and administrative support services; accounting and tax support; corporate financing and treasury support; benefits and human resources support services; corporate insurance; corporate procurement services complementary to KPLP procurement; project development and management services (including in connection with the TAD Sherbrooke Project), corporate development support, environmental support and corporate engineering support services. The annual management fee paid by KPLP to Kruger under this agreement will be \$7.4 million which amount will be adjusted for inflation annually.

During YTD 2020, management fees of \$3.7 million (YTD 2019 - \$2.2 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 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. during YTD 2020 were \$0.1 million (YTD 2019 – \$0.1 million). Sales of goods to subsidiaries of Kruger Inc. during YTD 2020 were nil (YTD 2019 – \$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. during YTD 2020 were \$4.9 million (YTD 2019 - \$3.1 million). Purchases of goods and services from subsidiaries of Kruger Inc. during YTD 2020 were \$30.9 million (YTD 2019 - \$17.9 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 this MD&A.

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 Liability

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require 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 June 30, 2020, \$143.5 million was recorded as a liability in respect of this obligation (December 31, 2019 - \$143.5 million). The Partnership units liability was adjusted during YTD 2020 to reflect the Tax Distribution required to meet KPT's taxes payable. The change in amortized cost of Partnership units liability of \$5.0 million recorded during YTD 2020 (YTD 2019 - \$3.1 million) has been included in Other (income) expense, reflecting KPLP's best estimate of the portion of the full year Tax Distribution.

KPLP considered whether the current market conditions resulting from the COVID-19 pandemic required a reassessment of the Partnership units liability and concluded that there had been no substantial change to the financial forecast used in the last assessment.

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.

KPLP considered whether the current market conditions resulting from the COVID-19 pandemic created an indicator of impairment in the KPT investment. KPLP concluded the future forecasts that support the investment value had not changed significantly and therefore there was no indication of impairment for the 6-month period ended June 30, 2020.

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 considered whether the events and changes in circumstances resulting from the COVID-19 pandemic indicated that the assets may be impaired and concluded that because the financial forecasts used to support the impairment tests had not changed significantly, there was no indication of impairment.

Although management has implemented certain strategies to mitigate the impact of COVID-19 on the AFH cash generating unit (CGU), the uncertainty in the market due to travel restrictions and remote working conditions could lead to a prolonged reduction in demand for AFH products and negatively impact underlying cash flows, and could also negatively

impact the underlying interest rates and risk premiums used to determine the cost of capital used in the valuation model. The uncertainties could trigger a decline in fair value that may trigger a future impairment charge. As of June 30, 2020, the carrying value of the AFH CGU's goodwill was \$8.9 million.

Income Taxes

KPLP 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.

KPLP considered whether the events and changes in circumstances resulting from the COVID-19 pandemic impacted its ability to utilize the U.S. state tax credits and concluded that because the financial forecasts used to support the assessment tests had not changed significantly, there was no need to perform a reassessment.

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.

Leases

A number of critical judgements are required in the application of IFRS 16. These judgements include 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 estimates in the application of IFRS 16 include estimating the lease term, determining the appropriate rate to discount lease payments, and assessing whether a right-of-use asset is impaired.

ACCOUNTING CHANGES AND FUTURE ACCOUNTING STANDARDS

Accounting Standards Implemented for the Period Ended June 30, 2020

- (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 was for annual periods beginning on or after January 1, 2020. The amended standards had no 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 was for annual periods beginning on or after January 1, 2020. The amended standard had no 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 was for annual periods beginning on or after January 1, 2020. The amended standards had no impact on the unaudited condensed consolidated financial statements.
- (iv) IFRS 16, COVID-19-Related Rent Concessions. In May 2020, the IASB issued an amendment to provide lessees with an exemption from assessing whether a COVID-19-related rent concession is a lease modification. The mandatory effective date was for annual periods beginning on or after June 1, 2020. The amended standard had no

impact on the unaudited condensed consolidated financial statements.

Future Accounting Standards

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2021, and with earlier application permitted. KPLP and KPT Management are in the process of assessing the impact of these standards and amendments, and have determined that the standards and amendments will not be early adopted.

- (i) IAS 1, Classification of Liabilities as Current or Non-current. In January 2020, the IASB issued an amendment to IAS 1 to clarify that liabilities are classified as either current or non-current, depending on the rights that exist at the end of the reporting period. The mandatory effective date would be annual periods beginning on or after January 1, 2022, with early adoption permitted. The amended standard is not expected to have an impact on the unaudited condensed consolidated financial statements.
- (ii) IFRS 3, Reference to Conceptual Framework. In May 2020, the IASB issued an amendment to IFRS 3 to (i) clarify references to the 2018 Conceptual Framework in order to determine what constitutes an asset or liability in a business combination, (ii) add an exception for certain liabilities and contingent liabilities to refer to IAS 37 or IFRIC 21 and (iii) clarify that an acquirer should not recognize contingent assets at the acquisition date. The mandatory effective date would be annual periods beginning on or after January 1, 2022, with early adoption permitted. The amended standard is not expected to have an impact on the unaudited condensed consolidated financial statements.
- (iii) IAS 37, Onerous Contracts – Cost of Fulfilling a Contract. In May 2020, the IASB issued an amendment to IAS 37 to clarify which costs to include in estimating the cost of fulfilling a contract for the purpose of assessing whether that contract is onerous. The mandatory effective date would be annual periods beginning on or after January 1, 2022, with early adoption permitted. The amended standard is not expected to have an impact on the unaudited condensed consolidated financial statements.
- (iv) IAS 16, Proceeds before Intended Use. In May 2020, the IASB issued an amendment to IAS 16 to clarify the accounting for the net proceeds from selling any items produced while bringing an item of property, plant and equipment into use. The mandatory effective date would be annual periods beginning on or after January 1, 2022, with early adoption permitted. The amended standard is 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)	June 30, 2020	December 31, 2019
KPT Financial Information		
Total assets	79.0	83.0
Total liabilities	4.9	5.9
KPLP Financial Information		
Total assets	1,802.5	1,623.6
Total liabilities	1,489.4	1,318.8

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

(C\$ millions, unless otherwise stated)	2020		2019				2018 (Restated)	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Number of days in the period	91	91	92	92	91	90	92	91
Revenue	386.8	375.1	348.1	369.4	365.7	351.0	359.3	348.6
Net income (loss) for the period	28.9	8.4	(6.1)	10.5	0.9	(3.2)	38.0	4.2
Reconciliation of Net income (loss) to Adjusted EBITDA								
Net income (loss)	28.9	8.4	(6.1)	10.5	0.9	(3.2)	38.0	4.2
Interest expense	11.3	10.6	10.9	11.4	11.4	11.3	13.5	13.5
Income taxes	8.8	(0.1)	0.8	0.7	1.1	(0.2)	(2.0)	(0.5)
Depreciation and amortization	17.0	16.9	16.0	15.1	15.1	14.8	16.2	15.8
Foreign exchange (gain) loss	(5.8)	9.3	(0.8)	0.5	(1.0)	(0.7)	1.3	(0.5)
Change in amortized cost of								
Partnership units liability	2.5	2.5	22.3	1.5	1.5	1.5	(42.6)	-
Change in fair value of derivatives	-	(0.4)	0.4	(0.3)	0.3	-	(0.1)	-
Loss on sale of property, plant and equipment	-	-	-	-	-	-	0.2	-
Loss on sale of shares	-	-	-	0.6	-	-	-	-
Restructuring costs, net	0.5	0.7	0.1	1.6	0.2	0.1	-	-
Consulting costs related to								
operational transformation initiatives	1.2	3.1	2.4	2.3	1.3	-	-	-
Corporate development related costs	-	-	-	0.1	0.7	-	-	-
Adjusted EBITDA	64.4	51.0	46.0	44.0	31.5	23.6	24.5	32.5

SHARE INFORMATION

KPT's authorized share capital consists of an unlimited number of Common Shares. As of August 5, 2020, there were 9,725,753 Common Shares issued and outstanding. Pursuant to the Exchange Agreement, Kruger Inc. 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 Inc. were to exchange all KPLP Units held by it as of August 5, 2020 for Common Shares, it would hold approximately 85.2% of the issued and outstanding Common Shares. As of August 5, 2020, there were no potentially dilutive instruments outstanding.

Pursuant to the Limited Partnership Agreement, KPLP may issue an unlimited number of KPLP Units. As of August 5, 2020, there were 65,814,575 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 2019 Annual Information Form dated March 30, 2020 available on SEDAR at 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.

The Corporations will file certifications, signed by the Corporations' CEO and CFO, with the Canadian Securities Administrators (CSA) upon filing of the Corporations' Annual Information Form. In those filings, the Corporations' CEO and CFO will certify, 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. The Corporations' CEO and CFO also certify the appropriateness of the financial disclosures in the Corporations' interim filings with securities regulators. In those interim filings, the Corporations' CEO and CFO also certify 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 financial statements and notes of KPT and the 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 Q2 2020 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.