



KRUGER PRODUCTS L.P.

UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENT

**FOR THE 13-WEEK AND 26-WEEK PERIODS ENDED JUNE 29, 2014
AND JUNE 30, 2013**

Kruger Products L.P.

Unaudited Condensed Consolidated Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	June 29, 2014 \$	December 31, 2013 \$
Assets		
Current assets		
Cash and cash equivalents	40,484	87,674
Trade and other receivables	101,487	94,789
Receivables from related parties (note 11)	325	1,429
Advances to partners (note 9)	1,390	-
Inventories	153,855	151,505
Current portion of income tax recoverable	545	630
Prepaid expenses	9,265	4,777
	<u>307,351</u>	<u>340,804</u>
Non-current assets		
Property, plant & equipment (note 6)	622,434	616,687
Other long-term assets	10,786	10,268
Income tax recoverable	14,481	14,132
Goodwill (note 4)	160,842	152,021
Intangible assets	13,920	13,483
Deferred income taxes	16,015	14,141
	<u>1,145,829</u>	<u>1,161,536</u>
Liabilities		
Current liabilities		
Trade and other payables	169,777	188,470
Payables to related parties (note 11)	9,325	5,134
Distributions payable (note 9)	9,550	9,455
Current portion of provisions (note 8)	2,192	999
Current portion of long-term debt	11,121	8,276
	<u>201,965</u>	<u>212,334</u>
Non-current liabilities		
Long-term debt	347,799	342,013
Other long-term liabilities	232	323
Provisions (note 8)	7,478	6,615
Pensions (note 7)	100,956	80,380
Post-retirement benefits (note 7)	52,937	48,746
	<u>711,367</u>	<u>690,411</u>
Liabilities to non-unitholders	711,367	690,411
Current portion of Partnership units liability (note 9)	3,475	3,475
Long-term portion of Partnership units liability (note 9)	115,754	114,364
	<u>119,229</u>	<u>117,839</u>
Total Partnership units liability	119,229	117,839
Total liabilities	<u>830,596</u>	<u>808,250</u>
Equity		
Partnership units (note 9)	291,137	282,672
Retained earnings	3,786	50,945
Accumulated other comprehensive income	20,310	19,669
	<u>315,233</u>	<u>353,286</u>
Total equity	315,233	353,286
Total equity and liabilities	<u>1,145,829</u>	<u>1,161,536</u>
Subsequent events (note 9)		

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

Kruger Products L.P.
Unaudited Condensed Consolidated Statement of Comprehensive Income (Loss)

For the 13-week and 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars)

	13-week period ended June 29, 2014 \$	13-week period ended June 30, 2013 \$	26-week period ended June 29, 2014 \$	26-week period ended June 30, 2013 \$
		(note 15)		(note 15)
Revenue (note 11)	265,284	246,769	499,892	468,554
Expenses				
Cost of sales (note 11)	226,352	201,629	425,223	384,800
Selling, general and administrative expenses (note 11)	19,882	22,383	40,408	43,168
Recovery of non-financial assets (note 6) □	-	(1,789)	-	(1,789)
Restructuring costs (note 8)	51	-	2,835	-
Operating income	18,999	24,546	31,426	42,375
Interest expense	11,393	11,007	22,301	20,897
Other (income) expense (note 5)	(158)	1,647	4,870	2,723
Income before income taxes	7,764	11,892	4,255	18,755
Income taxes (note 10)	(355)	(3,485)	(641)	(8,338)
Net income for the period	8,119	15,377	4,896	27,093
Other comprehensive income (loss)				
Items that will not be reclassified to net income:				
Remeasurements of pensions	(30,593)	21,203	(29,512)	33,698
Remeasurements of post-retirement benefits	(2,646)	1,504	(3,493)	1,504
Items that may be subsequently reclassified to net income:				
Available-for-sale investment	(113)	-	(138)	-
Cumulative translation adjustment	(10,027)	8,835	779	13,374
Total other comprehensive income (loss) for the period	(43,379)	31,542	(32,364)	48,576
Comprehensive income (loss) for the period	(35,260)	46,919	(27,468)	75,669

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

Kruger Products L.P.
Unaudited Condensed Consolidated Statement of Changes in Equity

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

	Partnership units		Retained earnings (deficit)	Accumulated other comprehensive income (loss)	Total equity
	#	\$	\$	\$	\$
As of January 1, 2013	51,014,300	257,516	(14,736)	3,245	246,025
Distributions payable	-	-	(9,367)	-	(9,367)
Distributions paid	-	-	(11,232)	-	(11,232)
Change in actuarial gains on pension	-	-	33,698	-	33,698
Change in actuarial gains on post retirement benefits	-	-	1,504	-	1,504
Cumulative translation adjustment	-	-	-	13,374	13,374
Net income for the period	-	-	27,093	-	27,093
Issuance of partnership units	1,025,035	17,383	-	-	17,383
As of June 30, 2013	52,039,335	274,899	26,960	16,619	318,478
As of January 1, 2014	52,527,550	282,672	50,945	19,669	353,286
Distributions payable (note 9)	-	-	(9,550)	-	(9,550)
Distributions paid (note 9)	-	-	(9,500)	-	(9,500)
Change in actuarial gains on pension	-	-	(29,512)	-	(29,512)
Change in actuarial gains on post retirement benefits	-	-	(3,493)	-	(3,493)
Change in available-for-sale investment	-	-	-	(138)	(138)
Cumulative translation adjustment	-	-	-	779	779
Net income for the period	-	-	4,896	-	4,896
Issuance of partnership units (note 9)	528,321	8,465	-	-	8,465
As of June 29, 2014	53,055,871	291,137	3,786	20,310	315,233

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

Kruger Products L.P.

Unaudited Condensed Consolidated Statement of Cash Flows

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars)

	26-week period ended June 29, 2014 \$	26-week period ended June 30, 2013 \$
Cash flows from (used in) operating activities		
Net income for the period	4,896	27,093
Items not affecting cash		
Depreciation	18,194	16,189
Amortization	331	276
Loss (gain) on sale of fixed assets	298	(4)
Change in amortized cost of Partnership units liability	4,864	-
Unrealized foreign exchange loss	83	2,493
Interest expense	22,301	20,897
Pension and post retirement benefits	5,004	5,164
Provisions	2,421	485
Income taxes	(641)	(8,338)
Recovery of non-financial assets	-	(1,789)
Total items not affecting cash	52,855	35,373
Net change in non-cash working capital (note 14)	(17,268)	(44,216)
Contributions to pension and post-retirement benefit plans	(16,216)	(14,717)
Provisions paid	(837)	(1,802)
Income tax payments	(886)	(1,737)
Net cash from (used in) operating activities	22,544	(6)
Cash flows from (used in) investing activities		
Purchases of property, plant & equipment	(13,366)	(7,590)
Purchases of through-air-dried (TAD) expansion	(6,212)	(28,773)
Purchases of software	(768)	(90)
Proceeds on sale of property, plant and equipment	1	4
Acquisition of business (note 4)	(23,360)	-
Net cash used in investing activities	(43,705)	(36,449)
Cash flows from (used in) financing activities		
Proceeds from credit facilities	-	4,571
Repayment of credit facilities	(510)	(3,730)
Payment of deferred financing fees	-	(453)
Interest paid on credit facilities	(10,397)	(13,971)
Distributions and advances paid (note 11)	(23,695)	(11,232)
Proceeds from issuing partnership units	8,465	17,383
Net cash used in financing activities	(26,137)	(7,432)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	108	762
Decrease in cash and cash equivalents during the period	(47,190)	(43,125)
Cash and cash equivalents - Beginning of period	87,674	121,489
Cash and cash equivalents - End of period	40,484	78,364

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

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

1 General information

Kruger Products L.P. (KPLP or the Partnership) is a limited partnership registered in the Province of Quebec, Canada whose partners are Kruger Inc., KPGP Inc. and KP Tissue Inc. (KPT). The Partnership manufactures, sells and distributes tissue products for household, industrial and commercial use. The Partnership has plants in New Westminster, British Columbia; Crabtree, Quebec; Sherbrooke, Quebec; Gatineau, Quebec; and Memphis, Tennessee. The Partnership's headquarters are located in Mississauga, Ontario, Canada.

2 Basis of presentation

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of interim financial statements including International Accounting Standard 34, Interim Financial Reporting as issued by the International Accounting Standards Board (IASB), and with interpretations of the International Financial Reporting Committee which the Canadian Accounting Standards Board has approved for incorporation into Part 1 of the CPA Canada Handbook - Accounting. These condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements of the Partnership for the year ended December 31, 2013. The Partnership reclassified certain prior year amounts in the condensed consolidated financial statements to conform to current year presentation (see note 15 for further details).

These condensed consolidated financial statements were approved by the board of directors of KPGP Inc. (KPGP) on August 12, 2014.

3 Summary of significant accounting policies

The significant accounting policies that have been used in the preparation of these condensed consolidated financial statements are described in the annual consolidated financial statements of the Partnership for the year ended December 31, 2013 and have been applied to all periods presented except the following accounting policies, which were adopted effective January 1, 2014:

- (i) Amendments to IAS 32, Offsetting Financial Assets and Financial Liabilities, prescribe rules for the offsetting of financial assets and financial liabilities. It specifies that a financial asset and a financial liability should be offset and the net amount reported when, and only when an entity has a legally enforceable right to set off the amounts, and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. The amendments require clarification on four main areas: the meaning of 'currently has a legally enforceable right of set-off', the application of simultaneous realization and settlement, the offsetting of collateral amounts, and the unit of account for applying the offsetting requirements. The adoption of this amendment had no significant impact on these condensed consolidated financial statements.
- (ii) IAS 39, Financial Instruments – Recognition and Measurement, has been amended to provide relief from discontinuing hedge accounting when novation of a hedging instrument to a central counterparty meets specified criteria. The adoption of this standard had no significant impact on these condensed consolidated financial statements.
- (iii) IAS 36, Impairment of Assets, has been amended to remove the requirement to disclose the recoverable amount when a cash generating unit (CGU) contains goodwill or indefinite lived intangible assets but there has been no impairment; to require disclosure of the recoverable amount of an asset or CGU when an impairment loss has been recognized or reversed; and to require detailed disclosure of how the fair value less costs of disposal has been measured when an impairment loss has been recognized or reversed. The adoption of this standard had no significant impact on these condensed consolidated financial statements.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

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, 2014 and have not been early adopted have been discussed in the annual financial statements for the year ended December 31, 2013, except for the following:

- (i) IFRS 15, Revenue from Contracts with Customers, specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with some informative, relevant disclosures. The standard supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions are leases, financial instruments and insurance contracts. IFRS 15 must be applied in an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2017 and early adoption is permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.
- (ii) IFRS 9, Financial Instruments. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 would be annual periods beginning on or after January 1, 2018, with early adoption permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

4 Business combinations

Acquisition of Metro Paper

On June 3, 2014, the Partnership acquired the Canadian tissue converting assets of Metro Paper Industries Inc. (Metro Paper) for cash consideration of \$23.4 million. The assets acquired include converting equipment in Scarborough and Trenton, Ontario, inventory, the entire Metro Paper North American Away-From-Home (AFH) customer base, as well as facility operating leases. This acquisition will be part of the AFH segment and is expected to create synergies, increase production capacity and add complementary product lines to the Partnership's AFH business.

The acquisition has been accounted for in accordance with IFRS 3, Business Combinations. The excess of the consideration paid over the fair value of the assets acquired resulted in deductible goodwill of \$8.8 million and has been allocated to a separate CGU. The Partnership has assessed the preliminary fair values of the assets acquired based on information available at the closing date, and therefore the values represent management's best estimates. The fair value of identifiable intangible assets are incomplete and subject to change and will be finalized within 12 months of the acquisition date.

The fair values of the assets acquired were as follows:

Fair value of identifiable assets acquired	
Inventory	6,299
Property, plant and equipment	8,240
Goodwill	8,821
Net assets acquired	<u>23,360</u>
Cash paid	<u>23,360</u>

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

5 Other (income) expense

	13-week period ended June 29, 2014	13-week period ended June 30, 2013	26-week period ended June 29, 2014	26-week period ended June 30, 2013
	\$	\$	\$	\$
Unrealized foreign exchange (gain) loss	(1,596)	1,638	83	2,493
Change in amortized cost of Partnership units liability	1,514	-	4,864	-
Miscellaneous (income) expense	(76)	9	(77)	230
	<u>(158)</u>	<u>1,647</u>	<u>4,870</u>	<u>2,723</u>

6 Property, plant and equipment

	Land \$	Buildings \$	Machinery and equipment \$	Assets under construction or development \$	Total \$
As of January 1, 2014					
Cost	40,564	166,719	854,566	12,207	1,074,056
Accumulated depreciation and impairments	-	(64,918)	(392,451)	-	(457,369)
Net book value as of January 1, 2014	40,564	101,801	462,115	12,207	616,687
Additions	-	-	-	14,319	14,319
Disposals	-	-	(299)	-	(299)
Investment tax credits	-	-	(190)	-	(190)
Transfers	-	521	12,053	(12,574)	-
Acquisition of business	-	-	8,240	-	8,240
Depreciation	-	(2,287)	(14,814)	-	(17,101)
Exchange differences	7	135	741	(105)	778
As of June 29, 2014	<u>40,571</u>	<u>100,170</u>	<u>467,846</u>	<u>13,847</u>	<u>622,434</u>
As of June 29, 2014					
Cost	40,571	167,364	874,545	13,847	1,096,327
Accumulated depreciation and impairment	-	(67,194)	(406,699)	-	(473,893)
Net book value as of June 29, 2014	<u>40,571</u>	<u>100,170</u>	<u>467,846</u>	<u>13,847</u>	<u>622,434</u>

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

7 Pensions and post-retirement benefits

The following were the significant assumptions for the defined benefit pension plans and other benefit plans:

Assumptions	Pensions		Post-retirement benefit plans	
	June 29, 2014	December 31, 2013	June 29, 2014	December 31, 2013
	%	%	%	%
Discount rate - accrued benefit obligation	4.00	4.60	4.00	4.60
Rate of compensation increases	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00

On February 13, 2014, the Canadian Institute of Actuaries (CIA) released their final report on Canadian Pensioner Mortality. The updated mortality assumption has been used in the valuation of the defined benefit pension plans and other benefit plans.

The net benefit pension plan expense included the following components:

Net benefit plan expense	Pensions		Post-retirement benefit plans	
	13-week period ended June 29, 2014	13-week period ended June 30, 2013	13-week period ended June 29, 2014	13-week period ended June 30, 2013
	\$	\$	\$	\$
Current service cost	1,946	2,108	362	348
Interest costs	6,402	5,947	544	516
Expected return on plan assets	(5,470)	(4,365)	-	-
	<u>2,878</u>	<u>3,690</u>	<u>906</u>	<u>864</u>

Net benefit plan expense	Pensions		Post-retirement benefit plans	
	26-week period ended June 29, 2014	26-week period ended June 30, 2013	26-week period ended June 29, 2014	26-week period ended June 30, 2013
	\$	\$	\$	\$
Current service cost	4,280	4,591	724	697
Interest costs	12,845	12,002	1,088	1,031
Expected return on plan assets	(10,959)	(8,771)	-	-
Gain on curtailment		(124)	-	-
	<u>6,166</u>	<u>7,698</u>	<u>1,812</u>	<u>1,728</u>

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

8 Provisions

	Environmental and asset retirement obligations	Long-term incentives	Restructuring	Total
	\$	\$	\$	\$
	(a)	(b)	(c)	
Provisions as of December 31, 2013	5,304	1,311	999	7,614
Current	-	-	999	999
Non-current	5,304	1,311	-	6,615
Provisions as of January 1, 2014	5,304	1,311	999	7,614
Additional provisions	340	411	2,010	2,761
Paid during the period	-	(20)	(817)	(837)
Interest accretion	132	-	-	132
Provisions as of June 29, 2014	5,776	1,702	2,192	9,670
Current	-	-	2,192	2,192
Non-current	5,776	1,702	-	7,478

a) Environmental and asset retirement obligations

The Partnership has made a provision for the potential obligation under a land lease at one of its plant locations to demolish the building and restore the land at the end of the lease to its original condition. The current lease ends in 2028 but can be renewed for another term. The estimated undiscounted amount to settle this obligation would be between \$10.6 million and \$13.7 million. The liability is estimated using a discounted cash flow with a discount rate of 4.25%.

b) Long-term incentives

Long-term incentives include the Executive Long-Term Incentive Plan for the Partnership. The plan is based on the earnings before interest, tax, depreciation and amortization (EBITDA) return on capital employed and is paid in the third year following the year it is earned. The compensation expense is recognized over the same period.

c) Restructuring

The restructuring charges at the New Westminster plant and other locations resulted in an increase in provisions of approximately \$8.6 million during fiscal 2012. The provisions are based on management's best estimate of the severance and other costs to be incurred. The remaining provision of \$0.8 million relates primarily to estimated costs to exit certain lease obligations and is expected to be substantially complete by the end of 2014.

In November 2013, the Partnership undertook an initiative to consolidate distribution activities from its Gatineau warehouse to its distribution operations in Laval. The Partnership has incurred restructuring costs of \$2.2 million as of June 29, 2014 related to this initiative.

During the first quarter of 2014, the Partnership undertook a review of corporate overhead costs and identified a number of cost reduction opportunities. The Partnership expects to incur restructuring costs of approximately

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

\$2.0 million, primarily related to severance. As of June 29, 2014, the Partnership had incurred \$0.6 million of the costs associated with this initiative.

9 Distributions

Partnership Unit distributions

On January 15, 2014, the Partnership paid a distribution of \$9.5 million. Pursuant to the Distribution Reinvestment Plan (DRIP), a portion of the distribution was reinvested by the partners and the Partnership issued 252,478 additional partnership units at a price of \$16.59 for the gross proceeds of \$4.2 million.

On March 19, 2014, the Partnership declared a distribution of \$9.5 million, which was paid on April 15, 2014. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 275,843 additional partnership units at a price of \$15.51 for the gross proceeds of \$4.3 million.

On May 9, 2014, the Partnership declared a distribution of \$9.6 million, which was paid on July 15, 2014. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 279,468 additional partnership units at a price of \$15.33 for the gross proceeds of \$4.3 million.

Subsequent to June 29, 2014, the Partnership declared a distribution of \$9.6 million, payable on October 15, 2014.

Tax distributions

On February 28, 2014, the Partnership paid a Tax Distribution of \$3.4 million of which \$0.5 million was used to pay the tax instalment on behalf of KPT and \$2.9 million was paid to Kruger Inc. and KPGP.

During the 26-week period ended June 29, 2014, pursuant to the Tax Distribution as defined in the Partnership Agreement, the Partnership made advances to its partners of \$1.4 million, of which \$0.2 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 and will be settled when the Tax distribution is declared annually.

10 Income taxes

The Partnership is not a tax paying entity for the 26-week periods ended June 29, 2014 and June 30, 2013. The income (loss) from the Partnership flows to the partners, Kruger Inc., KPGP, and KPT. However, the Partnership's subsidiaries Kruger Products (USA) Inc. (KP USA), K.T.G. (USA) Inc. (KTG), TAD Canco Inc., Grupo Tissue de Mexico S de RL de CV (GTM) and TAD Luxembourg S.A.R.L. are corporate entities and, therefore, are subject to tax.

Income tax expense (recovery) was recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. The estimated weighted average annual income tax rate for the 26-week period ended June 29, 2014 was (11.4)% (26-week period ended June 30, 2013 – (44.4)%). The tax recovery recorded in the 26-week period ended June 29, 2014 includes a benefit of \$0.07 million of an investment tax credit (26-week period ended June 30, 2013 - \$3.3 million).

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

The components of income taxes were as follows:

	13-week period ended June 29, 2014	13-week period ended June 30, 2013	26-week period ended June 29, 2014	26-week period ended June 30, 2013
	\$	\$	\$	\$
Current tax expense	519	372	1,241	829
Deferred tax credit	(874)	(3,857)	(1,882)	(9,167)
	<u>(355)</u>	<u>(3,485)</u>	<u>(641)</u>	<u>(8,338)</u>

11 Related party transactions

The Partnership makes sales to and acquires goods and services from Kruger Inc. and its subsidiary companies (related parties) in the normal course of business. These transactions are measured at the exchange amount, which is the amount agreed on by the related parties, and are non-interest bearing.

Sales of goods to Kruger Inc. for the 26-week periods ended June 29, 2014 were \$1.4 million (26-week period ended June 30, 2013 - \$2.1 million). Sales of goods to subsidiaries of Kruger Inc. for the 26-week periods ended June 29, 2014 were \$0.1 million (26-week period ended June 30, 2013 - \$0.5 million). Goods are sold based on the price lists in force and terms that would be available to third parties. Services are delivered at the terms outlined in the agreements between the related parties.

Purchases of goods and services from Kruger Inc. for the 26-week periods ended June 29, 2014 were \$14.2 million (26-week period ended June 30, 2013 - \$14.0 million). Purchases of goods and services from subsidiaries of Kruger Inc. for the 26-week periods ended June 29, 2014 were \$8.4 million (26-week period ended June 30, 2013 - \$4.3 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 operating expenses in the condensed consolidated statements of comprehensive income (loss). During the 26-week periods ended June 29, 2014, management fees of \$2.0 million (26-week period ended June 30, 2013 - \$2.0 million) were paid to Kruger Inc. for management services provided to the Partnership.

Balances due to and from related parties were as follows:

	June 29, 2014	December 31, 2013
	\$	\$
Receivables from Kruger Inc.	278	1,255
Receivables from subsidiaries of Kruger Inc.	47	174
	<u>325</u>	<u>1,429</u>
Payables to Kruger Inc.	7,285	3,472
Payables to subsidiaries of Kruger Inc.	2,040	1,662
	<u>9,325</u>	<u>5,134</u>

The receivables from and payables to related parties are due based on commercial terms agreed on between the parties. The receivables and payables are unsecured in nature and non-interest bearing. There were no provisions related to the receivables from related parties as of June 29, 2014 and December 31, 2013. There were no loans outstanding with related parties as of June 29, 2014 and December 31, 2013.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

As of June 29, 2014, the Partnership had declared distributions to its related parties as follows:

	June 29, 2014	December 31, 2013
	<u>\$</u>	<u>\$</u>
Distribution payable to Kruger Inc.	7,960	7,871
Distribution payable to KPGP	1	1
Distribution payable to KPT	<u>1,589</u>	<u>1,583</u>
Total distribution payable	<u><u>9,550</u></u>	<u><u>9,455</u></u>

The Partnership paid Partnership unit distributions, tax distributions and advances to its related parties as follows:

	26-week period ended June 29, 2014			
	Tax		Partnership	
	distributions	Advances	unit	Total
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Paid to Kruger Inc.	2,890	1,156	15,785	19,831
Paid to KPGP	1	-	2	3
Paid to KPT	<u>459</u>	<u>234</u>	<u>3,168</u>	<u>3,861</u>
Total paid	<u><u>3,350</u></u>	<u><u>1,390</u></u>	<u><u>18,955</u></u>	<u><u>23,695</u></u>

	26-week period ended June 30, 2013			
	Tax		Partnership	
	distributions	Advances	unit	Total
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>
Paid to Kruger Inc.	-	-	9,333	9,333
Paid to KPGP	-	-	1	1
Paid to KPT	<u>-</u>	<u>-</u>	<u>1,898</u>	<u>1,898</u>
Total paid	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>11,232</u></u>	<u><u>11,232</u></u>

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

12 Segment information

Reportable segments

Management has determined the operating segments based on the reports reviewed by the Chief Executive Officer who is considered to be the Chief Operating Decision Maker. The Partnership operates in three industry segments: Consumer, Away-From-Home (AFH) and Other.

a) Consumer

This segment operates using the Partnership's manufacturing facilities in Canada (New Westminster, British Columbia; Crabtree, Quebec; Sherbrooke, Quebec; Gatineau, Quebec) and in the United States (Memphis, Tennessee). The Consumer segment includes sales of branded tissue products such as Cashmere™, Purex™, White Swan™, Scotties™, Sponge Towels™ and White Cloud™ and private label tissue products.

b) AFH

This segment operates using the Partnership's manufacturing facilities in Canada. The AFH business sells tissue products primarily through distributors to businesses involved in property management, health care, food service, manufacturing and lodging and also to public facilities.

c) Other

This segment includes sales of parent rolls by the Partnership to other tissue manufacturing companies primarily in the United States and also in Canada. It also includes sales of recycled fibre primarily to its parent company. This segment operates using the Partnership's manufacturing facilities in Canada.

Segment operating profit is the earnings (loss) for each such segment before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (recovery) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) unrealized foreign exchange loss (gain), (viii) one-time costs related to restructuring activities, and (ix) change in amortized cost of Partnership units liability. The Partnership's assets, operations and employees are located primarily in Canada and the United States. The same long-term assets of the Partnership are used for the Consumer, AFH and Other segments. Accordingly, assets cannot be allocated to these segments.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

	13-week period ended June 29, 2014			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	216,900	44,264	4,120	265,284
Segment operating profit (loss)	29,541	137	(680)	28,998
Depreciation and amortization				9,574
Interest expense				11,393
Restructuring costs				51
Change in amortized cost of Partnership unit liability				1,514
Loss on sale of fixed assets				298
Unrealized foreign exchange gain				(1,596)
Income before income taxes				7,764
Income taxes				(355)
Net income for the period				8,119

	13-week period ended June 30, 2013			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	205,358	40,004	1,407	246,769
Segment operating profit (loss)	29,104	2,677	(33)	31,748
Depreciation and amortization				9,000
Interest expense				11,007
Recovery of non-financial assets				(1,789)
Unrealized foreign exchange loss				1,638
Income before income taxes				11,892
Income taxes				(3,485)
Net income for the period				15,377

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

	26-week period ended June 29, 2014			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	415,278	77,746	6,868	499,892
Segment operating profit (loss)	54,490	(387)	(942)	53,161
Depreciation and amortization				18,525
Interest expense				22,301
Change in amortized cost of Partnership unit liability				4,864
Loss on sale of fixed assets				298
Restructuring costs				2,835
Unrealized foreign exchange loss				83
Income before income taxes				4,255
Income taxes				(641)
Net income for the period				4,896

	26-week period ended June 30, 2013			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	389,761	75,285	3,508	468,554
Segment operating profit (loss)	53,027	4,140	(350)	56,817
Depreciation and amortization				16,465
Interest expense				20,897
Gain on sale of fixed assets				(4)
Recovery of non-financial assets				(1,789)
Unrealized foreign exchange loss				2,493
Income before income taxes				18,755
Income tax recovery				(8,338)
Net income for the period				27,093

Geographic segments

The Partnership operates in Canada, the United States and Mexico. Revenue and assets are allocated to geographic segment based on the location of the customer and long-term assets, respectively.

Revenue	Revenue			
	13-week period ended June 29, 2014	13-week period ended June 30, 2013	26-week period ended June 29, 2014	26-week period ended June 30, 2013
	\$	\$	\$	\$
Canada	172,981	183,087	334,141	340,649
US	86,310	56,331	153,068	113,465
Mexico	5,993	7,351	12,683	14,440
	265,284	246,769	499,892	468,554

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

	June 29, 2014			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	297,945	324,489	-	622,434
Goodwill	160,842	-	-	160,842
Intangible assets	13,920	-	-	13,920

	December 31, 2013			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	292,561	324,126	-	616,687
Goodwill	152,021	-	-	152,021
Intangible assets	13,483	-	-	13,483

13 Financial instruments

Classification of financial instruments

Financial instruments are classified into one of the following categories: fair value through profit and loss, fair value through other comprehensive income, loans and receivables and financial liabilities. As of June 29, 2014, the classification of the financial instruments, as well as their carrying amounts and fair values, was as follows:

	Classification	Measurement	Carrying amount	Fair Value
			\$	\$
Cash and cash equivalents	loans and receivables	amortized cost	40,484	40,484
Trade and other receivables	loans and receivables	amortized cost	101,487	101,487
Receivables from related parties	loans and receivables	amortized cost	325	325
Embedded derivative	fair value through profit or loss	fair value	3,583	3,583
Available-for-sale investment	fair value through other comprehensive income or loss	fair value	768	768
Trade and other payables	financial liabilities	amortized cost	(169,777)	(169,777)
Payables to related parties	financial liabilities	amortized cost	(9,325)	(9,325)
Distribution payable	financial liabilities	amortized cost	(9,550)	(9,550)
Long-term debt	financial liabilities	amortized cost	(358,920)	(379,097)
Partnership unit liability	financial liabilities	amortized cost	(119,229)	(119,229)

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

The following table details the fair value hierarchy of financial instruments carried at fair value by level as of June 29, 2014:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Embedded derivative	-	3,583	-	3,583
Available-for-sale investment	768	-	-	768

As of December 31, 2013, the classification of the financial instruments, as well as their carrying amounts and fair values, was as follows:

	Classification	Measurement	Carrying amount	Fair Value
			\$	\$
Cash and cash equivalents	loans and receivables	amortized cost	87,674	87,674
Trade and other receivables	loans and receivables	amortized cost	94,789	94,789
Receivables from related parties	loans and receivables	amortized cost	1,429	1,429
Embedded derivative	fair value through profit or loss	fair value	3,028	3,028
Available-for-sale investment	fair value through other comprehensive income or loss	fair value	906	906
Trade and other payables	financial liabilities	amortized cost	(188,470)	(188,470)
Payables to related parties	financial liabilities	amortized cost	(5,134)	(5,134)
Distribution payable	financial liabilities	amortized cost	(9,455)	(9,455)
Long-term debt	financial liabilities	amortized cost	(350,289)	(377,295)
Partnership unit liability	financial liabilities	amortized cost	(117,839)	(117,839)

The following table details the fair value hierarchy of financial instruments carried at fair value by level as of December 31, 2013:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Embedded derivative	-	3,028	-	3,028
Available-for-sale investment	906	-	-	906

Fair value

Cash and cash equivalents, trade and other receivables, receivables from related parties, trade and other payables and payables to related parties and distribution payable are short-term financial instruments whose fair value approximates the carrying amount, given they will mature in the near future. As of June 29, 2014, the fair value of the senior notes was \$189.0 million (December 31, 2013 - \$189.0 million) based on the trading value of the debt on the over-the-counter market. The fair values of the Nordea Facility and the Caisse Facility were \$42.2 million and \$145.1 million (December 31, 2013 - \$42.1 million and \$143.0 million), respectively, which approximates the current principal amount outstanding as the interest rate approximates current market interest rates. As of June 29, 2014, the fair value of the loans payable was \$2.8 million (December 31, 2013 - \$3.2 million).

Management has estimated the fair value of the embedded derivative using a probability-weighted interest rate pricing method. The valuation methodology used is categorized as a Level 2 methodology.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

The fair value of the Available-for-sale investment is based on quoted market price in the active market. Unrealized losses were not significant as of June 29, 2014 and have been recorded in other comprehensive income until realized. The valuation methodology used is categorized as a Level 1 methodology.

Fair value of the Partnership units liability

The Partnership units liability is classified as a financial liability at amortized cost. Management has estimated the fair value of the Partnership units liability using discounted cash flow model. Significant assumptions include the income tax obligation, discount rate and an industry capitalization rate.

14 Consolidated statements of cash flows

Non-cash working capital

The change in non-cash working capital on the condensed consolidated statements of cash flows comprises the following:

	June 29, 2014	June 30, 2013
	<u>\$</u>	<u>\$</u>
Decrease (increase) in trade receivables	(6,775)	1,751
Decrease (increase) in receivables from related parties	1,104	(1,242)
Decrease (increase) in inventories	2,668	(18,784)
Increase in prepaid expenses	(4,491)	(4,014)
Increase in other long-term assets	(102)	(1,300)
Decrease (increase) in income tax recoverable	(323)	74
Decrease in trade and other payables	(13,415)	(15,657)
Increase (decrease) in payables to related parties	4,066	(5,044)
	<u>(17,268)</u>	<u>(44,216)</u>

As of June 29, 2014, purchases of property, plant and equipment of \$0.3 million (June 30, 2013 - \$6.2 million) were not paid.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week periods ended June 29, 2014 and June 30, 2013

(tabular amounts are in thousands of Canadian dollars, except unit amounts)

15 Reclassifications in the financial statements

The following items were reclassified in the condensed consolidated statements of comprehensive income (loss) for the 13-week and 26-week periods ended June 30, 2013 to conform to current year presentation:

	13-week period ended June 30, 2013			26-week period ended June 30, 2013		
	As presented	Adjustments	Recast presentation \$	As presented	Adjustments	Recast presentation \$
Revenue	246,769		246,769	468,554		468,554
Expenses						
Cost of sales	173,308	28,321	201,629	330,469	54,331	384,800
Operating expenses ⁽¹⁾	52,351	(29,968)	22,383	100,222	(57,054)	43,168
Recovery of non-financial assets	(1,789)	-	(1,789)	(1,789)	-	(1,789)
Operating income	22,899	1,647	24,546	39,652	2,723	42,375
Interest expense	11,007	-	11,007	20,897	-	20,897
Other expense	-	1,647	1,647	-	2,723	2,723
Income before income taxes	11,892	-	11,892	18,755	-	18,755
Income taxes	(3,485)	-	(3,485)	(8,338)	-	(8,338)
Net income for the period	15,377	-	15,377	27,093	-	27,093

(1) Operating expenses were renamed selling, general and administrative expenses.

The reclassification in the financial statements increases the understandability of the Partnership's operations and results in classifications that are more comparable to its peers. The reclassifications had no impact on the reported net income for the 13-week and 26-week periods ended June 30, 2013. Other items remain unchanged.