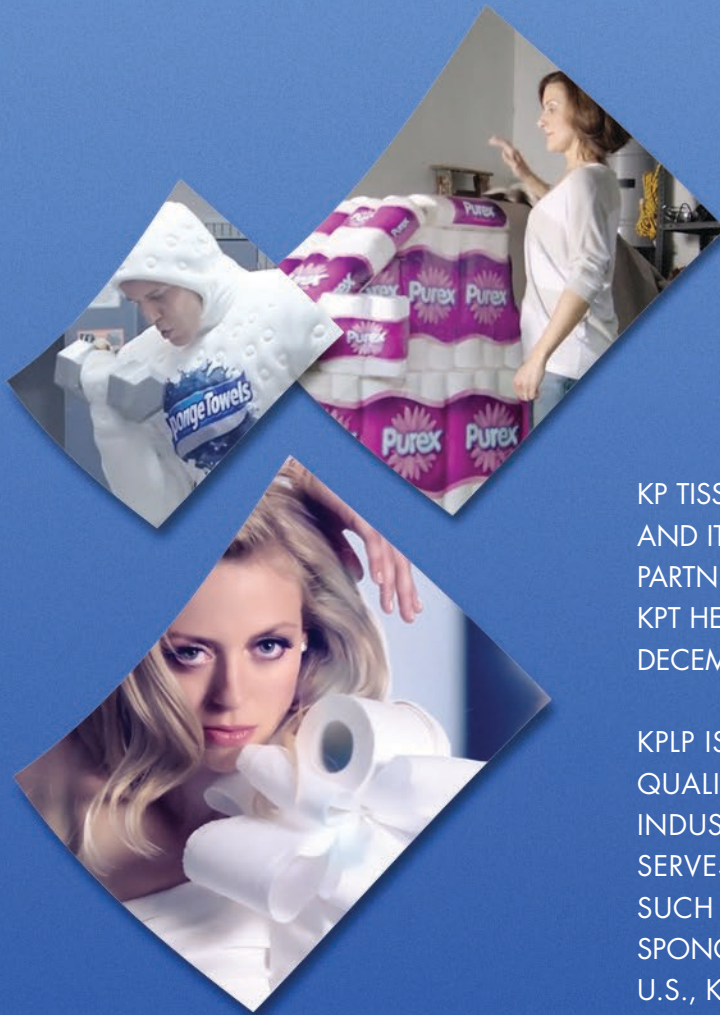




# 2014

ANNUAL REPORT





KP TISSUE INC. (KPT) WAS CREATED TO ACQUIRE, AND ITS BUSINESS IS LIMITED TO HOLDING, A LIMITED PARTNERSHIP INTEREST IN KRUGER PRODUCTS L.P. (KPLP). KPT HELD A MINORITY INTEREST IN KPLP OF 16.5% AS AT DECEMBER 31, 2014 AND 16.4% AS AT MAY 6, 2015 <sup>(1)</sup>.

KPLP IS CANADA'S LEADING MANUFACTURER OF QUALITY TISSUE PRODUCTS FOR HOUSEHOLD, INDUSTRIAL AND COMMERCIAL USE. THE COMPANY SERVES THE CANADIAN CONSUMER MARKET WITH SUCH WELL-KNOWN BRANDS AS CASHMERE®, PUREX®, SPONGETOWELS®, SCOTTIES® AND WHITE SWAN®. IN THE U.S., KPLP MANUFACTURES THE WHITE CLOUD® BRAND, AS WELL AS MANY PRIVATE LABEL PRODUCTS. THE AWAY-FROM-HOME DIVISION MANUFACTURES AND DISTRIBUTES HIGH QUALITY, COST-EFFECTIVE PRODUCT SOLUTIONS TO A WIDE RANGE OF COMMERCIAL AND PUBLIC ENTITIES. THE COMPANY HAS APPROXIMATELY 2,500 EMPLOYEES AND OPERATES FIVE FSC® COC-CERTIFIED PLANTS ACROSS NORTH AMERICA.

<sup>(1)</sup> KPT (the Corporation) holds a limited partnership interest in KPLP. Since KPT is a reporting issuer in all provinces and territories of Canada, it reports the financial and business information of KPLP.

©2014 KP Tissue ®Registered and ™trademarks of Kruger Products, L.P. ®Registered trademark of Kimberly-Clark Worldwide, Inc. used under license. ®Forest Stewardship Council and FSC logo—Forest Stewardship Council, A.C.

Forward looking information: For any information on statements in this Annual Report that are of a forward-looking nature, please consult the section on "Cautionary forward looking statement." on page 3 in the Management's discussion and analysis of results of operations and financial position.

# FIVE-YEAR FINANCIAL PERFORMANCE\*

(In millions of Canadian dollars)

For the years ended December 31	2014	2013	2012	2011	2010
Revenue	<b>1046.2</b>	955.3	922.9	892.6	897.7
Operating income	<b>81.6</b>	82.2	67.8	49.0	81.2
Net income	<b>21.1</b>	48.9	41.4	28.6	65.0

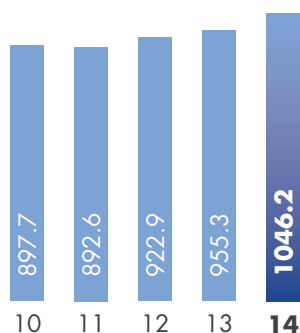
## OTHER FINANCIAL DATA

EBITDA	<b>121.6</b>	116.2	110.9	81.8	113.1
EBITDA margin	<b>11.6%</b>	12.2%	12.0%	9.2%	12.6%
Capital expenditures	<b>42.3</b>	59.0	184.8	109.4	27.9
Working capital	<b>122.4</b>	128.5	134.3	107.0	113.1
Long-term debt	<b>358.6</b>	342.0	323.9	251.7	179.7

\* All financial information presented herein are related to KPLP unless otherwise noted and have been prepared in accordance with IFRS. For the year ended December 31, 2014, KPT reported an equity loss of \$2.4 million, a net loss of \$2.5 million and basic earnings (loss) per share of (\$0.29). For more information refer to the KPT Audited Financial Statements for the period ended December 31, 2014. EBITDA and EBITDA margin are non-GAAP financial measures. Refer to the MD&A for the definition and reconciliation of EBITDA.

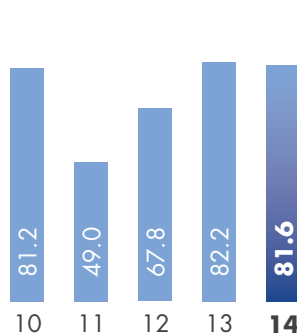
### REVENUE

(in millions of Canadian dollars)



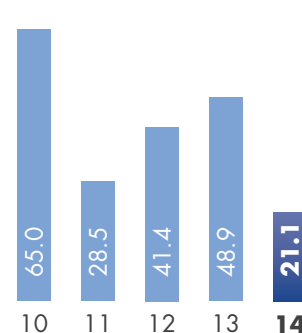
### OPERATING INCOME

(in millions of Canadian dollars)



### NET INCOME

(in millions of Canadian dollars)



## 2014 HIGHLIGHTS

- Revenue of \$1,046.2 million, up to 9.5% over 2013.
- EBITDA increased 4.6% to \$121.6 million primarily due to higher TAD product sales in the U.S.
- TAD product EBITDA contribution of \$26.9 million.
- Metro Paper Acquisition contributed positively to AFH EBITDA.
- Launched two new TAD branded products in Canada: Cashmere UltraLuxe Bathroom Tissue and SpongeTowels UltraStrong.
- At the year-end, cash and cash equivalents was \$51.8 million.
- Named the #1 CPG company by a major industry survey of retailers in Canada, for the second year in a row.



# TO OUR SHAREHOLDERS



I am delighted to have the opportunity to share some of our achievements in Fiscal 2014 and to provide you with an overview of our principal objectives for the current year.

## FINANCIAL HIGHLIGHTS

In Fiscal 2014, Kruger Products achieved excellent results. Revenues rose to a record level of just over \$1 billion, which represents a 9.5% increase over 2013. Additionally, our EBITDA grew by 4.6% to \$121.6 million in spite of the higher Canadian dollar and very high pulp prices.

Of special note is the contribution to EBITDA generated by the successful rollout of our TAD Project. The TAD Product EBITDA contribution was \$26.9 million, up from \$1.1 million in the previous year.

For the full year, our CAPEX totaled \$42.3 million. Of this amount, \$7.7 million was committed to complete the TAD project, and a further \$7.0 million was used for high return projects.

## THE TAD PROJECT

In late 2011, we initiated the most significant capital project in our history and commenced construction of the TAD facility in Memphis, Tennessee. This project was brought in on time and under budget.

In the spring of 2013 we introduced our TAD products to the marketplace and its initial success has fully met our expectations. Today, we have more than 20 TAD customers in Canada and the United States, and our brand-new Cashmere UltraLuxe and SpongeTowels UltraStrong TAD Products have been picked up by every major retailer in Canada and by hundreds of thousands of Canadian consumers.

With this positive growth outlook, we anticipate the TAD Product EBITDA range for 2015 will be between \$36 million and \$42 million. By Fiscal 2017, we shall expect our TAD products to generate a \$60 million EBITDA contribution.

## THE METRO PAPER ACQUISITION

Another of the more significant events in 2014 was our acquisition of Metro Paper Industries' Canadian tissue converting assets and North American customer base.

This acquisition brings us a number of critical benefits. First, it will add approximately \$50 million to our revenue on an annualized basis. Second, it presents us with new avenues in which to grow our AFH business, particularly in the U.S. Finally, the acquisition enhances our U.S. platform and provides us with needed additional capacity.

## OUR BRAND LEADERSHIP

In 2014, our brands once again captured the greatest overall market share in terms of both volume and dollar value.

We remain dedicated to delivering products that are innovative and unsurpassed in their quality, and to executing on sales and marketing initiatives that ensure our products are front-and-centre in consumer consciousness. I'm proud to report that we were named the #1 CPG Company for the second year in a row and for the fourth year out of five, by a major industry survey of retailers in Canada.

## OUR COMMITMENT TO COMMUNITY

Our Sustainability 2015 program has established targets that focus on decreasing fibre use, energy, waste, packaging materials and greenhouse gasses. We have gone a long way

towards meeting these targets, and I invite you to visit our program website at <http://www.sustainability2015.ca>.

Supporting philanthropic and community causes is also a priority. We are very proud of our continuing relationship with the Scotties Tournament of Hearts (the Canadian Women's Curling Championship) which we have sponsored for 32 years, and with the Canadian Breast Cancer Foundation. For the past 25 years we have also participated in the Ronald MacDonald House Charities, and for over 15 years we have been involved with Friends of We Care, an organization that sends children to Easter Seals Camps. Additionally, we participate in a number of local civic and charitable activities that make a lasting positive difference in their communities.

IN 2014, OUR BRANDS ONCE AGAIN CAPTURED THE GREATEST OVERALL MARKET SHARE IN TERMS OF BOTH VOLUME AND DOLLAR VALUE.

#### **BUILDING VALUE**

In 2015 our focus is on a range of strategies and initiatives that will enable us to deliver even greater value to our customers, to consumers and to our shareholders.

In Canada, our efforts are on maintaining the momentum of our consumer brands. In the U.S., the premium private label market is expanding, and we are very well-positioned to make the most of the growth opportunities. Further, we are currently looking into the possibility of further premium tissue capacity expansion.

In the AFH segment, we will be making the most of the operational synergies that can be derived from the Metro Paper acquisition, and further reinforcing our market coverage in this category.

There are also challenges ahead, high commodity prices and the negative impact the lower Canadian dollar exerts on our results. To address these conditions, we have already initiated a series of cost optimization projects, and we will examine other cost-cutting measures to protect and maintain our margins.

In addition, we are directing our CAPEX budget to high-return projects that will boost our manufacturing efficiency and improve our profitability in Canada. To broaden and deepen our market coverage, we are also engaged in reviewing further M&A opportunities in both Canada and the U.S.

#### **A WORD OF THANKS**

The dedication of the entire Kruger Products team has made possible the successes we enjoyed in 2014. For their superb efforts I wish to express my sincere thanks. Our Board of Directors has also played a key role in providing counsel and guidance.

Finally, on behalf of our entire team, I would like to express my appreciation for the support of all our suppliers, customers, and shareholders. Your loyalty and commitment to KP Tissue are the bedrock of our success.



Mario Gosselin  
Chief Executive Officer  
KP Tissue Inc., and Kruger Products L.P.



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

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

**FOR THE FOURTH QUARTER AND FISCAL YEAR ENDED DECEMBER 31, 2014**

**DATED MARCH 11, 2015**

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The following Management's Discussion and Analysis (MD&A) 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 financial statements of KPT for the years ended December 31, 2014 and December 31, 2013, and the consolidated financial statements of KPLP for the years ended December 31, 2014 (Fiscal 2014) and December 31, 2013 (Fiscal 2013), 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 16.5% interest in KPLP (16.5% as of December 31, 2014). The following MD&A provides discussion and analysis related to KPT to the extent necessary to understand the equity method of accounting. However, most 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. 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 information is based on certain key expectations and assumptions made by KPT or KPLP, including continued growth of the U.S. private label market and demand for TAD products in the U.S., orders for the TAD machine's products, the demand and timing of distributions made by KPLP, and Kruger Inc.'s cash requirements. The financial outlook that KPLP Management provides on page 3 of this MD&A concerning the potential incremental EBITDA generated by the TAD Project (as defined below) may be considered forward-looking information and is based on additional key expectations and assumptions, including but not limited to (i) limited incremental overhead relating to the operation of the TAD machine and distribution and sale of products, (ii) the TAD machine operating at near full capacity and products being sold at prices consistent with current market prices, adjusted for inflation, and (iii) a cost of pulp and energy based on recent prices, adjusted for inflation, and (iv) a foreign exchange rate between the Canadian and U.S. dollars approximating current levels. 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 information 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 12, 2015 available on SEDAR at [www.sedar.com](http://www.sedar.com) (the Annual Information Form): Kruger Inc.'s influence over KPLP; KPLP's reliance on Kruger Inc.; consequences of an event of insolvency relating to Kruger Inc.; risks associated with the TAD Project; operational risks; Gatineau Plant land lease; significant increases in input costs; reduction in supply of fibre; increased pricing pressure and intense competition; KPLP's inability to innovate effectively; adverse economic conditions; dependence on key retail trade customers; damage to the reputation of KPLP or KPLP's brands; KPLP's sales being less than anticipated; KPLP's failure to implement its business and operating strategies; KPLP's obligation to make regular capital expenditures; KPLP's entering into unsuccessful acquisitions; KPLP's dependence on key personnel; KPLP's inability to retain its existing customers or obtain new customers; KPLP's loss of key suppliers; KPLP's failure to adequately protect its intellectual property rights; KPLP's reliance on third party intellectual property licenses; adverse litigation and other claims affecting KPLP; material expenditures due to comprehensive environmental regulation affecting KPLP's cash flow; KPLP's pension obligations are significant and can be materially higher than predicted if KPLP Management's underlying assumptions are incorrect; labour disputes adversely affecting KPLP's cost structure and KPLP's ability to run its plants; exchange rate and U.S. competitors; KPLP's inability to service all of its indebtedness; exposure to potential consumer product liability, restrictive covenants; interest rate and refinancing risk; information technology and innovation; insurance; and internal controls.



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.

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 of the TAD Project 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, and the financial outlook that KPLP Management provides on page 3 of this MD&A concerning the potential incremental EBITDA generated by the TAD Project, are, without limitation, based on the assumptions and subject to the risks set out above.

The forward-looking information contained herein is expressly qualified in its entirety by this cautionary statement. The forward-looking information contained herein is made as of the date of this MD&A and KPT and KPLP undertake no obligation to publicly update such forward-looking information to reflect new information, subsequent or otherwise, unless required by applicable securities laws.

## **OVERVIEW**

### **Business Overview**

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 January 15, 2015, KPT held 16.5% of the KPLP Partnership Units (KPLP Units).

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) market (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.

KPLP is headquartered in Mississauga, Ontario and has approximately 2,500 employees across North America. KPLP's Canadian manufacturing facilities, consisting of three tissue plants in Québec, two plants in Ontario, and one plant in British Columbia, have a combined annual tissue production capacity of approximately 246,000 metric tonnes.

KPLP's U.S. manufacturing facility held through K.T.G. (USA) Inc. (KTG) and located in Memphis, Tennessee consists of two existing paper machines with an aggregate annual capacity of 57,000 metric tonnes, and one adjacent 60,000 metric tonne state-of-the-art, Through-Air-Dried (TAD) tissue machine and related infrastructure (the TAD Project).

### **Basis of Presentation**

The consolidated financial statements of KPLP presented for Fiscal 2014 and Fiscal 2013 have been prepared in accordance with IFRS (International Financial Reporting Standards). The financial statements of KPT for the years ended December 31, 2014 and December 31, 2013 have also been prepared in accordance with IFRS.

### **Accounting Periods**

This MD&A, the consolidated financial statements of KPLP and accompanying notes thereto include financial information for Q4 2014, Q4 2013, Fiscal 2014 and Fiscal 2013.

## **Financial Measures and Key Indicators**

This MD&A uses certain non-IFRS financial measures and ratios which KPLP believes provide useful information to both KPLP Management and the readers of the consolidated financial statements in measuring the financial performance and financial condition of KPLP. These measures do not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similarly titled measures presented by other companies. An example of such measures is EBITDA. EBITDA is not a measurement of operating performance computed in accordance with IFRS and should not be considered as a substitute for operating income, net income or cash flows from operating activities computed in accordance with IFRS. This MD&A contains a reconciliation of EBITDA to the most comparable IFRS measures on page 6.

“EBITDA” is calculated by KPLP as net income (loss) 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) changes in the amortized cost of the Partnership units liability.

“KTG EBITDA” is calculated as net income (loss) of KTG as reported in the financial statements of KTG before (i) interest expense, (ii) income taxes, (iii) depreciation, and (iv) amortization, as defined in the TAD Credit Facility (as described below).

“TAD Product EBITDA” represents the portion of KTG EBITDA generated by the sale of TAD products.

## **Outlook**

KPLP is committed to building great consumer brands and developing winning products for its retail and commercial customers. KPLP’s strategy is to maintain its leadership position in the Canadian market, which continues to exhibit strong fundamentals. 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.

In the U.S., KPLP will seek to grow by leveraging its TAD capabilities and focusing on the high-end private label business. The TAD Project (see Business Highlights, TAD Project) is a key component to KPLP’s strategy of growing its operations in the U.S. private label market. KPLP Management believes that the TAD Project has the potential to generate approximately \$60 million EBITDA annually for KPLP by 2017, being the year in which the TAD paper machine is expected to reach full production capacity. TAD Product EBITDA was \$9.1 million in Q4 2014 and \$26.9 million for Fiscal 2014. TAD Product EBITDA is expected to be in the \$36 to \$42 million range for fiscal 2015. The foregoing estimates of future incremental EBITDA may be considered forward-looking information and are based upon certain key assumptions, including (i) limited incremental overhead relating to the operation of the TAD machine and distribution and sale of products, (ii) the TAD machine operating at near full capacity and products being sold at market prices consistent with current market prices, adjusted for inflation, and (iii) a cost of pulp and energy based on recent prices, adjusted for inflation, and (iv) a foreign exchange rate between the Canadian and U.S. dollars approximating current levels. The foregoing factors could cause TAD Product EBITDA to differ materially from the amount set forth in the foregoing estimate.

## **Factors Affecting the Results of Operations**

### ***Revenue***

KPLP generates revenue on the sale of branded, private label and AFH tissue products in Canada and the U.S. Revenue is reported on a net basis, after deducting rebates and allowances. KPLP’s revenue is impacted by advertising, discounts and promotions, merchandising, packaging, the availability of shelf and display space at retail customers, the timing of new product launches and line extensions and competitive pricing, all of which have a significant impact on consumer buying decisions. Continued growth of our revenue will depend substantially on the continued strength of our brands, retail support and our ability to effectively maintain sufficient product supply to meet customer demand.

KPLP has three reportable business segments: (i) consumer products sold through traditional retail channels such as grocery stores, mass merchandisers, club stores, drug stores and convenience stores (Consumer), (ii) AFH, and (iii) Other. The Consumer segment includes sales of branded tissue products such as *Cashmere*, *Purex*, *Scotties*, *SpongeTowels*, *White Cloud* and *White Swan*. AFH sells commercial tissue products primarily through distributors to businesses involved in property management, health care, food service, manufacturing and lodging, and to other public facilities. The Other segment includes the sale of parent rolls to other tissue manufacturing companies as well as the sale of recycled fibre. KPLP's current sales focus includes all regions of Canada and the United States. KPLP is partially exposed to fluctuations in the U.S. dollar against the Canadian dollar, as sales made to U.S. customers are made in U.S. dollars. To manage this foreign exchange risk, KPLP has occasionally entered into foreign currency forward contracts and may continue to do so going forward.

### ***Cost of Sales***

Cost of sales includes fixed and variable costs to manufacture our products, freight, and warehousing and handling costs. Input costs associated with the manufacturing of tissue paper are primarily variable. Fibre, labour, and energy costs are the largest components, representing 50% to 70% of total cost of sales, depending on the type of fibre and paper making technology being used. Typically producers have been able to pass along commodity input cost increases (fibre and energy) to end customers and consumers within a six to nine month period following any such increase. For this reason KPLP Management believes that there is a correlation between pulp prices and end product pricing. Periodically, KPLP also enters into fibre commodity swap contracts, to reduce exposure to fluctuations in this key input cost. These typically do not exceed 15% of total fibre purchases. KPLP is exposed to fluctuations in the U.S. dollar against the Canadian dollar on production inputs, U.S. dollar denominated debt and other operating costs denominated in U.S. dollars. To manage this foreign exchange risk, KPLP has occasionally entered into foreign currency forward contracts and may continue to do so going forward. Fixed costs at the plants include plant maintenance, overhead, insurance, property taxes, information technology, as well as depreciation and amortization (substantially all depreciation and amortization is included in cost of sales).

Freight, warehousing and handling costs vary based on sales volume, the geographical mix of the product shipped, and the cost of fuel used by freight carriers.

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

KPLP's selling, general and administrative expenses include marketing and selling, general and administrative costs, which include a very small portion of the overall depreciation and amortization.

Selling costs include the costs related to sales and marketing activities, including advertising and promotion and market research, as well as selling expenses, commissions and other related costs. General and administrative expenses consist of costs related to operations, finance, information technology, product development, legal, human resources, executive administration and other corporate expenses. It also includes the foreign exchange gains and losses realized during the period.

### ***Interest Expense***

Interest expense is derived from the financing activities of KPLP. KPLP is a borrower under certain credit facilities (each of which are described under "Liquidity and Capital Resources", below). Interest costs related to the TAD Credit Facility (as defined below) recorded during the construction period (i.e. before start of operations) were capitalized, and allocated to property, plant and equipment and are being depreciated along with the assets. Depreciation of the capitalized interest commenced in Q1 2013 with the completion of the construction period. Refer to note 14, "Long-term debt" in the consolidated financial statements for Fiscal 2014 for additional information. KPLP also records amortization related to deferred financing fees and interest costs related to pensions and post-retirement benefits in interest expense.

### ***Other Income (Expense)***

Other income (expense) includes foreign exchange gains and losses, the change in the amortized costs of the Partnership unit liability, and other items deemed to be non-operational in nature.



## ***Income Taxes***

KPLP is not a tax paying entity. The income (loss) from KPLP flowed to the partners, Kruger Inc., KPGP and KPT for Fiscal 2014 and Fiscal 2013. The income taxes recorded in the consolidated financial statements of KPLP relate to the income taxes for its incorporated subsidiaries in the U.S., Canada, Luxembourg and Mexico.

## **BUSINESS HIGHLIGHTS**

### **TAD Project**

In the autumn of 2011, KPLP, through KTG, commenced the construction of the TAD Project. The TAD Project was originally expected to cost up to U.S.\$322 million (including reserves for contingencies, interest during construction, working capital and start-up costs). On February 22, 2013, KPT announced that KPLP had successfully finished the construction phase of the TAD Project, on time and on budget. As of December 31, 2014, a total of U.S.\$311.7 million had been spent on the TAD Project, financed by a U.S.\$186.7 million investment by KPLP into KTG and a drawdown of U.S.\$125.0 million on the TAD Credit Facility (as defined below). KPLP invested into KTG, primarily to finance the TAD Project, U.S.\$70.0 million of the proceeds from the subscription by KPT for units of KPLP in the context of KPT's initial public offering in December 2012.

### **Eastern Warehousing Initiative**

In November 2013, following a review of its distribution operations KPLP undertook an initiative to consolidate distribution activities from its Gatineau warehouse to its distribution operations in Laval (Eastern Warehousing Initiative). KPLP has completed this initiative and incurred restructuring costs of \$2.2 million. This initiative will reduce costs by \$1.6 million annually and will be fully realized by Q2 2015.

### **Corporate Restructuring Initiative**

During Q1 2014, KPLP undertook a review of its corporate overhead costs and identified a number of cost reduction opportunities (Corporate Restructuring Initiative). KPLP expects to incur restructuring costs of approximately \$2.0 million, primarily related to severance, and reduce costs by approximately \$2.4 million annually as a result of this initiative. As of December 31, 2014, KPLP has incurred \$1.2 million of the costs associated with this initiative and recorded a provision for the remaining \$0.8 million.

Together with the Eastern Warehousing initiative discussed above, KPLP expects annualized savings of \$4.0 million.

### **Acquisition of Metro Paper**

On June 3, 2014, KPLP 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. Metro Paper's revenues in 2013 were approximately \$65 million, split almost equally between the US and Canada, of which approximately \$15 million was sold to KPLP. This acquisition is 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.

## RESULTS OF OPERATIONS

### Results of Operations of KPLP

(C\$ millions, unless otherwise noted)	\$ Change				
	Fiscal 2014	Fiscal 2013	Fiscal 2012	Fiscal 2014 vs. Fiscal 2013	Fiscal 2013 vs. Fiscal 2012
Statement of Operations Data:					
Revenue	1,046.2	955.3	922.9	90.9	32.4
Cost of sales	(879.2)	(786.8)	(749.5)	(92.4)	(37.3)
Selling, general and administrative expenses	(82.6)	(86.7)	(90.8)	4.1	4.1
Recovery (impairment) of non-financial assets	-	1.8	(4.6)	(1.8)	6.4
Restructuring costs	(2.8)	(1.4)	(9.4)	(1.4)	8.0
Operating income	81.6	82.2	68.6	(0.6)	13.6
Interest expense	(44.7)	(42.2)	(27.8)	(2.5)	(14.4)
Other income (expense)	(17.6)	(2.0)	(0.8)	(15.6)	(1.2)
Income before income taxes	19.3	38.0	40.0	(18.7)	(2.0)
Income taxes:					
Combined income tax rate after manufacturing and processing credits	(6.9)	(9.9)	(10.4)	3.0	0.5
Income tax in partners' hands	8.2	15.1	10.3	(6.9)	4.8
Other	0.5	5.7	1.5	(5.2)	4.2
Income taxes	1.8	10.9	1.4	(9.1)	9.5
Net income	21.1	48.9	41.4	(27.8)	7.5

(C\$ millions, unless otherwise noted)	Fiscal 2014	Fiscal 2013	Fiscal 2012	\$ Change	
				Fiscal 2014 vs. Fiscal 2013	Fiscal 2013 vs. Fiscal 2012
<b>Reconciliation of EBITDA</b>					
<b>to Net income:</b>					
<b>Net income</b>	21.1	48.9	41.4	(27.8)	7.5
Income taxes	(1.8)	(10.9)	(1.4)	9.1	(9.5)
Interest expense	44.7	42.2	27.8	2.5	14.4
Loss (gain) on disposal of property, plant and equipment	(0.1)	-	1.0	(0.1)	(1.0)
Depreciation and amortization	37.6	34.1	28.9	3.5	5.2
Unrealized foreign exchange (gain) loss	3.5	3.0	(0.8)	0.5	3.8
Change in amortized cost of Partnership units liability	13.8	(0.7)	-	14.5	(0.7)
Impairment (recovery) of non-financial assets	-	(1.8)	4.6	1.8	(6.4)
Restructuring costs	2.8	1.4	9.4	1.4	(8.0)
<b>EBITDA</b>	121.6	116.2	110.9	5.4	5.3

### *Results of Operations Fiscal 2014 compared to Fiscal 2013*

#### *Revenue*

Revenue was \$1,046.2 million in Fiscal 2014 compared to \$955.3 million in Fiscal 2013, an increase of \$90.9 million or 9.5%. Revenue increased in all segments and across all regions. The increase in revenue was primarily due to additional sales volume in the Consumer segment in the U.S. driven by TAD product sales and the favourable impact of foreign exchange on

U.S. dollar sales. The acquisition of Metro Paper on June 3, 2014 also contributed to a significant increase in AFH segment revenue in Canada and particularly in the U.S.

From a geographic perspective, revenue in the U.S. increased \$77.5 million, or 32.4%. Revenue in Canada increased \$11.8 million, or 1.7%. KTG revenue (sold primarily in the U.S. and including intercompany sales) was \$240.5 million in Fiscal 2014 compared to \$199.3 million in Fiscal 2013.

#### *Cost of Sales*

Cost of sales was \$879.2 million in Fiscal 2014 compared to \$786.8 million in Fiscal 2013, an increase of \$92.4 million or 11.7%. As a percentage of revenue, cost of sales was 84.0% in Fiscal 2014 compared to 82.4% in Fiscal 2013. Cost of sales was impacted in Fiscal 2014 as commodity prices, particularly fibre costs, continued to trend upward during the year. Pulp market prices (NBSK) were U.S.\$1,025 per metric tonne on average in Fiscal 2014 compared to U.S.\$941 per metric tonne on average in Fiscal 2013. Cost of sales was also negatively impacted by foreign exchange fluctuations, higher natural gas prices, and increased depreciation expense as a result of the TAD Project. Finally, freight expense increased as a result of higher sales volumes associated primarily with new TAD business in the U.S. and warehousing expense increased as a result of higher inventory levels during 2014.

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

SG&A expenses were \$82.6 million in Fiscal 2014 compared to \$86.7 million in Fiscal 2013, a decrease of \$4.1 million or 4.7%. As a percentage of revenue, SG&A expenses were 7.9% in Fiscal 2014 compared to 9.1% in Fiscal 2013. The decrease was primarily related to a reduction in departmental spending related to cost initiatives announced earlier in 2014 and lower advertising and promotion expenses.

#### *EBITDA*

EBITDA was \$121.6 million in Fiscal 2014 compared to \$116.2 million in Fiscal 2013, an increase of \$5.4 million. The increase was due to lower SG&A expenses, and higher sales that were partially offset by higher cost of sales. KTG had EBITDA of \$28.8 million in Fiscal 2014 compared to \$9.3 million in Fiscal 2013, which included TAD Project start-up costs of \$4.2 million.

#### *Restructuring Costs and Recovery of Non-Financial Assets*

Restructuring costs of \$2.8 million in Fiscal 2014 related to the Eastern Warehousing Initiative and Corporate Restructuring Initiative of \$0.8 million and \$2.0 million, respectively. Refer to the Business Highlights section for additional details.

A recovery of \$1.8 million was recognized in Fiscal 2013 related to the reversal of a previously recorded provision against certain lands.

#### *Interest Expense*

Interest expense was \$44.7 million in Fiscal 2014 compared to \$42.2 million in Fiscal 2013, an increase of \$2.5 million. The increase was primarily due to interest expense related to the TAD Project recorded in Fiscal 2014, which was capitalized for a portion of Fiscal 2013, unfavourable foreign exchange fluctuations and the revaluation of the embedded derivative related to the Senior Unsecured Notes, partially offset by lower pension interest in Fiscal 2014 compared to Fiscal 2013.

#### *Other Expense*

Other expense was \$17.6 million in Fiscal 2014 compared to expense of \$2.0 million in Fiscal 2013, an increase of \$15.6 million. Other expense in Fiscal 2014 was primarily due to a change in the amortized cost of the Partnership unit liability of \$13.8 million and an unrealized foreign exchange loss of \$3.5 million. Other expense in Fiscal 2013 was primarily due to an unrealized foreign exchange loss of \$3.0 million, partially offset by a change in the amortized cost of the Partnership unit liability of \$0.7 million.



### *Income Taxes*

An income tax recovery of \$1.8 million was recorded in Fiscal 2014 compared to an income tax recovery of \$10.9 million in Fiscal 2013, a change of \$9.1 million relating primarily to KTG in the U.S. As previously discussed, KPLP is not directly taxable on its Canadian business. The income tax recoveries recorded in both Fiscal 2014 and Fiscal 2013 related primarily to additional tax deductions and state tax credits in respect of the TAD Project. Income tax in partner's hands was \$8.2 million in Fiscal 2014 compared to \$15.1 million in Fiscal 2013.

### *Net Income*

Net income was \$21.1 million in Fiscal 2014 compared to \$48.9 million in Fiscal 2013, a decrease of \$27.8 million. The decrease was primarily due to non-operational charges related to restructuring and impairment totaling \$3.3 million and the change in the amortized cost of the Partnership unit liability of \$13.8 million, a decrease in the deferred tax recovery of \$9.1 million, and increases in interest expense of \$2.5 million and depreciation expense of \$3.6 million partially offset by the increase in EBITDA of \$5.6 million. KTG had a net loss of \$6.2 million in Fiscal 2014 compared to a net loss of \$11.2 million in Fiscal 2013.

### **Results of Operations of KPT**

(C\$ millions, unless otherwise noted)	Fiscal	Fiscal
	2014	2013
Equity income (loss)	(2.4)	1.1
Net loss for the year	(2.5)	(0.3)
<b>Basic loss per share (whole dollars)</b>	<b>(0.29)</b>	<b>(0.03)</b>

The selected financial information presented above is based on KPT's interest in KPLP for Fiscal 2014 and Fiscal 2013. The equity income (loss) includes KPT's share of profit of KPLP of \$3.5 million for Fiscal 2014 and \$8.2 million for Fiscal 2013, reduced by depreciation expense of \$5.9 million and \$7.1 million, respectively, related to adjustments to the carrying amount of the assets and liabilities of KPLP on its acquisition by KPT. Refer to note 5 in KPT's financial statements for additional information.

The current income tax expense of \$1.1 million for Fiscal 2014 and \$0.6 million for Fiscal 2013 was based on KPT's share of the taxable income (loss) of KPLP for the same periods. The deferred tax recovery of \$0.9 million for Fiscal 2014 and the deferred tax expense of \$1.4 million for Fiscal 2013 was a result of changes in the temporary differences of KPLP's assets and liabilities since acquisition and the difference between the accounting and tax basis for KPT's investment in KPLP. Refer to note 6 in KPT's financial statements for additional information. Pursuant to the Tax Distribution as defined in the Partnership Agreement, KPLP paid a Tax Distribution of \$3.5 million in Fiscal 2014, of which \$0.6 million was used to pay the tax instalment on behalf of KPT and \$2.9 million was paid to Kruger Inc. and KPGP. KPT received an advance from KPLP of \$0.6 million in Fiscal 2014 to pay the monthly tax instalments. The advance is non-interest bearing and non-recourse and is settled when the Tax Distribution is declared annually. On February 27, 2015, the Partnership declared the Tax Distribution and paid \$6.9 million, of which \$1.2 million was used to pay the final tax instalment on behalf of KPT and settle the advance and \$5.7 million was paid to Kruger Inc. and KPGP.

Otherwise, the discussion and analysis provided above for the results of operations of KPLP applies on a proportionate basis to KPT's results of operations.

### **SEGMENT INFORMATION**

#### **Segment Operating Profit**

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 the Partnership unit liability (Segment EBITDA). "AFH Segment EBITDA", "Consumer

Segment EBITDA” and “Other Segment EBITDA” means in each case the segment operating profit for the referring reportable segment of KPLP.

## Segment Results

	Fiscal 2014	Fiscal 2013	Fiscal 2012	Fiscal 2014 vs. Fiscal 2013		Fiscal 2013 vs. Fiscal 2012	
				\$ Change	% Change	\$ Change	% Change
<b>Segment Revenue</b>							
Consumer	842.6	792.7	745.6	49.9	6.3%	47.1	6.3%
AFH	184.3	154.3	156.6	30.0	19.4%	(2.3)	-1.5%
Other	19.3	8.3	20.7	11.0	132.5%	(12.4)	-59.9%
Total segment revenue	1,046.2	955.3	922.9	90.9	9.5%	32.4	3.5%
<b>Segment EBITDA</b>							
Consumer	123.6	110.3	113.7	13.3		(3.4)	
AFH	1.7	6.6	3.0	(4.9)		3.6	
Other	(3.7)	(0.7)	(5.8)	(3.0)		5.1	
Total segment EBITDA	121.6	116.2	110.9	5.4		5.3	

### Consumer Segment

#### *Fiscal 2014 compared to Fiscal 2013*

Consumer segment revenue was \$842.6 million in Fiscal 2014 compared to \$792.7 million in Fiscal 2013, an increase of \$49.9 million or 6.3%. The increase resulted from higher sales volumes in the U.S. due to TAD product sales and the favourable impact of foreign exchange related to U.S. dollar sales.

Consumer Segment EBITDA was \$123.6 million in Fiscal 2014 compared to \$110.3 million in Fiscal 2013, an increase of \$13.3 million. The increase in Consumer segment EBITDA was primarily due to the increase in revenue and lower SG&A spending, partially offset by higher commodity costs, particularly fibre and natural gas, and increased warehousing costs.

### AFH Segment

#### *Fiscal 2014 compared to Fiscal 2013*

AFH segment revenue was \$184.3 million in Fiscal 2014 compared to \$154.3 million in Fiscal 2013, an increase of \$30.0 million or 19.4%, driven by approximately 7 months of sales related to the Metro Paper acquisition during Fiscal 2014. AFH segment revenue increased in the U.S. and Canada.

AFH Segment EBITDA was \$1.7 million in Fiscal 2014 compared to \$6.6 million in Fiscal 2013, a decrease of \$4.9 million. The decrease in AFH Segment EBITDA was primarily due to increases in cost of sales primarily due to fibre and energy costs.

### Other Segment

#### *Fiscal 2014 compared to Fiscal 2013*

Other segment revenue was \$19.3 million in Fiscal 2014 compared to \$8.3 million in Fiscal 2013, an increase of \$11.0 million primarily due to the sale of parent rolls.

Other Segment EBITDA was a loss of \$3.7 million in Fiscal 2014 compared to a loss of \$0.7 million in Fiscal 2013, an increase of \$3.0 million. The increase was due to losses on parent roll sales as a result of increased commodity costs.

## LIQUIDITY AND CAPITAL RESOURCES

### Overview

KPLP's principal uses of funds are for operating costs, working capital, capital expenditures and pension contributions (together, the Funding Requirements). To date, KPLP has met the Funding Requirements by using cash generated from operating activities and from 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, together with amounts available under the various debt facilities will be sufficient to meet its future funding requirements. However, KPLP's ability to fund future requirements and its ability to make scheduled payments of interest 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.

As of December 31, 2014, KPLP was in compliance with all of its financial covenants under all of its outstanding credit facilities. As of December 31, 2014, no amount was drawn from the \$125 million committed amount under the Senior Credit Facility. KPLP had \$29.6 million of letters of credit outstanding, resulting in \$95.4 million available.

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.

### Cash Flows

(C\$ millions unless otherwise stated)	Fiscal 2014	Fiscal 2013	Fiscal 2012	\$ Change	
				Fiscal 2014 vs. Fiscal 2013	Fiscal 2013 vs. Fiscal 2012
Net cash flows from operating activities	92.9	55.5	123.2	37.4	(67.7)
Net cash flows used in investing activities	(65.3)	(59.9)	(184.8)	(5.4)	124.9
Net cash flows from (used in) financing activities	(65.0)	(30.4)	151.5	(34.6)	(181.9)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	1.5	1.0	(0.2)	0.5	1.2
Increase (decrease) in cash and cash equivalents	(35.9)	(33.8)	89.7	(2.1)	(123.5)
Beginning cash and cash equivalents	87.7	121.5	31.8	(33.8)	89.7
Ending cash and cash equivalents	51.8	87.7	121.5	(35.9)	(33.8)

#### *Net Cash Flows from Operating Activities*

Net cash from operating activities was \$92.9 million in Fiscal 2014 compared to \$55.5 million in Fiscal 2013. Cash from operating activities in Fiscal 2014 was primarily driven by EBITDA of \$121.6 million, partially offset by higher funds required by working capital components and funding of pension and post retirement plans higher than the related expense.

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

Net cash used in investing activities was \$65.3 million in Fiscal 2014 compared to \$59.9 million in Fiscal 2013. Metro Paper was acquired for cash consideration of \$23.4 million in Fiscal 2014. TAD Project capital expenditures declined to \$7.7 million in Fiscal 2014 compared to \$39.6 million in Fiscal 2013 as a result of the end of the spending phase of the TAD Project. Other capital expenditures, primarily across the plant sites, were \$33.3 million in Fiscal 2014 compared to \$20.3 million in Fiscal 2013.



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

Financing activities in Fiscal 2014 resulted in a use of cash of \$65.0 million compared to a use of cash of \$30.4 million in Fiscal 2013. Net cash used in financing activities in Fiscal 2014 was primarily due to interest paid of \$28.4 million, distributions paid of \$29.1 million, and the repayment of credit facilities of \$8.6 million.

### **Contractual Obligations**

KPLP's contractual obligations consist of long-term debt (principal repayments and interest payments), operating leases for the rental of property, equipment and automobiles, partnership units liability and other long-term liabilities.

<b>(C\$ millions unless otherwise stated)</b>	<b>Fiscal 2015</b>	<b>Fiscal 2016</b>	<b>Fiscal 2017</b>	<b>Fiscal 2018</b>	<b>Thereafter</b>
<b>Contractual obligations:</b>					
Revolving credit facility, principal repayments	-	-	-	-	-
Senior unsecured notes, principal repayments	-	-	-	175.0	-
Nordea facilities, principal repayments	7.7	7.7	7.7	7.7	7.7
TAD Credit Facility, principal repayments	0.1	19.8	-	145.0	-
Loan payable, principal repayments	1.2	1.1	-	-	-
Interest expense	26.2	24.8	24.5	15.1	0.2
Operating leases	14.8	13.3	12.1	11.5	63.2
Service contracts	1.6	0.4	0.1	0.1	0.1
<b>Total contractual obligations</b>	<b>51.6</b>	<b>67.1</b>	<b>44.4</b>	<b>354.4</b>	<b>71.2</b>

KPLP's cash pension contribution for defined benefit pension arrangements in Fiscal 2014 was \$19.9 million, while its post-retirement benefits contribution was \$2.5 million. In addition, as of December 31, 2014, KPLP had \$29.6 million of letters of credit related to pensions outstanding. Pension and post-retirement contributions for fiscal 2015 are expected to be \$16.4 million.

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. As of December 31, 2014, \$128.1 million was recorded as a liability in respect of this obligation (December 31, 2013 - \$117.8 million). The amount is in respect of a previously disclosed obligation owed to the partners of KPLP. It does not change the rights of or obligations owed to the partners of KPLP, and does not result in any change to the financial statements of KPT.

Pursuant to the Exchange Agreement, KPT has granted Kruger Inc. the right to exchange KPLP Units it holds from time to time for common shares of KPT (Common Shares) issued by KPT on the basis of one KPLP Unit for one Common Share, subject to adjustment upon the occurrence of certain events that would result in the indirect economic interest in KPLP represented by a Common Share diverging from the direct economic interest in KPLP represented by a KPLP Unit, including splits or consolidations of the common shares without a corresponding split or consolidation of the KPLP Units, issuances or repurchases of Common Shares without corresponding issuances or repurchases of KPLP Units, acquisition of assets by KPT other than KPLP Units or incurrence of liabilities other than ordinary course liabilities, or special distributions by KPT, certain other securities, debt or assets to all shareholders. If at any time the Kruger Inc. aggregate ownership interest is less than 20% in KPLP, KPT may require the exchange of all outstanding KPLP Units held by Kruger Inc. or its affiliates in return for Common Shares on the basis of one KPLP Unit for one Common Share subject to adjustment as set forth above.

Pursuant to the Administration Agreement, KPLP, as administrator (the Administrator) has full power and authority to administer, subject to the general supervision and any specific instructions of the KPT Board, all of the ongoing operations and affairs of KPT in order for KPT to carry on its activities as a public company. The Administrator shall directly bear and pay for all KPT's normal operating expenses incurred in connection with the ordinary course operation of a company that is a

reporting issuer. The Administrator may also advance funds to KPT in an amount equal to pay for any expenses of KPT that are outside of such ordinary course expenses, by way of non-recourse, interest-free loans, repayable upon payment by the Administrator of distributions to KPT. As KPT's agent, the Administrator will also bear and pay all outlays and expenses to third parties incurred by the Administrator in the administration of the affairs of KPT and the performance by the Administrator of its duties under the Administration Agreement.

## **Indebtedness**

### ***Senior Credit Agreement***

#### *General*

KPLP is a party to a fourth amended and restated credit agreement dated as of May 16, 2013 entered into between KPLP as borrower, the lenders party thereto and National Bank of Canada, as administrative agent (the Senior Credit Agreement) pursuant to which a senior secured revolving credit facility in a maximum amount of \$125 million with a \$120 million accordion feature (the Senior Credit Facility) is made available to KPLP. The maturity date of the Senior Credit Facility is July 22, 2016. The Senior Credit Facility is to be used by KPLP to finance general corporate purposes and the ongoing working capital requirements of the Restricted Credit Parties (as defined below) and to finance the cash portion of any permitted acquisition or investment by any such Restricted Credit Party (as defined below).

Under the Senior Credit Agreement, "Restricted Credit Parties" means KPLP, KPGP, Kruger Inc., 8031754 Canada Inc. and their respective subsidiaries involved in the tissue business but excluding the Unrestricted Credit Parties (which include TAD Canco Inc. ("TAD Canco"), TAD Luxembourg S.a.r.l. ("TAD Luxembourg") and KTG) and the Non-Material Credit Parties (as such terms are defined in the Senior Credit Agreement).

#### *Interest Rates and Fees*

Borrowings under the Senior Credit Facility bear interest at a base rate of Prime Rate, U.S. Base Rate, LIBOR, Bankers' Acceptance Stamping Fees or LC Fees (as defined in the Senior Credit Agreement), plus a margin varying between 0.20% and 2.50% depending on the Restricted Credit Parties' ratio of funded debt to EBITDA (as defined in the Senior Credit Agreement) and the type of advance. Stand-By Fees are also payable on the available portion of the Senior Credit Facility at a rate varying between 0.24% and 0.50% depending on the Restricted Credit Parties' ratio of funded debt to EBITDA (as defined in the Senior Credit Agreement).

#### *Prepayments and Repayments*

KPLP may voluntarily cancel or reduce the Senior Credit Facility, in whole or in part, subject to minimum amounts and notice periods, with customary restrictions on prepayment of Banker's Acceptances, Libor Loans and liabilities under Letters of Credit (in each case, as defined in the Senior Credit Agreement).

#### *Covenants*

The Senior Credit Agreement contains customary affirmative covenants, including, but not limited to, delivery of financial and other information to the administrative agent, delivery of notice to the administrative agent upon the occurrence of certain material events, preservation of existence and authorizations, maintenance of insurance, compliance with laws, payment of taxes and other claims, limitation of transactions with affiliates and maintenance of security.

The Senior Credit Agreement requires the Restricted Credit Parties to comply with certain financial covenants, including, but not limited to, the maintenance of (i) a ratio of funded debt to EBITDA not greater than 3.50 to 1.00, (ii) a ratio of funded debt to capitalization not greater than 60%, and (iii) a minimum interest coverage ratio of 3.00 to 1.00. 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, indebtedness under the TAD Credit Facility and KTG's EBITDA are not included in such calculations.

The Senior Credit Agreement contains customary negative covenants of KPLP, including, but not limited to, (i) restrictions on the ability of KPLP and the Restricted Credit Parties to, subject to certain exceptions, grant liens, incur

indebtedness, merge or consolidate, amend, restate or otherwise modify the Limited Partnership Agreement, make investments and loans, grant guarantees, make acquisitions, declare, set apart and pay distributions (which does not apply to the Tax Distribution (as defined below) to KPT), reduce capital, sell or otherwise dispose of assets, incur capital expenditures or materially change their business, (ii) restrictions on the indebtedness of TAD Canco, TAD Luxembourg and KTG and the amendment of the TAD financing documents, and (iii) restrictions on the repayment of the Senior Unsecured Notes (except for repayments made within three months of the Offering Closing Date and funded exclusively from the net proceeds of the Offering).

### *Events of Default*

The Senior Credit Agreement contains customary events of default, including, but not limited to, non-payment, misrepresentation, breach of covenants, cross-default and cross-acceleration to other debt above a certain threshold, cross defaults to the Nordea Credit Facility (as defined below), the TAD Credit Facility (as defined below) and the Senior Unsecured Notes (as defined below), insolvency, change of control of KPLP or Kruger and enforcement proceedings.

### *Security and Guarantees*

The Senior Credit Facility is guaranteed by each Restricted Credit Party. KPLP and each Restricted Credit Party granted first ranking security interests and hypothecs over their current and future tangible and intangible assets (subject to permitted liens) to secure the obligations under the Senior Credit Facility, including a pledge of all capital stock or ownership interest in all subsidiaries owned by KPLP and the Restricted Credit Parties. The guarantees and security are granted on a pari passu basis in favour of the lenders and the administrative agent under the Senior Credit Agreement and the lenders and the administrative agent under the Nordea Credit Agreement (as defined below).

### *Indenture*

#### *General*

On August 9, 2011, KPLP issued \$175 million of 8.0% senior unsecured notes due August 9, 2018 (the Senior Unsecured Notes) by way of private placement in Canada in accordance with applicable Canadian prospectus and registration exemptions. The Senior Unsecured Notes were issued pursuant to the Indenture. Interest on the Senior Unsecured Notes accrues at 8.0% per year and is payable semi-annually on February 9 and August 9 of each year.

Under the Senior Unsecured Notes, “Restricted Subsidiaries” means any subsidiary of KPLP that is not an Unrestricted Subsidiary (as defined in the Indenture and which include TAD Canco, TAD Luxembourg, KTG and non material subsidiaries).

#### *Guarantees*

The Senior Unsecured Notes are unconditionally guaranteed, jointly and severally, by the Restricted Credit Parties.

#### *Redemption*

KPLP may redeem all or part of the Senior Unsecured Notes at any time prior to August 9, 2015 at a make-whole price which is equal to the greater of (i) the Canada Yield Price (as defined in the Indenture), and (ii) 101% of the aggregate principal amount of Senior Unsecured Notes redeemed, plus accrued and unpaid interest to the redemption date. On or after August 9, 2015, KPLP may redeem all or part of the Senior Unsecured Notes at the following redemption prices, plus accrued and unpaid interest if redeemed during the 12-month period commencing August 9 of the year set forth below:

<u>Year</u>	<u>Percentage</u>
2015	104%
2016	102%
2017 and thereafter	100%

### *Change of Control*

Upon the occurrence of a Change of Control of KPLP (as defined in the Indenture), KPLP will be required to offer to repurchase all or any part of each holders Senior Unsecured Notes for a payment in cash equal to 101% of the aggregate principal amount of Senior Unsecured Notes repurchased, plus accrued and unpaid interest thereon to the purchase date.

### *Covenants*

The Indenture contains negative covenants of KPLP and the Restricted Subsidiaries, including, but not limited to, (i) limitations on making certain restricted payments (as described further below), (ii) restrictions on incurring certain indebtedness (as described further below), (iii) limitations on creating any contractual restrictions on the ability of Restricted Subsidiaries of KPLP to take certain actions, such as the payment of dividends or making of distributions, (iv) restrictions on KPLP and its Restricted Subsidiaries on incurring liens, (v) restrictions on transactions with affiliates, (vi) limitations on engaging in any line of business other than the businesses in which KPLP and the Restricted Subsidiaries were engaged on the date of issuance of the Senior Unsecured Notes, and any business reasonably related, incidental, complementary or ancillary thereto, (vii) restrictions on consolidating, amalgamating or merging into any other person, and (viii) restrictions on selling, transferring, assigning, leasing, conveying or otherwise disposing of all or substantially all of the property of KPLP and the Restricted Subsidiaries taken as a whole.

Pursuant to the Indenture, KPLP covenants not to make certain Restricted Payments (as defined below) unless at the time of, and after giving effect to, such Restricted Payment: (a) no default or event of default under the Indenture has occurred or would occur as a result thereof; (b) KPLP could incur at least \$1 of additional indebtedness pursuant to the restrictions on incurring indebtedness set out in the Indenture (as described further below); and (c) such Restricted Payment, together with all Restricted Payments made by KPLP and its Restricted Subsidiaries from the date of issuance of the Senior Unsecured Notes, is less than an amount (the “Restricted Payments Basket”) equal to the sum of (A) 50% of Consolidated Net Income of KPLP (as defined in the Indenture) from May 1, 2011 to the end of KPLP’s most recently completed fiscal quarter (or, if Consolidated Net Income is a deficit, minus 100% of the deficit); plus (B) 100% of the aggregate net cash proceeds received by KPLP since the date of issuance of the Senior Unsecured Notes as a contribution to its common equity capital, or from the issue or sale of equity interests of KPLP; plus (C) any proceeds from the sale of investments made after the issue date of the Senior Unsecured Notes, plus (D) the fair market value of any investments in unrestricted subsidiaries that are redesignated as Restricted Subsidiaries, plus (E) any dividends or distributions received from an unrestricted subsidiary after the date of issue of the Senior Unsecured Notes to the extent not already included in Consolidated Net Income of KPLP.

As defined under the Indenture, “Restricted Payments” include, among other things, (i) the declaration or payment of dividends by KPLP or any Restricted Subsidiary, other than a dividend or distribution paid in partnership interests or share capital, and (ii) any payment of principal on any subordinated indebtedness prior to the stated maturity of such indebtedness. The Restricted Payments covenant is subject to a number of exclusions as set out in the Indenture, including (i) Restricted Payments made after the issue date of the Senior Unsecured Notes in an aggregate principal amount not to exceed \$20 million, and (ii) the payment or declaration of distributions by KPLP to a parent entity of KPLP. Distributions made to KPT are Restricted Payments under the Indenture.

As of December 31, 2014, the amount of the Restricted Payments Basket was approximately \$104.4 million, and, factoring that no Restricted Payments have been made in reliance on the \$20.0 million exclusion from the definition of Restricted Payments referred to above, there was a total basket of approximately \$124.4 million available under the Indenture as of December 31, 2014 for the making of Restricted Payments.

Pursuant to the Indenture, KPLP and its Restricted Subsidiaries may not incur any indebtedness (excluding trade debt and accounts payable incurred in the ordinary course of business and due within 12 months) unless immediately thereafter and giving effect thereto (a) the Consolidated Coverage Ratio, being the ratio of Adjusted EBITDA to Consolidated Interest Expense (as such terms are defined and subject to certain adjustments set out in the Indenture), would be at least 2:0 to 1:0; and (b) no default or event of default has occurred and its continuing under the Indenture. The restrictions on incurring indebtedness are subject to a number of exclusions set out in the Indenture.

### *Events of Default*

The Indenture contains customary events of default, including without limitation, non-payment, insolvency, cross default to other debt above a certain threshold and breach of covenants.

### ***Nordea Credit Agreement***

#### *General*

KPLP is a party to an amended and restated credit agreement dated as of May 16, 2013 entered into between KPLP, as borrower, the lender party thereto and Nordea Bank A.B. (publ), as administrative agent, as amended by a first amending agreement dated as of February 28, 2013 (the Nordea Credit Agreement) pursuant to which a senior secured non-revolving loan facility in a maximum amount of U.S.\$46.2 million (the “Nordea Credit Facility”) is made available to KPLP. The Nordea Credit Facility is to be used to pay up to 85% of the equity investment of KPLP in the TAD Project and the fees of EKN in connection with its guarantee of the Nordea Credit Facility. The Nordea Credit Facility matures on December 30, 2019.

#### *Interest Rates and Fees*

Borrowings under the Nordea Credit Facility bear interest at a fixed interest rate of approximately 3% per annum, comprised of a Swedish state reported interest rate, risk premium and administrative margin.

#### *Prepayments and Repayments*

The Nordea Credit Facility is repayable in 14 equal consecutive semi-annual installments of principal together with interest commencing on June 30, 2013. Prepayments are allowed subject to a make-whole payment on account of interest losses.

#### *Covenants*

The covenants, financial covenants and negative covenants provided by KPLP under the Senior Credit Agreement are incorporated and made part of the Nordea Credit Agreement. See “Senior Credit Agreement — Covenants” above. The Nordea Credit Agreement contains restrictions on amendments to the Senior Credit Agreement and related security and other documents.

### *Events of Default*

The Nordea Credit Agreement contains customary events of default such as non-payment, misrepresentation and breach of covenants and also provides for a cross-default to the Senior Credit Agreement and a default related to the termination or loss of the EKN guarantee.

#### *Security and Guarantees*

The Nordea Credit Agreement provides for pari passu security and guarantees on the assets and undertaking of KPLP and each Restricted Credit Party, the relationship between the lender and administrative agent under the Nordea Credit Agreement and the administrative agent and the lenders under the Senior Credit Agreement being governed by a collateral agency and security sharing agreement.

### ***TAD Credit Agreement***

#### *General*

TAD Canco is a party to a credit agreement dated as of August 16, 2011 entered into between TAD Canco, as borrower, TAD Luxembourg and KTG, as guarantors, and Caisse de dépôt et placement du Quebec (Caisse), as lender (as amended as of September 21, 2012, the TAD Credit Agreement) pursuant to which a non revolving term loan facility for a maximum amount of U.S.\$211.1 million is made available to TAD Canco (the TAD Credit Facility). Under the terms of the Caisse



Facility, the Partnership could only make draws until February 15, 2014. As of that date, the Partnership had drawn U.S.\$125.0 million. The TAD Credit Facility is to be used by TAD Canco to invest in TAD Luxembourg, which in turn lends such proceeds to KTG on substantially the same terms and conditions as the TAD Credit Facility to finance the TAD Project. Recourse under the TAD Credit Facility is limited to TAD Canco, TAD Luxembourg and KTG. The TAD Credit Facility matures on August 16, 2018.

#### *Interest Rates and Fees*

Borrowings under the TAD Credit Facility will bear interest at a base rate of 8% per annum plus an applicable margin determined as follows: of (i) 5% per annum at any time prior to the TAD Project service commencement date and KTG Excess Cash Flow has become positive, and (ii) thereafter, if the net debt to KTG EBITDA ratio is (A) higher or equal to 2.5, the greater of interest calculated at 5% per annum and an amount equal to 30% of KTG Excess Cash Flow (B) lower than 2.5 but not lower than 2.0, the greater of interest calculated at 5% per annum and an amount equal to 25% of KTG Excess Cash Flow or (C) lower than 2.0, the greater of interest calculated at 4% per annum and an amount equal to 15% of KTG Excess Cash Flow. Under the TAD Credit Facility, "Excess Cash Flow" is defined as, with respect to KTG, the EBITDA minus, without duplication, cash income tax, cash interest payments, positive change in working capital (or plus negative change in working capital, as the case may be) and capital expenditures, in each case, for the last completed four fiscal quarters of KTG.

#### *Prepayments and Repayments*

TAD Canco is required to make annual mandatory KTG Excess Cash Flow prepayments starting from the TAD Project service commencement date in an amount equal to a percentage of the KTG Excess Cash Flow determined based on the KTG Net Debt to EBITDA Ratio (as defined in the TAD Credit Agreement). TAD Canco may, once a year, within specific periods and upon notice to Caisse de dépôt, voluntarily prepay up to 10% of the principal balance of the outstanding advances under the TAD Credit Facility, subject to a 2% penalty and provided that, amongst other things, no such optional prepayment may be effected if it would result in the aggregate outstanding principal amount of advances under the TAD Credit Facility falling below \$125 million.

#### *Change of Ownership*

Upon the occurrence of a change of ownership, direct or indirect, of any equity securities of TAD Canco, TAD Luxembourg or KTG, or in the power to exercise any rights with respect to such equity securities, Caisse de dépôt will have the option, exercisable at its sole discretion, to require the repayment by TAD Canco, in whole or in part, of the amounts due under the TAD Credit Facility, together with a penalty of 1% of the principal balance of the repaid loans.

#### *Covenants*

The TAD Credit Agreement contains customary affirmative covenants, including, but not limited to, delivery of financial and other information to Caisse de dépôt, delivery of notice to Caisse de dépôt upon the occurrence of certain material events, preservation of existence and authorizations, maintenance of insurance, compliance with laws, payment of taxes and other claims, performance of material project agreements, limitations on use of project revenues, maintenance of security, and granting of further assurances.

The TAD Credit Agreement contains customary negative covenants, including, but not limited to, restrictions on the ability of TAD Canco, TAD Luxembourg and KTG, subject to certain exceptions, to grant liens, incur indebtedness, engage in businesses other than those specifically permitted, make investments and loans, merge or consolidate, enter into transactions with affiliates, grant guarantees, reduce capital, sell or otherwise dispose of assets, incur capital expenditures, or amend or assign material project agreements. Distributions by TAD Canco are also subject to specific conditions including that distributions must be made from KTG Excess Cash Flow.

#### *Events of Default*

Events of default under the TAD Credit Agreement include, but are not limited to, non-payment, misrepresentation, breach of covenants, termination or default under a material project agreements, cross-default to KPLP, TAD Canco, TAD Luxembourg or KTG other indebtedness above certain thresholds, insolvency, enforcement proceedings, and abandonment of the TAD Project.

### *Security and Guarantees*

The TAD Credit Facility is guaranteed by TAD Luxembourg and KTG. TAD Canco granted first ranking security on all present and future movable and immovable property of TAD Canco, including its equity securities in TAD Luxembourg. KTG granted first ranking security on all present and future movable and immovable property of KTG, including, the Memphis Plant, the TAD machine and all of KTG's rights under the material agreements to which it is party. TAD Luxembourg granted security on all equity securities held in KTG and all rights under material agreements. Blocked account agreements were also entered into in favour of Caisse de dépôt.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

### **Currency Risk**

Currency risk is the risk that KPLP's earnings may fluctuate due to changes in Canadian to U.S. dollar exchange rates, as the financial results are reported in Canadian dollars. KPLP sells certain of its products in U.S. dollars at prevailing U.S. dollar prices. A majority of the currency exposure is naturally offset by U.S. dollar expenses and the U.S. dollar denominated debt. As a result, KPLP at different times during the year can be a net buyer or net seller of U.S. dollars.

As of December 31, 2014, KPLP had net liabilities denominated in U.S. dollars of \$42.2 million (December 31, 2013 – \$50.0 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 Fiscal 2014 would have been an increase (decrease) of \$2.1 million (Fiscal 2013 – \$2.5 million). KPLP continuously monitors foreign exchange risk and to manage this foreign exchange risk occasionally enters into foreign currency forward contracts and may continue to do so going forward. KPLP had no foreign currency forward contracts outstanding as of December 31, 2014.

### **Interest Rate Risk**

KPLP's interest rate risk arises from its variable rate debt related to the revolving credit facility. As of December 31, 2014, KPLP had variable rate debts of nil (December 31, 2013 – nil) and accordingly KPLP's exposure to interest rate risk is not significant. This facility bears interest at 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 2.50%.

From time to time, KPLP uses interest rate swaps to manage part of its exposure to movements in interest rates on its credit facilities.

KPLP had no interest rate swaps or interest rate derivatives outstanding as of December 31, 2014.

### **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 December 31, 2014 included cash and cash equivalents, trade and other receivables, receivables from related parties and advances to partners. KPLP places its cash and cash equivalents with financial institutions of high creditworthiness.

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

### **Liquidity Risk**

The purpose of liquidity risk management is to maintain sufficient cash and cash equivalents and to ensure KPLP has sufficient authorized credit facilities as financing sources. KPLP has a credit facility of \$125 million maturing in July 2016.

As of December 31, 2014, KPLP had credit available of \$95.4 million (December 31, 2013 – \$92.6 million). KPLP prepares projections to ensure it has sufficient funds to fulfill its obligations. Refinancing risks are minimized by ensuring the credit facility will not mature for two years. The ability to pay its obligations relies on KPLP collecting its trade receivables in a timely manner and by maintaining sufficient cash and cash equivalents in excess of anticipated needs. KPLP's trade and other payables of \$173.2 million as of December 31, 2014 (December 31, 2013 – \$188.5 million) are all due for payment within twelve months of the dates of the consolidated statements of financial position.

KPLP believes its cash flows generated from operations combined with its available cash and credit facilities provide sufficient funding to meet its obligations.

### **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. KPLP's main raw material is fibre, which changes price due to market conditions. Historically, the industry has generally been able to mitigate its exposure to commodity price risk by passing increases in its supply costs onto its customers through incremental price increases, depending on the supply and demand balance. From time to time, KPLP enters into futures contracts to manage its commodity risk. No such contracts were outstanding as of December 31, 2014.

## **TRANSACTIONS WITH RELATED PARTIES**

Kruger provides certain management and support services to KPLP, including corporate management and administrative support; accounting and tax support; corporate financing support; corporate treasury support; benefits and human resources support; corporate legal and secretarial, corporate insurance; corporate procurement support; and corporate engineering support. Such services are provided pursuant to a Management Services Agreement. KPLP pays Kruger an annual management fee of \$4.0 million.

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 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 during Fiscal 2014 were \$1.7 million (Fiscal 2013 – \$4.8 million). Sales of goods to subsidiaries of Kruger during Fiscal 2014 were \$0.2 million (Fiscal 2013 – \$0.6 million).

Purchases of goods and services from Kruger during Fiscal 2014 were \$27.4 million (Fiscal 2013 - \$28.6 million). Purchases of goods and services from subsidiaries of Kruger during Fiscal 2014 were \$15.9 million (Fiscal 2013 - \$9.5 million). Goods are purchased from Kruger 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 in the consolidated statements of comprehensive income (loss). During Fiscal 2014, management fees of \$4.1 million (Fiscal 2013 - \$4.0 million) were paid to Kruger Inc. for management services provided to KPLP.

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

KPLP has entered into operating lease commitments related to land, buildings, IT services, vehicles and other machines and equipment. Contractual obligations including these operating 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.

### **Environmental and Asset Retirement Obligations**

The environmental and asset retirement obligations are recognized in the period in which they are incurred if a reasonable estimate of fair value can be made. The estimate is added to the carrying amount of the associated asset and amortized over the estimated remaining useful life of the corresponding asset. The liability accretes due to the increase in the fair value resulting from the passage of time and the accretion is charged to operating expenses for the period.

KPLP has made a provision for the estimated fair value of its potential obligation under a land lease to demolish the buildings at one of its plant locations and restore the land at the end of the lease to its original condition (including any environmental remediation). The current lease ends in 2028, but this lease could also be renewed for another term. KPLP assesses its provision for environmental and asset retirement obligations annually or more frequently if events or changes in circumstances would require adjustments to the significant estimates and assumptions. Significant estimates and assumptions are made in determining the provision for asset retirement obligations, as there are numerous factors that will affect the ultimate amount payable. These factors include estimates of the extent and costs of restoration activities, technological changes, regulatory changes, cost increases as compared to the inflation rates and changes in the discount rate. In addition, estimates of environmental remediation costs are based on a number of assumptions that are inherently difficult to determine and no assurance can be given that the actual costs will not differ from the estimates based on environmental test results, changes in laws, regulations or enforcement policies or other factors. These uncertainties may result in future actual expenditures differing from the amounts currently provided. Management retained a third party to assist with the estimate of the environmental remediation obligation. The provision at the reporting date represents KPLP's best estimate of the present value of the environmental and asset retirement obligation. The estimated undiscounted amount to settle this obligation is expected to be between \$10.6 million and \$13.7 million. KPLP used a discount rate of 4.25% to estimate the liability. As of December 31, 2014, a liability of \$5.9 million (December 31, 2013 - \$5.3 million) was recorded in provisions.

### **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 long-term rate of return on plan assets, the expected growth rate of health care costs, the rate of compensation increase, and retirement ages and mortality rates. These assumptions are reviewed quarterly by KPLP Management and KPLP's actuaries. The discount rate (based on market rates), the expected long-term rate of return on plan assets, and the expected growth rate in health care costs represent the three most significant assumptions.

### **Partnership Units**

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. As of December 31, 2014, \$128.1 million was recorded as a liability in respect of this obligation (December 31, 2013 - \$117.8 million).

The change in amortized cost of \$13.8 million has been included in other expense, which includes \$6.8 million for the reassessment performed as of December 31, 2014. The reassessment reflects KPLP's estimate of the net present value of the financial liability arising from the obligation to make the Tax Distribution using estimates of tax payable by KPT and a discount rate and terminal growth rate of 11.0% and 0% (December 31, 2013 - 11.5% and 0%), respectively. The change in the discount rate resulted in an increase in liability of \$5.8 million. The provisions are based on management's best estimate of expected future Tax Distributions. Projections of tax payable are based on additional assumptions including estimates of taxable income and tax 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.

The Partnership units liability was also adjusted during the year ended December 31, 2014 to reflect the current year advances made to the partners required to allow KPT to make tax installment payments. The advances of \$3.5 million were offset against the Tax Distributions of \$6.9 million paid by the Partnership on February 27, 2015.

### **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.

### **Income taxes**

The Partnership computes its income taxes in each jurisdiction in which its subsidiaries operate. Estimation of income taxes includes evaluating the recoverability of the deferred tax assets and the income taxes recoverable 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 US State tax credits. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period.

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.

## **ACCOUNTING CHANGES AND FUTURE ACCOUNTING STANDARDS**

### **Accounting Standards Implemented for the Year Ended December 31, 2014**

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 consolidated financial statements.

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 consolidated financial statements.

IAS 36, Impairment of Assets, has been amended to remove the requirement to disclose the recoverable amount when a 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 consolidated financial statements.

KPLP adopted these amendments retrospectively.



## Future Accounting Standards

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2015, and with earlier application permitted. KPLP and KPT Management have not yet assessed the impact of these standards and amendments or determined whether it will early adopt them, except as noted below.

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.

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.

IAS 19, Employee Benefits. The IASB has issued an amendment to clarify the application of IAS 19, to plans that require employees or third parties to contribute towards the cost of benefits. The mandatory effective date of IAS 19 would be annual periods beginning on or after July 1, 2014, and early adoption is permitted. Management has evaluated the standard and concluded that the amendment will not have a material impact on its consolidated financial statements.

IAS 1, Presentation of Financial Statements. In December 2014, the IASB issued amendments to clarify guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The amendments form a part of the IASB's Disclosure Initiative, which explores how financial statement disclosures can be improved. The mandatory effective date of IAS 1 would be annual periods beginning on or after January 1, 2016, with early adoption permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

## SELECTED ANNUAL FINANCIAL INFORMATION

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

	<u>December 31, 2014</u>	<u>December 31, 2013</u>
<b>KPT Financial Information</b>		
Total assets	155.3	163.2
Total liabilities	4.7	5.2
<b>KPLP Financial Information</b>		
Total assets	1,192.0	1,161.5
Total liabilities	844.5	808.3

## SELECTED QUARTERLY FINANCIAL INFORMATION

The following table summarizes quarterly financial results for KPLP for the last eight quarters. Financial data for all periods presented is in C\$ millions.

### Quarterly Financial Information

	2014				2013			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	278.6	267.6	265.3	234.6	242.9	243.8	246.8	221.8
Net income for the period	0.1	16.1	8.1	(3.2)	7.6	14.2	15.4	11.7
<b>Reconciliation of Net income to EBITDA</b>								
<b>Net income</b>	0.1	16.1	8.1	(3.2)	7.6	14.2	15.4	11.7
Income taxes	0.3	(1.5)	(0.3)	(0.3)	(1.2)	(1.3)	(3.5)	(4.9)
Interest expense	9.8	12.6	11.4	10.9	9.9	11.4	11.0	9.9
Loss on disposal of property, plant and equipment	0.1	(0.6)	0.3	-	-	-	-	-
Depreciation and amortization	10.6	8.5	9.5	9.0	9.9	7.7	9.0	7.5
Unrealized foreign exchange (gain) loss	1.6	1.8	(1.6)	1.7	1.4	(0.9)	1.6	0.9
Change in amortized cost of Partnership units liability	7.9	1.1	1.5	3.3	(0.7)	-	-	-
Recovery of non-financial assets	-	-	-	-	-	-	(1.8)	-
Restructuring costs	-	-	0.1	2.8	1.4	-	-	-
<b>EBITDA</b>	<b>30.4</b>	<b>38.0</b>	<b>29.0</b>	<b>24.2</b>	<b>28.3</b>	<b>31.1</b>	<b>31.7</b>	<b>25.1</b>

### *Results of Operations Q4 2014 compared to Q4 2013*

#### *Revenue*

Revenue was \$278.6 million in Q4 2014 compared to \$242.9 million in Q4 2013, an increase of \$35.7 million or 14.7%. Revenue increased in all segments and across all regions. The increase in revenue was primarily due to additional sales volume in the Consumer segment in the U.S. driven by TAD product sales and the favourable impact of foreign exchange on U.S. dollar sales. The acquisition of Metro Paper on June 3, 2014 also contributed to a significant increase in AFH segment revenue in Canada and particularly in the U.S.

From a geographic perspective, revenue in the U.S. increased \$22.3 million, or 35.1%. Revenue in Canada increased \$11.4 million, or 6.6%. KTG revenue (sold primarily in the U.S. and including intercompany sales) was \$63.0 million in Q4 2014 compared to \$56.3 million in Q4 2013.

#### *Cost of Sales*

Cost of sales were \$234.0 million in Q4 2014 compared to \$201.2 million in Q4 2013, an increase of \$32.8 million or 16.3%. As a percentage of revenue, cost of sales were 84.0% in Q4 2014 compared to 82.8% in Q4 2013. Cost of sales were impacted in Q4 2014 as commodity prices, particularly fibre costs, continued to remain high. Pulp market prices (NBSK) were U.S.\$1,025 per metric tonne on average in Q4 2014 compared to U.S.\$983 per metric tonne on average in Q4 2013. There was also an unfavourable impact of foreign exchange movements on cost of sales. Freight expense increased as a result of higher sales volumes associated primarily with new TAD business in the U.S.

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

SG&A expenses were \$24.5 million in Q4 2014 compared to \$23.9 million in Q4 2013, an increase of \$0.6 million or 2.7%. As a percentage of revenue, SG&A expenses were 8.8% in Q4 2014 compared to 9.8% in Q4 2013. The \$0.6 million increase was primarily related to higher advertising and promotion expenses, partially offset by the impact of realized foreign exchange movements.

### *EBITDA*

EBITDA in Q4 2014 was \$30.4 million compared to \$28.3 million in Q4 2013, an increase of \$2.1 million, primarily due to an increase in revenue that was partially offset by higher cost of sales. KTG EBITDA was \$9.5 million in Q4 2014 compared to \$7.2 million in Q4 2013.

### *Interest Expense*

Interest expense was \$9.8 million in Q4 2014 compared to \$10.0 million in Q4 2013, a decrease of \$0.2 million. The decrease was primarily due to an adjustment recorded as a result of changes in assumptions used to calculate interest related to the TAD Project and lower pension interest in Q4 2014 compared to Q4 2013, partially offset by the change in value of the embedded derivative related to the Senior Unsecured Notes.

### *Other income (expense)*

Other income (expense) was an expense of \$10.0 million in Q4 2014 compared to expense of \$0.2 million in Q4 2013, a change of \$9.8 million. Other expense in Q4 2014 was primarily due to an unrealized foreign exchange loss of \$1.6 million and a change in the amortized cost of the Partnership unit liability of \$7.9 million. Other expense in Q4 2013 was primarily due to an unrealized foreign exchange loss of \$1.4 million, offset by a change in the amortized cost of the Partnership unit liability of \$0.7 million.

### *Income Taxes*

An income tax expense of \$0.3 million was recorded in Q4 2014 compared to an income tax credit of \$1.3 million in Q4 2013, a change of \$1.6 million relating to KPLP subsidiaries in the U.S. and Mexico. As previously discussed, KPLP is not directly taxable on its Canadian business. The income tax credit in Q4 2013 related primarily to additional tax deductions in respect of the TAD project. Income tax in partners' hands was \$1.5 million in Q4 2014 compared to \$2.1 million in Q4 2013.

### *Net Income*

Net income was \$0.1 million in Q4 2014 compared to \$7.7 million in Q4 2013, a decrease of \$7.6 million. The decrease was primarily due to a change in the amortized cost of the Partnership unit liability, a tax expense in Q4 2014 compared to a deferred tax credit in Q4 2013 and higher depreciation expense, partially offset by higher EBITDA. KTG had a net loss of \$1.0 million in Q4 2014 compared to a net loss of \$1.2 million in Q4 2013.

### **Segment Information Q4 2014 compared to Q4 2013**

	Q4 2014	Q4 2013	Q4 2014 vs. Q4 2013	
			\$ Change	% Change
<b>Segment Revenue</b>				
Consumer	217.8	202.1	15.7	7.8%
AFH	53.9	38.7	15.2	39.3%
Other	6.9	2.1	4.8	228.6%
Total segment revenue	278.6	242.9	35.7	14.7%
<b>Segment EBITDA</b>				
Consumer	31.4	27.2	4.2	15.4%
AFH	0.3	1.3	(1.0)	-76.9%
Other	(1.3)	(0.2)	(1.1)	550.0%
Total segment EBITDA	30.4	28.3	2.1	7.4%

### ***Consumer Segment***

Consumer segment revenue was \$217.8 million in Q4 2014 compared to \$202.1 million in Q4 2013, an increase of \$15.7 million or 7.8%. The increase was primarily due to new business related to the TAD Project and the favourable impact of foreign exchange on U.S. based sales and increased sales volume in Canada.

Consumer Segment EBITDA was \$31.4 million in Q4 2014 compared to \$27.2 million in Q4 2013, an increase of \$4.2 million, primarily due to an increase in revenues, in particular relating to the TAD Project, partially offset by higher operating costs as discussed above.

### ***AFH Segment***

AFH segment revenue was \$53.9 million in Q4 2014 compared to \$38.7 million in Q4 2013, an increase of \$15.2 million or 39.3%, driven by Q4 2014 sales related to the Metro Paper acquisition. AFH segment revenue increased in the U.S. and Canada.

AFH Segment EBITDA was \$0.3 million in Q4 2014 compared to \$1.3 million in Q4 2013, a decrease of \$1.0 million. The decrease in AFH Segment EBITDA was primarily due to higher operating costs as discussed above, partially offset by increased revenues.

### ***Other Segment***

Other segment revenue was \$6.9 million in Q4 2014 compared to \$2.1 million in Q4 2013 primarily due to an increase in the sale of parent rolls.

Other Segment EBITDA was a loss of \$1.3 million in Q4 2014 compared to a loss of \$0.2 million in Q4 2013. The increase was due to losses on parent roll sales as a result of increased commodity costs.

## **SHARE INFORMATION**

KPT's authorized share capital consists of an unlimited number of Common Shares. As of March 11, 2015, there were 8,873,842 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 were to exchange all KPLP Units held by it as of March 11, 2015 for Common Shares, it would hold approximately 83.5% of the issued and outstanding Common Shares. As of March 11, 2015, there were no potentially dilutive instruments outstanding.

Pursuant to the Limited Partnership Agreement, KPLP may issue an unlimited number of KPLP Units. As of March 11, 2015, there were 53,880,850 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 Annual Information Form. 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 Corporation's 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 Committee reviewed this MD&A and the audited consolidated financial statements, and the Corporations' Board of Directors approved these documents prior to their release.

#### ***Management's Report on Disclosure Controls and Procedures***

Management, under the supervision of and with the participation of the Corporations' CEO and CFO, evaluated the effectiveness of the Corporations' disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as of December 31, 2014, that such disclosure controls and procedures were effective.

#### ***Management's Report on Internal Controls over Financial Reporting***

Management, under the supervision of and with the participation of the Corporations' CEO and CFO, evaluated the effectiveness of the Corporations' internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions (COSO) in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as of December 31, 2014, the Corporations' internal controls over financial reporting were effective. This evaluation took into consideration the Corporations' Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

### **ADDITIONAL INFORMATION**

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





**KRUGER PRODUCTS L.P.**

**AUDITED CONSOLIDATED FINANCIAL STATEMENT**

**FOR THE YEARS ENDED DECEMBER 31, 2014 AND DECEMBER 31, 2013**

March 11, 2015

## **Independent Auditor's Report**

### **To the Unitholders of Kruger Products L.P.**

We have audited the accompanying consolidated financial statements of Kruger Products L.P. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2014 and December 31, 2013 and the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

#### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Kruger Products L.P. and its subsidiaries as at December 31, 2014 and December 31, 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

**(signed) PricewaterhouseCoopers LLP**

**Chartered Professional Accountants, Licensed Public Accountants**  
Toronto, Ontario

# Kruger Products L.P.

## Consolidated Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	December 31, 2014	December 31, 2013
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	51,788	87,674
Trade and other receivables (note 7)	107,092	94,789
Receivables from related parties (note 17)	301	1,429
Advances to partners (note 15)	3,474	-
Inventories (note 8)	150,328	151,505
Current portion of income tax recoverable (note 16)	1,302	630
Prepaid expenses and other current assets (note 14)	7,351	4,777
	<u>321,636</u>	<u>340,804</u>
<b>Non-current assets</b>		
Property, plant & equipment (note 9)	652,762	616,687
Other long-term assets	7,738	10,268
Income tax recoverable (note 16)	15,309	14,132
Goodwill (note 10)	160,939	152,021
Intangible assets (note 10)	14,052	13,483
Deferred income taxes (note 16)	19,565	14,141
	<u>1,192,001</u>	<u>1,161,536</u>
<b>Total assets</b>		
<b>Liabilities</b>		
<b>Current liabilities</b>		
Trade and other payables (note 12)	173,228	188,503
Payables to related parties (note 17)	4,387	5,134
Distributions payable (notes 15 and 17)	9,781	9,455
Current portion of provisions (note 13)	2,967	999
Current portion of long-term debt (note 14)	8,879	8,243
	<u>199,242</u>	<u>212,334</u>
<b>Non-current liabilities</b>		
Long-term debt (note 14)	358,646	342,013
Other long-term liabilities	156	323
Provisions (note 13)	6,441	6,615
Pensions (note 11)	98,533	80,380
Post-retirement benefits (note 11)	53,357	48,746
	<u>716,375</u>	<u>690,411</u>
<b>Liabilities to non-unitholders</b>		
Current portion of Partnership units liability (note 15)	6,949	3,475
Long-term portion of Partnership units liability (note 15)	121,174	114,364
<b>Total Partnership units liability</b>	<u>128,123</u>	<u>117,839</u>
<b>Total liabilities</b>	<u>844,498</u>	<u>808,250</u>
<b>Equity</b>		
Partnership units (note 15)	299,616	282,672
Retained earnings	4,424	50,945
Accumulated other comprehensive income	43,463	19,669
<b>Total equity</b>	<u>347,503</u>	<u>353,286</u>
<b>Total equity and liabilities</b>	<u>1,192,001</u>	<u>1,161,536</u>
<b>Commitments and contingencies (note 18)</b>		
<b>Subsequent events (note 15)</b>		

Approved by the Board of Directors

/s/ James Hardy \_\_\_\_\_  
Director

/s/ David Spraley \_\_\_\_\_  
Director

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

# Kruger Products L.P.

## Consolidated Statement of Comprehensive Income

For the years ended December 31, 2014 and December 31, 2013

(tabular amounts are in thousands of Canadian dollars)

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
		(note 27)
<b>Revenue (notes 17 and 25)</b>	1,046,168	955,346
<b>Expenses</b>		
Cost of sales (notes 17 and 19)	879,139	786,825
Selling, general and administrative expenses (notes 17 and 19)	82,625	86,720
Recovery of non-financial assets (note 9)	-	(1,789)
Restructuring costs (note 13)	2,835	1,372
<b>Operating income</b>	81,569	82,218
Interest expense	44,730	42,251
Other expense (note 6)	17,612	1,979
<b>Income before income taxes</b>	19,227	37,988
<b>Income taxes (note 16)</b>	(1,840)	(10,940)
<b>Net income for the year</b>	21,067	48,928
<b>Other comprehensive income (loss)</b>		
<b>Items that will not be reclassified to net income:</b>		
Remeasurements of pensions	(25,689)	55,619
Remeasurements of post-retirement benefits	(3,466)	599
<b>Items that may be subsequently reclassified to net income:</b>		
Available-for-sale investment	15	69
Cumulative translation adjustment	23,779	16,355
<b>Total other comprehensive income (loss) for the year</b>	(5,361)	72,642
<b>Comprehensive income for the year</b>	15,706	121,570

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

**Kruger Products L.P.**  
**Consolidated Statement of Changes in Equity**  
**For the years ended December 31, 2014 and December 31, 2013**

(tabular amounts are in thousands of Canadian dollars)

	<b>Partnership units</b>		<b>Retained earnings (deficit)</b>	<b>Accumulated other comprehensive income</b>	<b>Total equity</b>
	<b>#</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>As of January 1, 2013</b>	51,014,300	257,516	(14,736)	3,245	<b>246,025</b>
Distributions payable	-	-	(9,455)	-	<b>(9,455)</b>
Distributions paid	-	-	(30,010)	-	<b>(30,010)</b>
Change in actuarial gains on pension	-	-	55,619	-	<b>55,619</b>
Change in actuarial gains on post retirement benefits	-	-	599	-	<b>599</b>
Change in available-for-sale investment	-	-	-	69	<b>69</b>
Cumulative translation adjustment	-	-	-	16,355	<b>16,355</b>
Net income for the year	-	-	48,928	-	<b>48,928</b>
Issuance of Partnership units (note 15)	1,513,250	25,156	-	-	<b>25,156</b>
<b>As of December 31, 2013</b>	<b>52,527,550</b>	<b>282,672</b>	<b>50,945</b>	<b>19,669</b>	<b>353,286</b>
<b>As of January 1, 2014</b>	52,527,550	282,672	50,945	19,669	<b>353,286</b>
Distributions payable (note 15)	-	-	(9,652)	-	<b>(9,652)</b>
Fair value adjustment (note 15)	-	-	(129)	-	<b>(129)</b>
Distributions paid (note 15)	-	-	(28,652)	-	<b>(28,652)</b>
Change in actuarial losses on pension	-	-	(25,689)	-	<b>(25,689)</b>
Change in actuarial losses on post retirement benefits	-	-	(3,466)	-	<b>(3,466)</b>
Change in available-for-sale investment	-	-	-	15	<b>15</b>
Cumulative translation adjustment	-	-	-	23,779	<b>23,779</b>
Net income for the year	-	-	21,067	-	<b>21,067</b>
Issuance of Partnership units (note 15)	1,096,710	16,944	-	-	<b>16,944</b>
<b>As of December 31, 2014</b>	<b>53,624,260</b>	<b>299,616</b>	<b>4,424</b>	<b>43,463</b>	<b>347,503</b>

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



# Kruger Products L.P.

## Consolidated Statement of Cash Flows

For the years ended December 31, 2014 and December 31, 2013

(tabular amounts are in thousands of Canadian dollars)

	2014 \$	2013 \$
<b>Cash flows from (used in) operating activities</b>		
Net income for the year	21,067	48,928
Items not affecting cash		
Depreciation	37,049	33,561
Amortization	649	581
Gain on sale of fixed assets	(135)	(5)
Change in amortized cost of Partnership units liability (note 6)	13,759	(723)
Unrealized foreign exchange loss	3,522	2,992
Interest expense	44,730	42,251
Pension and post retirement benefits	9,874	9,959
Provisions (note 13)	3,762	800
Income taxes	(1,840)	(10,940)
Recovery of non-financial assets (note 9)	-	(1,789)
Total items not affecting cash	111,370	76,687
Net change in non-cash working capital (note 26)	(12,454)	(34,271)
Contributions to pension and post-retirement benefit plans	(22,414)	(30,369)
Provisions paid	(2,562)	(2,841)
Income tax payments	(2,102)	(2,675)
<b>Net cash from operating activities</b>	<b>92,905</b>	<b>55,459</b>
<b>Cash flows from (used in) investing activities</b>		
Purchases of property, plant & equipment	(33,296)	(20,265)
Purchases of through-air-dried (TAD) expansion	(7,738)	(39,631)
Available-for-sale investment	(277)	(836)
Government grants received	-	1,078
Purchases of software	(1,218)	(236)
Proceeds on sale of property, plant and equipment	578	5
Acquisition of business (note 5)	(23,360)	-
<b>Net cash used in investing activities</b>	<b>(65,311)</b>	<b>(59,885)</b>
<b>Cash flows from (used in) financing activities</b>		
Proceeds from credit facilities	-	10,813
Repayment of credit facilities	(8,577)	(7,999)
Payment of deferred financing fees	-	(641)
Interest paid on credit facilities	(28,389)	(27,676)
Distributions and advances paid (note 17)	(29,054)	(17,536)
Equity issuance costs	-	(1,206)
Proceeds from issuing partnership units	1,070	13,888
<b>Net cash used in financing activities</b>	<b>(64,950)</b>	<b>(30,357)</b>
<b>Effect of exchange rate changes on cash and cash equivalents held in foreign currency</b>	<b>1,470</b>	<b>968</b>
<b>Decrease in cash and cash equivalents during the year</b>	<b>(35,886)</b>	<b>(33,815)</b>
<b>Cash and cash equivalents - Beginning of year</b>	<b>87,674</b>	<b>121,489</b>
<b>Cash and cash equivalents - End of year</b>	<b>51,788</b>	<b>87,674</b>

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

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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(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. (KPGP), 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; Scarborough and Trenton, Ontario and Memphis, Tennessee. The Partnership's headquarters are located in Mississauga, Ontario, Canada.

### 2 Basis of presentation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) 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 consolidated financial statements were approved by the board of directors of KPGP Inc. on March 11, 2015.

The Partnership consolidates all entities over which it has the ability to exercise decision making authority, with respect to relevant activities.

The principal subsidiaries of the Partnership are as follows:

K.T.G. (USA) Inc. (KTG)  
Kruger Products (USA) Inc. (KP USA)  
Grupo Tissue de Mexico S de RL de CV (GTM)  
Kruger Products AFH L.P.  
TAD Luxembourg S.A.R.L  
TAD Canco Inc.  
Kruger Products Real Estate Holding Inc.  
8528365 Canada Inc.  
West Tree Farms Limited  
White Swan Tissue Company  
Aztec Investments Inc.

### 3 Summary of significant accounting policies

The significant accounting policies used in the preparation of these consolidated financial statements were as follows:

#### (a) *Basis of measurement*

The consolidated financial statements have been prepared under the historical cost convention, except for available-for-sale investment and embedded derivatives on debt, which are measured at fair value through profit or loss.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Partnership's accounting policies. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant are disclosed in note 4.

#### (b) *Consolidation*

Subsidiaries are all those entities over which the Partnership has the power over the investee, is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect these returns through

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

its power over the investee. Subsidiaries are fully consolidated from the date on which control is transferred to the Partnership and de-consolidated from the date that control ceases. Intercompany transactions, balances and unrealized gains/losses on transactions between group companies are eliminated on consolidation.

The purchase method of accounting is used to account for the acquisition of subsidiaries that are not under common control. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities assumed at the date of exchange. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of acquisition over the fair value of the Partnership's share of the identifiable net assets acquired is recorded as goodwill.

(c) *Segment reporting*

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer. The operating segments for the Partnership include Consumer, Away-From-Home (AFH) and Other.

(d) *Foreign currency translation*

(i) Functional and presentation currency

Items included in the consolidated financial statements of each entity of the Partnership are measured using the currency of the primary economic environment in which the entity operates (the functional currency). These consolidated financial statements are presented in Canadian dollars, which is the Partnership's functional currency.

The Partnership has determined that its foreign operations located in the United States (KTG and KP USA) and TAD Canco Inc. and TAD Luxembourg S.A.R.L. have a functional currency of U.S. dollars. Mexico (GTM) has a functional currency of the Mexican peso. Consequently, revenue and expenses of these foreign operations are recorded using the rate of exchange in effect at the dates of the transactions and the translation of assets and liabilities uses the rates of exchange in effect at the period-end date, with the resulting net unrealized gains and losses arising from the translation of these foreign operations included as part of the currency translation adjustment in other comprehensive income.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the rate of exchange in effect at the dates of the transactions. Foreign exchange gains and losses arising from translating monetary foreign currency balances are included in selling, general and administrative (SG&A) expenses or other expenses.

(e) *Cash and cash equivalents*

The Partnership considers all highly liquid investments purchased three months or less from maturity to be cash equivalents.

(f) *Trade receivables*

Trade receivables are amounts due from customers from the sale of products or services rendered in the ordinary course of business. Trade receivables are classified as current assets if payment is due within one year or less. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost, less provision for doubtful accounts.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

(g) *Inventories*

Inventories of raw materials and spare parts are valued at the lower of weighted average cost and net realizable value. Finished products and work-in-process are valued at the lower of standard cost and net realized value and include the cost of raw materials, direct labour and manufacturing overhead expenses. Net realizable value is the estimated selling prices less applicable selling expenses and costs to complete. If the carrying value exceeds the net realizable value, a write-down is recognized.

(h) *Borrowing costs*

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of these assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the consolidated statements of comprehensive income in the period in which they are incurred.

(i) *Property, plant and equipment*

Property, plant and equipment are stated at cost, less accumulated depreciation, investment tax credits, US State tax credits, government grants and accumulated impairment loss. Cost includes expenditures that are directly attributable to the acquisition of the asset and an estimate of the asset retirement obligation. The Partnership allocates the amount initially recognized to an item of property, plant and equipment to its segregated parts and depreciates each of these segregated parts separately. The Partnership also capitalizes costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of the asset. Subsequent costs are included in the asset's carrying value or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Partnership and the cost can be reliably measured. The carrying amount of a replaced asset is derecognized when replaced. Residual values, method of depreciation and useful lives of property, plant and equipment are reviewed annually and adjusted if appropriate.

Depreciation of property, plant and equipment is generally calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives as follows:

Buildings	20 to 40 years
Machinery and equipment	5 to 40 years

For certain major pieces of equipment, depreciation is calculated using the unit-of-production method. Assets under construction or development are depreciated from the date the asset is ready for productive use. Land is not depreciated.

Repairs and maintenance costs are charged to the consolidated statements of comprehensive income during the period in which they are incurred.

Gains and losses on disposals of property, plant and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included in SG&A expenses.

(j) *Goodwill*

Goodwill arises on the acquisition of subsidiaries, associates and joint ventures and represents the excess of the consideration transferred over the Partnership's interest in fair value of the net identifiable assets, liabilities and contingent liabilities of the acquiree. Goodwill is carried at cost less accumulated impairment losses.

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For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the cash-generating units (CGUs), or groups of CGUs, that is expected to benefit from the synergies of the combination. Each CGU or group of CGUs to which the goodwill is allocated represents the lowest level within the Partnership at which the goodwill is monitored for internal management purposes.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of the CGU is compared to the recoverable amount, which is the higher of the value in use and the fair value less costs to sell. Any goodwill impairment is recognized immediately as an expense and is not subsequently reversed.

*(k) Intangible assets*

*(i) Trademarks*

Separately acquired trademarks have indefinite useful lives and are carried at cost. The trademarks have indefinite useful lives as the trademarks can be renewed infinitely without substantial cost. Management believes the trademarks are very well established in the marketplace and will continue to provide benefits indefinitely into the future.

*(ii) Software and licences*

Costs to purchase non-integral software and licences are capitalized and included as part of intangible assets on the consolidated statement of financial position. Costs associated with maintaining software programs are recognized as an expense as incurred.

Software and licence costs recognized as assets are amortized over their estimated useful lives, which represent management's view of the expected period over which the Partnership will receive benefits from the software and licences. The useful life of software and licences is five years.

*(l) Impairment of non-financial assets*

The carrying values of non-financial assets with finite lives, such as property, plant and equipment and intangible assets with finite useful lives are assessed for impairment whenever events or changes in circumstances indicate their carrying amounts may not be recoverable. Non-financial assets that are not amortized are subject to an annual impairment test. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use (which is the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (CGUs). Non-financial assets other than goodwill that have suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

*(m) Related party transactions*

Related party transactions that are in the normal course of operations and have commercial substance are made under competitive terms and conditions or in accordance with the agreements with the related party.

*(n) Leases*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the consolidated statement of comprehensive income on a straight-line basis over the period of the lease.

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*(o) Provisions*

Provisions include environmental and asset retirement obligations, long-term incentives and restructuring. A provision is recognized when the Partnership has a legal or constructive obligation as a result of a past event and it is probable that settlement of the obligation will require a financial payment or cause a financial loss and a reliable estimate can be made of the amount of the obligation.

If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recorded in the consolidated statement of financial position as a separate asset, but only if it is virtually certain that the reimbursement will be received.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

*(p) Government grants, investment tax credits and US State tax credits*

Government grants, investment tax credits, and US State tax credits are accounted for using the cost reduction method, whereby such amounts are deducted from the expenditures or assets to which they relate when there is reasonable assurance that the grant or credit will be received and where the Partnership will comply with the conditions attached to the assistance.

*(q) Revenue recognition*

The Partnership recognizes revenue when it is probable that the economic benefits will flow to the Partnership, the significant risks and benefits of ownership are transferred (based on shipping terms), the price is fixed or determinable and collection of the resulting receivable is reasonably assured.

Revenue is measured based on the price specified in the sales contract and is net of discounts, rebates and allowances. Reductions to revenue for expected and actual payments to customers for rebates and allowances are based on actual expenses incurred during the period, on estimates of what is due to customers for estimated credits earned during the period and any adjustments for credits based on actual activity.

*(r) Cost of sales and SG&A expenses*

Cost of sales includes cost of finished goods sold, freight, warehousing, handling costs, and inventory write-downs. Marketing, selling, and general and administrative expenses are included in SG&A expenses.

*(s) Pensions and post-retirement benefits*

The Partnership accrues its obligation under employee benefit plans and the related costs, net of plan assets. The Partnership has the following policies:

- The costs of pensions under defined benefit plans and post-retirement benefits are actuarially determined using the projected unit credit method and management's best estimate of expected plan investment performance for funded plans, salary escalation, retirement ages of employees and expected health-care costs. Actuarial valuations for defined benefit plans and post-retirement benefits are completed annually. The discount rate applied in arriving at the present value of the pension liability represents the yield on high quality corporate bonds denominated in the currency in which the benefits are to be paid and having terms to maturity approximating the terms of the related pension liability.

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- Pension assets are valued at fair value.
- Past-service costs from plan amendments are recognized immediately to the extent the benefits are vested in net income and are otherwise amortized on a straight-line basis over the average period until the benefits become vested.
- The actuarial gains or losses are recognized in full in the period in which they occur in other comprehensive income without recycling to the income statement in subsequent periods. Amounts recognized in other comprehensive income are recognized immediately in retained earnings.
- The pension expense is split into two components: (i) current service costs and past-service costs have been recognized in cost of sales and SG&A expenses; and (ii) the interest cost on the benefit obligation offset by the expected return on plan assets is recorded within interest expense on the consolidated statement of comprehensive income.
- The Partnership also participates in a multi-employer pension plan and defined contribution pension plans. The costs of the multi-employer pension plan and defined contribution pension plans are charged to expense as the contributions become payable.

### (t) *Income taxes*

The tax expense for the year comprises current and deferred tax. Tax is recognized in net income, except to the extent that it relates to items recognized in other comprehensive income (loss) or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

The Partnership is not a tax paying entity. The income from the Partnership flows to the partners, Kruger Inc., KPGP and KPT. Accordingly no provision for income taxes has been made for the Partnership's income. The U.S. entities, KP USA and KTG are subject to tax on the basis of the tax laws enacted in the U.S. where the entities operate and generate taxable income. The remaining entities, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L., are subject to tax on the basis of the laws enacted in Canada, Mexico and Luxembourg, respectively.

Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. The Partnership establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax is the expected tax payable on the taxable income for the year at closing tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill, or from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the consolidated statement of financial position dates and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

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Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis. Deferred income tax assets and liabilities are presented as non-current.

### (u) *Financial instruments*

Financial assets and liabilities are recognized when the Partnership becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Partnership has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expired.

Financial assets and liabilities are offset and the net amount is reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Partnership classifies its financial instruments in the following categories:

- (i) *Financial assets and liabilities at fair value through profit or loss*: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. The financial instruments classified in this category include the embedded derivatives.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of comprehensive income in SG&A expenses. Gains and losses arising from changes in fair value of the embedded derivatives are presented in the consolidated statement of comprehensive income within interest expense in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current, except for the portion expected to be realized or paid beyond 12 months of the dates of the consolidated statement of financial position, which are classified as non-current.

- (ii) *Financial assets and liabilities at fair value through other comprehensive income or loss*: A financial asset or liability is classified in this category if acquired for the purpose of holding the investment for a long-term period. The financial instruments classified in this category would include the available-for-sale investment.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of comprehensive income in SG&A expenses. Gains and losses arising from changes in fair value of the available-for-sale investment are presented in the other comprehensive income in the period in which they arise. Financial assets and liabilities at fair value through other comprehensive income or loss are classified as current, except for the portion expected to be realized or paid beyond 12 months of the dates of the consolidated statement of financial position, which are classified as non-current.

- (iii) *Loans and receivables*: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include cash and cash equivalents, receivables from related parties and trade and other receivables. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment. Loans and receivables are classified as current, except for the portion expected to be realized beyond 12 months of the dates of the consolidated statement of



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financial position, which are classified as non-current.

- (iv) *Financial liabilities at amortized cost:* Financial liabilities at amortized cost include trade and other payables, payables to related parties, long-term debt and the Partnership units liability. Payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade and other payables are measured at amortized cost using the effective interest method. Long-term debt is recognized initially at fair value, net of any transaction costs incurred and subsequently at amortized cost using the effective interest method. The Partnership units liability is recognized initially at fair value and subsequently at amortized cost. Amortized cost is estimated based on the expected tax distributions to be paid as required by the partnership agreement using a discount rate that reflects current market assessments of the time value of money and the rates specific to the obligation, and a terminal value as the obligation will continue indefinitely.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

(v) *Fair value hierarchy*

The Partnership categorizes its financial assets and liabilities measured at fair value into one of three different levels depending on the inputs used in the measurement.

- Level 1 - fair value based on unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date;
- Level 2 - valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. Derivative instruments in this category are valued using models or other industry standard valuation techniques derived from observable market inputs; and
- Level 3 - valuations based on inputs that are less observable, unavailable or where the observable data does not support a significant portion of the instrument's fair value.

(w) *Embedded derivatives*

The senior unsecured notes include an early repayment option. The Partnership has determined that the early repayment option is an embedded derivative that is not closely related to the senior unsecured notes. Accordingly, the embedded derivative has been bifurcated from the senior unsecured notes. The embedded derivative is recorded at its fair value with changes in fair value included in interest expense in the consolidated statement of comprehensive income.

(x) *Dividend reinvestment plan*

Pursuant to the Dividend Re-investment Plan (DRIP), the Partnership is required to issue Partnership units in lieu of cash distributions at the option of the Partners. Upon settlement of the DRIP, the difference between the distributions declared and the fair value of the units issued is charged to retained earnings.

(y) *Accounting standards implemented for the year ended December 31, 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

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amendment had no significant impact on these 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 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 consolidated financial statements.

(z) *Accounting standards issued but not yet applied*

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2015, except as noted below, with earlier application permitted. The Partnership continues to assess the impact of these standards and amendments and has not yet determined whether it will early adopt them.

- (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.
- (iii) IAS 19, Employee Benefits. The IASB has issued an amendment to clarify the application of IAS 19, to plans that require employees or third parties to contribute towards the cost of benefits. The mandatory effective date of IAS 19 would be annual periods beginning on or after July 1, 2014, and early adoption is permitted. The amended standard will not have a material impact on the consolidated financial statements.
- (iv) IAS 1, Presentation of Financial Statements. In December 2014, the IASB issued amendments to clarify guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The amendments form a part of the IASB's Disclosure Initiative, which explores how financial statement disclosures can be improved. The mandatory effective date of IAS 1 would be annual periods beginning on or after January 1, 2016, with early adoption permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

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### 4 Critical accounting estimates and judgments

The preparation of these consolidated financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities in the consolidated financial statements and the disclosure of contingencies at the dates of the consolidated statements of financial position, and the reported amounts of revenues and expenses during the reporting period. On a regular basis and with the information available, management reviews its estimates, including those related to environmental and asset retirement obligations, pensions and post-retirement obligations, the Partnership units liability, and income taxes. Actual results could differ from those estimates. When adjustments become necessary, they are reported in earnings in the period in which they occur. The following are the estimates and judgments applied by management that most significantly affect the Partnership's consolidated financial statements.

#### *Environmental and asset retirement obligations*

The Partnership has made a provision for the estimated fair value of its potential obligation under a land lease to demolish the buildings at one of its plant locations and restore the land at the end of the lease to its original condition (including any environmental remediation). The current lease ends in 2028, but this lease can be renewed at the Partnership's option for another term. The Partnership assesses its provision for environmental and asset retirement obligations annually or more frequently if events or changes in circumstances would require adjustments to the significant estimates and assumptions. Significant estimates and assumptions are made in determining the provision for asset retirement obligations, as there are numerous factors that will affect the ultimate amount payable. These factors include estimates of the extent and costs of restoration activities, technological changes, regulatory changes, cost increases as compared to the inflation rates and changes in the discount rate. In addition, estimates of environmental remediation costs are based on a number of assumptions that are inherently difficult to determine and no assurance can be given that the actual costs will not differ from the estimates based on environmental test results, changes in laws, regulations or enforcement policies or other factors. These uncertainties may result in future actual expenditures differing from the amounts currently provided. Management has retained a third party to assist with the estimate of the environmental remediation obligation and the costs to demolish the buildings. The provision at the reporting date represents the Partnership's best estimate of the present value of the environmental and asset retirement obligation.

#### *Pensions and post-retirement benefit obligations*

The present value of the pension and post-retirement obligations is dependent on actuarial calculations, which include a number of assumptions. These assumptions include the discount rate, which is used to calculate the present value of the estimated future cash outflows that will be required to meet the pension obligations. In determining the discount rate to use, the Partnership considers market yields of high quality corporate bonds denominated in Canadian dollars that have terms to maturity approximating the terms of the pension liability.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in note 11.

#### *Partnership units*

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. As of December 31, 2014, \$128.1 million was recorded as a liability in respect of this obligation (December 31, 2013 - \$117.8 million).

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The change in amortized cost of \$13.8 million has been included in other expense, which includes \$6.8 million for the reassessment performed as of December 31, 2014. The reassessment reflects KPLP's estimate of the net present value of the financial liability arising from the obligation to make the Tax Distribution using estimates of tax payable by KPT and a discount rate and terminal growth rate of 11.0% and 0% (December 31, 2013 – 11.50% and 0%), respectively. The change in the discount rate resulted in an increase in liability of \$5.8 million. The provisions are based on management's best estimate of expected future Tax Distributions. Projections of tax payable are based on additional assumptions including estimates of taxable income and tax 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.

The Partnership units liability was also adjusted during the year ended December 31, 2014 to reflect the current year advances made to the partners required to allow KPT to make tax installment payments. The advances of \$3.5 million were offset against the Tax Distributions of \$6.9 million paid by the Partnership on February 27, 2015.

### *Income taxes*

The Partnership computes its income taxes in each jurisdiction in which its subsidiaries operate. Estimation of income taxes includes evaluating the recoverability of the deferred tax assets and the income taxes recoverable 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 US State tax credits. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period.

## 5 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 tax deductible goodwill of \$8.9 million and has been allocated to the Canada CGU. The Partnership has assessed the 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 values of the assets acquired were as follows:

	<b><u>Metro Paper</u></b>
Fair value of identifiable assets acquired	
Inventory	6,299
Property, plant and equipment	8,240
Goodwill	8,918
Accrued liabilities	<u>(97)</u>
Net assets acquired	<u>23,360</u>
Cash paid	<u>23,360</u>

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### 6 Other expense

	2014 \$	2013 \$
Unrealized foreign exchange loss	3,522	2,992
Change in amortized cost of Partnership units liability	13,759	(723)
Miscellaneous (income) expense	331	(290)
	<u>17,612</u>	<u>1,979</u>

### 7 Trade and other receivables

	December 31, 2014 \$	December 31, 2013 \$
Trade receivables	102,555	90,782
Other receivables	5,189	4,345
Employee loans	20	15
Less: Allowance for doubtful accounts	(672)	(353)
Trade and other receivables	<u>107,092</u>	<u>94,789</u>

### 8 Inventories

	December 31, 2014 \$	December 31, 2013 \$
Finished products	65,171	74,476
Work-in-process	30,245	27,881
Raw materials and supplies	27,237	24,872
Spare parts	27,675	24,276
	<u>150,328</u>	<u>151,505</u>

Total inventories recognized as cost of sales during the year ended December 31, 2014 were \$751.8 million (December 31, 2013 - \$675.7 million). The Partnership wrote-off inventories during the year ended December 31, 2014 totalling \$0.1 million (December 31, 2013 - \$0.1 million), primarily related to obsolete packaging. Inventory provisions as of December 31, 2014 were \$5.0 million (December 31, 2013 - \$4.9 million).

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### 9 Property, plant and equipment

	Land	Buildings	Machinery and equipment	Assets under construction or development	Total
	\$	\$	\$	\$	\$
<b>As of January 1, 2013</b>					
Cost	40,426	132,448	634,410	203,356	1,010,640
Accumulated depreciation and impairments	(1,789)	(60,288)	(367,749)	-	(429,826)
<b>Net book value as of January 1, 2013</b>	38,637	72,160	266,661	203,356	580,814
Additions	-	1	4	59,509	59,514
Capitalized interest	-	-	-	507	507
Investment tax credits	-	-	(12,382)	-	(12,382)
Transfers	63	30,742	226,560	(257,365)	-
Depreciation	-	(4,352)	(30,086)	-	(34,438)
Recovery	1,789	-	-	-	1,789
Exchange differences	75	3,250	11,358	6,200	20,883
<b>As of December 31, 2013</b>	40,564	101,801	462,115	12,207	616,687
<b>As of December 31, 2013</b>					
Cost	40,564	166,719	854,566	12,207	1,074,056
Accumulated depreciation and impairment	-	(64,918)	(392,451)	-	(457,369)
<b>Net book value as of December 31, 2013</b>	40,564	101,801	462,115	12,207	616,687
Additions	-	-	-	35,186	35,186
Disposals	-	-	(443)	-	(443)
Investment tax credits	-	-	(525)	-	(525)
Transfers	4	2,658	31,966	(34,628)	-
Acquisition of business	-	-	8,240	-	8,240
Depreciation	-	(4,694)	(31,054)	-	(35,748)
Exchange differences	110	4,451	24,511	293	29,365
<b>As of December 31, 2014</b>	40,678	104,216	494,810	13,058	652,762
<b>As of December 31, 2014</b>					
Cost	40,678	174,340	918,867	13,058	1,146,943
Accumulated depreciation and impairment	-	(70,124)	(424,057)	-	(494,181)
<b>Net book value as of December 31, 2014</b>	40,678	104,216	494,810	13,058	652,762

During the year ended December 31, 2013, an adjustment was recorded related to the estimated fair value of the timber lands resulting in the reversal of a portion of a previously recorded write-down of \$1.8 million.

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## Notes to Consolidated Financial Statements

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### 10 Goodwill and intangible assets

	Trademarks \$	Software \$	Total \$
<b>As of January 1, 2013</b>			
Cost	11,825	3,254	15,079
Accumulated amortization	-	(1,251)	(1,251)
<b>Net book value as of January 1, 2013</b>	11,825	2,003	13,828
Additions	-	236	236
Amortization	-	(581)	(581)
<b>Net book value as of December 31, 2013</b>	11,825	1,658	13,483
<b>As of January 1, 2014</b>			
Cost	11,825	3,490	15,315
Accumulated amortization	-	(1,832)	(1,832)
<b>Net book value as of January 1, 2014</b>	11,825	1,658	13,483
Additions	-	1,218	1,218
Amortization	-	(649)	(649)
<b>Net book value as of December 31, 2014</b>	11,825	2,227	14,052
<b>As of December 31, 2014</b>			
Cost	11,825	4,708	16,533
Accumulated amortization	-	(2,481)	(2,481)
<b>Net book value as of December 31, 2014</b>	11,825	2,227	14,052

The carrying value of goodwill as of December 31, 2014 was \$160.9 million (December 31, 2013 - \$152.0 million). The increase of \$8.9 million in goodwill is due to the acquisition of Metro Paper (note 5).

#### *Impairment tests*

The Partnership performed its annual impairment tests for goodwill and indefinite lived trademarks as of December 31, 2014 and December 31, 2013 and no impairments were recognized. Goodwill is allocated to Canada (CGU). The recoverable amount of the CGU is determined based on value in use. The estimates of value in use were based on the present value of the forecasted future cash flows expected to be derived from Canada CGU. Based on the sensitivity analysis, no reasonable change in assumptions would result in an impairment.

### 11 Pensions and post-retirement benefits

The Partnership sponsors a number of defined benefit and defined contribution pension plans, with participation available to substantially all of its employees. Length of service and individual earnings determine the pension and post-retirement benefits for all members of the Partnership plans.

The Partnership has five registered defined benefit pension plans with a final average salary component, four of which are registered in the province of Quebec and one of which is registered in the province of Ontario. The pension obligation, net of plan assets for these five plans of \$75.3 million as of December 31, 2014 (December 31, 2013 - \$58.9 million) is included in pensions on the consolidated statement of financial position.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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The Partnership has a Supplementary Retirement Plan (SRP) for designated employees. The accrued benefit liability, net of plan assets related to the SRP as of December 31, 2014 was \$15.1 million (December 31, 2013 - \$14.0 million) and is supported by irrevocable letters of credit in the amount of \$24.6 million (December 31, 2013 - \$26.8 million).

The Partnership also sponsors a Term Annuity Arrangement for the Western Manufacturing Division, which provides hourly employees with a bridging supplement commencing at age 61 and payable up to but not including age 65. The Term Annuity Arrangement is unfunded and the pension obligation of \$8.1 million as of December 31, 2014 (December 31, 2013 - \$7.5 million) is included in pensions on the consolidated statement of financial position.

The Partnership's hourly employees at the Western Manufacturing Division are members of an industry multi-employer pension plan to which the Partnership contributes monies. During the year ended December 31, 2014, the Partnership contributed and expensed \$2.4 million (December 31, 2013 - \$2.4 million) related to this defined benefit plan. Sufficient information regarding the Partnership's share of the defined benefit obligation is not available and accordingly the Partnership accounts for the multi-employer plan as a defined contribution plan.

The Partnership sponsors a defined contribution plan which covers substantially all of its salaried employees. During the year ended December 31, 2014, the Partnership recorded an expense of \$2.4 million (December 31, 2013 - \$2.3 million) related to this plan.

KTG sponsors a defined contribution plan that covers substantially all of its employees. During the year ended December 31, 2014, the Partnership recorded an expense of \$0.6 million (December 31, 2013 - \$0.6 million) related to this plan.

The Partnership provides certain health and other similar benefits for qualifying retirees (post-retirement benefit plans). These plans are not funded.

The measurement date of the employee future benefit plans is December 31 of each year.

By their design, the defined benefit pension plans and the post-retirement benefits plan exposes the Partnership to the typical risks faced by such plans such as investment performance (pension plans only), changes to the discount rate used to value the obligations, longevity of plan members and future inflation. Pension and benefit risk is managed by regular monitoring of the plans, applicable regulations and other factors that could impact the expenses and cash flows of the Partnership. As of December 31, 2013, the aggregate solvency deficit of the defined benefit plans was \$66.8 million (December 31, 2012 - \$176.6 million). The next required revaluation will be completed in the first half of fiscal 2015. The funding obligations are dependent on a number of factors, including the assumptions used in the most recent actuarial valuation. Actual contributions that are determined on the basis of future valuation reports may vary significantly from the predictions.

The cumulative actuarial losses recognized in retained earnings as of December 31, 2014 and December 31, 2013 were as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Pensions	94,275	68,586
Post-retirement benefits	14,975	11,509
Total	109,250	80,095



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Information about the Partnership's defined benefit pension plans and post-retirement benefit plans was as follows:

	<b>Pensions</b>		<b>Post-retirement benefit plans</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Change in defined benefit obligation:</b>				
<b>As of January 1</b>	561,134	568,223	48,746	48,302
Gain on curtailment	-	(124)	-	-
Current service cost	7,850	8,158	1,446	1,395
Interest costs	25,672	23,969	2,175	2,061
Employee contributions	3,773	3,815	-	-
Benefits paid	(29,415)	(32,430)	(2,476)	(2,413)
Remeasurements:				
Losses/(Gains) from changes in experience	2,840	(4,981)	3	-
Losses/(Gains) from changes in economic assumptions	52,217	(23,646)	3,896	(2,099)
Losses/(Gains) from changes in demographic assumptions	(1,884)	18,150	(433)	1,500
<b>As of December 31</b>	<b>622,187</b>	<b>561,134</b>	<b>53,357</b>	<b>48,746</b>
<b>Change in plan assets at fair value:</b>				
<b>As of January 1</b>	480,754	419,234	-	-
Expected return on plan assets	21,698	17,567	-	-
Remeasurements:				
Gains on plan assets	27,484	45,142	-	-
Administrative costs	(578)	(530)	-	-
Employer contributions	19,938	27,956	2,476	2,413
Employee contributions	3,773	3,815	-	-
Benefits paid	(29,415)	(32,430)	(2,476)	(2,413)
<b>As of December 31</b>	<b>523,654</b>	<b>480,754</b>	<b>-</b>	<b>-</b>
<b>Accrued benefit liability</b>				
Funded status - deficit	98,533	80,380	53,357	48,746

# Kruger Products L.P.

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Plan assets, which are funding the Partnership's defined benefit plans, are comprised as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>%</b>	<b>%</b>
Fixed income	40.0	38.0
Public equities	31.0	33.0
Alternative assets	29.0	29.0
Total	100.0	100.0
Quoted on an active market	69.0	70.0
Unquoted	31.0	30.0
	100.0	100.0

The following were the significant assumptions for the defined benefit pension plans and post-retirement benefit plans as of December 31:

	<b>Pensions</b>		<b>Post-retirement benefit plans</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Assumptions				
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		

Post-retirement benefit plans:

For measurement purposes, the trend factor for all health-care expenses, excluding medication, was assumed to be 3.5% for the first year, with an annual 0.025% reduction for 20 years and 3.0% thereafter. The trend factor for medication was assumed to be 7.0% the first year, with an annual 0.2% reduction for 20 years, and 3.0% thereafter.

The sensitivity analysis presented was performed by changing each assumption individually. If an actual change were to occur, it is likely that some of these assumptions would correlate, which would create a combined impact.

The effect of a 1% change in the assumed health care cost trend rate was as follows:

	<b>December 31, 2014</b>		<b>December 31, 2013</b>	
	<b>1% increase</b>	<b>1% decrease</b>	<b>1% increase</b>	<b>1% decrease</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Increase (decrease) in:				
current service cost and interest cost for the year	369	(335)	352	(321)
post-retirement benefit obligations	4,862	(4,337)	4,112	(3,698)

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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The effect of a 1% change in the assumed discount rate was as follows:

	December 31, 2014		December 31, 2013	
	1% increase	1% decrease	1% increase	1% decrease
	\$	\$	\$	\$
Increase (decrease) in:				
Current service cost and interest cost for the year	(511)	642	(508)	639
Post-retirement benefit obligations	(6,255)	7,710	(5,549)	6,819

The effect of a one-year change in the assumed mortality rate was as follows:

	December 31, 2014		December 31, 2013	
	One-year increase	One-year decrease	One-year increase	One-year decrease
	\$	\$	\$	\$
Increase (decrease) in:				
Current service cost and interest cost for the year	53	(59)	52	(53)
Post-retirement benefit obligations	1,187	(1,208)	985	(994)

Except for the discount rate, the assumptions represent management's best estimates. The discount rate was based on the yield of high quality Canadian corporate fixed income investments with cash flows that match expected benefit payments.

Pensions:

Expected fees payable by the plan were deducted from the expected rate of return of plan assets.

The effect of a 1% reduction in the discount rate, a 1% increase in the rate of compensation and one-year change in mortality rate were:

	Discount rate		Rate of compensation		Life expectancy	
	December 31, 2014	December 31, 2013	December 31, 2014	December 31, 2013	December 31, 2014	December 31, 2013
	\$	\$	\$	\$	\$	\$
Increase in Pension expense	2,957	3,055	418	417	173	196
Increase in Pension obligation	95,447	82,100	9,443	8,890	13,111	11,024

Contributions to the defined benefit pension plans for the year ending December 31, 2015 are expected to be \$13.4 million.

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The net benefit pension plan expense included the following components:

	<b>Pensions</b>		<b>Post-retirement benefit plans</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Net plan expense</b>				
Current service cost	7,850	8,158	1,446	1,395
Interest costs	25,672	23,969	2,175	2,061
Expected return on plan assets	(21,698)	(17,567)	-	-
Administrative costs	578	530	-	-
Gain on curtailment	-	(124)	-	-
	<u>12,402</u>	<u>14,966</u>	<u>3,621</u>	<u>3,456</u>

The following amounts are recognized in other comprehensive income:

	<b>Pensions</b>		<b>Post-retirement benefit plans</b>	
	<b>December 31, 2014</b>	<b>December 31, 2013</b>	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Gains (losses) from changes in experience	(2,840)	4,981	(3)	-
Gains (losses) from changes in economic assumptions	(52,217)	23,646	(3,896)	2,099
Gain (losses) from changes in demographic assumptions	1,884	(18,150)	433	(1,500)
Gains on plan assets	<u>27,484</u>	<u>45,142</u>	<u>-</u>	<u>-</u>
	<u>(25,689)</u>	<u>55,619</u>	<u>(3,466)</u>	<u>599</u>

## 12 Trade and other payables

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Trade payables	61,666	61,536
Accrued expenses	65,781	69,929
Merchandising accruals	<u>45,781</u>	<u>57,038</u>
	<u>173,228</u>	<u>188,503</u>

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## Notes to Consolidated Financial Statements

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### 13 Provisions

	Environmental and asset retirement obligations \$ (a)	Long-term incentives \$ (b)	Restructuring \$ (c)	Total \$
<b>Provisions as of January 1, 2013</b>	4,874	1,118	3,233	9,225
Additional provisions	213	800	-	1,013
Paid during the year	-	(607)	(2,234)	(2,841)
Interest accretion	217	-	-	217
<b>Provisions as of December 31, 2013</b>	5,304	1,311	999	7,614
<b>Current</b>	-	-	999	999
<b>Non-current</b>	5,304	1,311	-	6,615
<b>Provisions as of January 1, 2014</b>	5,304	1,311	999	7,614
Additional provisions	340	927	2,835	4,102
Paid during the year	-	(52)	(2,510)	(2,562)
Interest accretion	254	-	-	254
<b>Provisions as of December 31, 2014</b>	5,898	2,186	1,324	9,408
<b>Current</b>	-	1,643	1,324	2,967
<b>Non-current</b>	5,898	543	-	6,441

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 at the Partnership's option. 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 earnings before interest, taxes, 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 the year ended December 31, 2012. There were no restructuring charges at the New Westminster plant and other locations during the year ended December 31, 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 incurred restructuring costs of \$2.2 million related to this initiative, of which \$0.8 million were incurred during the year ended December 31, 2014.

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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 \$2.0 million, primarily related to severance. As of December 31, 2014, the Partnership had incurred \$1.2 million of the costs associated with this initiative. The remaining provision of \$0.8 million relates primarily to management's best estimate of the severance costs to be incurred.

### 14 Long-term debt

		December 31, 2014	December 31, 2013
	Maturity	\$	\$
Revolving credit facilities <sup>(a)</sup>	2016	-	-
8% Senior unsecured notes <sup>(b)</sup>	2018	172,594	171,926
2.87% Nordea facility <sup>(c)</sup>	2019	37,428	40,904
Loan payable <sup>(d)</sup>	2016	2,167	3,225
Caisse facility <sup>(e)</sup>	2018	155,336	134,201
		367,525	350,256
Less: Current portion of long-term debt		8,879	8,243
		358,646	342,013

#### a) Revolving credit facilities

On May 16, 2013, the Partnership entered into the fourth amended and restated credit agreement (the Credit Agreement) related to its revolving credit facilities. The Credit Facility was reduced from \$195.0 million to \$125.0 million. The borrowings under the Credit Facility bear interest at a base rate of Prime Rate, U.S. Base Rate and Libor, plus a margin varying between 0.20% and 2.50% depending on the Partnership's rate of funded debt to EBITDA and the type of advance. The Credit Agreement is for a three year period and will mature on July 22, 2016. The Credit Agreement provides for certain restrictive undertakings and covenants to be complied with by the Partnership. The transaction costs of \$0.6 million have been deferred and classified as other long-term assets during the years ended December 31, 2014 and December 31, 2013.

The Credit Agreement is guaranteed by KP USA, GTM and any new subsidiaries acquired by the Partnership (the Restricted Subsidiaries). The Partnership and the Restricted Subsidiaries provide first ranking security interests and hypothecs over their current and future tangible assets to secure the obligations under the Credit Agreement including a pledge of 100% of the stock or ownership interest in all subsidiaries owned by the Partnership and the Restricted Subsidiaries.

As of December 31, 2014, the Partnership had \$95.4 million (net of letters of credit of \$29.6 million) available on this facility (December 31, 2013 - \$92.6 million, net of letters of credit of \$32.4 million). The weighted average interest rate for the year ended December 31, 2014 was nil (December 31, 2013 - nil).

#### b) Senior unsecured notes

On August 9, 2011, the Partnership issued \$175 million in an aggregate principal amount of 8.0% senior unsecured notes due August 9, 2018 (the Notes) through a private placement. As of December 31, 2014, unamortized deferred financing fees were \$2.4 million (December 31, 2013 - \$3.1 million). The Partnership pays interest on the Notes in equal instalments on February 9 and August 9 of each year, commencing February 9, 2012. The Partnership may, at its option, redeem all or part of the Notes at any time prior to August 9, 2015 at an applicable redemption premium and on or after August 9, 2015 at fixed redemption prices plus, in each case,

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accrued and unpaid interest, if any, to the applicable redemption date. If the Partnership undergoes a change in control, it will be required to offer to purchase the Notes.

The Notes include an early repayment option. The Partnership has determined that the early repayment option is an embedded derivative that is not closely related to the Notes. Accordingly, the embedded derivative has been bifurcated from the Notes. The embedded derivative is recorded at its fair value with changes in fair value included in interest expense in the consolidated statement of comprehensive income. During the year ended December 31, 2014, management revised its assumptions with respect to the valuation of the embedded derivative. An asset of \$2.4 million has been recognized as of December 31, 2014 (December 31, 2013 - \$3.0 million) to record the embedded derivative at its fair value.

The Notes are senior unsecured obligations of the Partnership. The Notes rank senior in right of payment to all existing and future subordinated indebtedness of the Partnership and equal in right of payment to all indebtedness of the Partnership that is not subordinated in right of payment to the Notes other than any indebtedness of the Partnership, including the Credit Agreement and the Nordea Facility, to the extent of the assets securing such indebtedness. The Notes are unconditionally guaranteed, jointly and severally, by the Partnership's Restricted Subsidiaries.

c) Nordea facilities

On July 8, 2011, the Partnership entered into a credit agreement with Nordea Bank AB (the Nordea Facility), providing for a term loan in the principal amount of approximately U.S.\$46.2 million, to be used for the financing of a TAD tissue machine in its subsidiary, KTG. The Nordea Facility has a term of seven years and bears interest at a fixed interest rate of approximately 3% per annum, comprised of a Swedish state reported interest rate, risk premium and administrative margin. The loan is secured by the assets of the Partnership ranking pari passu with the Senior Lenders of the Credit Agreement. The loan is repayable in 14 equal consecutive semi-annual instalments of principal together with interest commencing on June 30, 2013. The Partnership fully utilized the Nordea Facility by making a final draw of U.S.\$4.5 million during the first quarter of 2013. As of December 31, 2014, U.S.\$33.0 million was outstanding related to the facility (December 31, 2013 - U.S.\$39.6 million). As of December 31, 2014 unamortized deferred financing fees were \$0.8 million (December 31, 2013 - \$1.2 million). On May 16, 2013, the Partnership entered into the amended credit agreement (the "Credit Agreement") related to its Nordea Facility. No significant changes were made to the Nordea Facility.

d) Loan payable

The loan payable is related to an agreement with the Government of Quebec for financing related to its Crabtree converting line expansion. The loan payable is secured with the converting line assets and is non-interest bearing. The loan was valued on discounted future cash flows using a market rate of 6.0%. The Partnership had a moratorium on repayment of the principal for the initial 12 quarters, with repayment commencing on April 30, 2013. As of December 31, 2014, \$2.2 million was outstanding related to the loan (December 31, 2013 - \$3.2 million).

e) Caisse facility

On August 6, 2011, TAD Canco Inc. entered into a credit agreement with the Caisse de dépôt for a term loan facility (the Caisse Facility) for U.S.\$211.1 million for the purposes of financing the expansion of KTG, including construction of a new TAD paper machine and expansion of the tissue plant. Under the terms of the Caisse Facility, draws were only permitted until February 15, 2014, at which time the Partnership had drawn U.S. \$125.0 million.

The Caisse Facility is for a seven-year term, maturing on August 16, 2018. The Caisse Facility bears interest at a base rate of 8% per annum, with an applicable margin rate set each period based on KTG's net debt to EBITDA

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ratio and KTG's excess cash flows, as defined in the agreement. The applicable margin consists of (i) 5% per annum at any time prior to the TAD Project service commencement date and KTG Excess cash flow has become positive, and (ii) thereafter, if the net debt to KTG EBITDA ratio is (A) higher or equal to 2.5, the greater of interest calculated at 5% per annum and an amount equal to 30% of KTG excess cash flow (B) lower than 2.5 but not lower than 2.0, the greater of interest calculated at 5% per annum and an amount equal to 25% of KTG excess cash flow or (C) lower than 2.0, the greater of interest calculated at 4% per annum and an amount equal to 15% of KTG excess cash flow. The weighted average interest rate on the Caisse Facility was 15.00% for the year ended December 31, 2014 (December 31, 2013 – 15.44%).

The Caisse Facility is secured by all assets of TAD Canco Inc., KTG and all equity interests of TAD Luxembourg S.A.R.L. The facility was drawn only after the base equity investment of U.S.\$107.0 million by the Partnership had been contributed to TAD Canco Inc.

As of December 31, 2014, TAD Canco Inc. had received proceeds of U.S.\$125.0 million from this facility (December 31, 2013 – U.S.\$125.0 million).

TAD Canco Inc. does not need to comply with financial covenants within this credit agreement. In addition, the Caisse Facility has cross default provisions with certain debt agreements of the Partnership.

The Credit Agreement has cross default covenants with the Notes, the Nordea Facility and the Caisse Facility.

The financing fees for the loans are amortized using the effective interest method over the expected life of the loans. The amortization amounts are included in interest expense.

The aggregate future principal repayments required on long-term debt are as follows:

	<u>\$</u>
Less than 1 year	8,879
Between 1 and 5 years	370,631
More than 5 years	<u>-</u>
	<u><u>379,510</u></u>

Interest expense reflected on the consolidated statement of comprehensive income was as follows:

	<b>2014</b>	<b>2013</b>
	<u>\$</u>	<u>\$</u>
Interest expense on long-term debt	37,730	34,871
Interest accredited on provisions and other liabilities	254	217
Pension and post-retirement benefits, net	6,149	8,463
Embedded derivatives on debt	<u>597</u>	<u>(1,300)</u>
Interest expense	<u><u>44,730</u></u>	<u><u>42,251</u></u>



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### 15 Distributions and Partnership units liability

	<b>Partnership units liability</b>
	<b>\$</b>
As of January 1, 2013	118,562
Issuance of Partnership units	-
Change in amortized cost of Partnership units liability	(723)
As of December 31, 2013	<u>117,839</u>
As of January 1, 2014	117,839
Issuance of Partnership units	-
Change in amortized cost of Partnership units liability (note 4)	13,759
Tax Distributions paid	(3,475)
As of December 31, 2014	<u>128,123</u>

The Partnership unit distributions paid, the portion of the distribution reinvested by the partners, the additional Partnership units issued at the unit price, and the gross proceeds were as follows:

	<b>2014</b>			
	<b>Partnership unit</b>	<b>Unit price</b>	<b>Issuance of</b>	<b>Gross proceeds</b>
<b>Distribution Payment Date</b>	<b>distributions</b>		<b>Partnership units</b>	
	<b>\$</b>	<b>\$</b>	<b>#</b>	<b>\$</b>
January 15, 2014	9,455	16.59	252,478	4,188
April 15, 2014	9,501	15.51	275,843	4,277
July 15, 2014	9,550	15.33	279,468	4,284
October 15, 2014	9,601	14.52	288,921	4,195
	<u>38,107</u>		<u>1,096,710</u>	<u>16,944</u>

	<b>2013</b>			
	<b>Partnership unit</b>	<b>Unit price</b>	<b>Issuance of</b>	<b>Gross proceeds</b>
<b>Distribution Payment Date</b>	<b>distributions</b>		<b>Partnership units</b>	
	<b>\$</b>	<b>\$</b>	<b>#</b>	<b>\$</b>
April 15, 2013	11,233	18.58	275,035	5,110
July 15, 2013	9,367	16.76	241,241	4,043
October 15, 2013	9,410	16.53	246,974	4,082
	<u>30,010</u>		<u>763,250</u>	<u>13,235</u>

On November 12, 2014, the Partnership declared a distribution of \$9.7 million, which was paid on January 15, 2015. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 256,590 additional Partnership units at a price of \$16.46 for the gross proceeds of \$4.2 million. A fair value adjustment of \$0.1 million was recorded at December 31, 2014 to reflect the market value of the Partnership units issued (December 31, 2013 – nil).

Subsequent to December 31, 2014, the Partnership declared a distribution of \$9.7 million, payable on April 15, 2015.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

### *Tax Distributions*

On February 27, 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 year ended December 31, 2014, pursuant to the Tax Distribution as defined in the Partnership Agreement, the Partnership made advances to its partners of \$3.5 million, of which \$0.6 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 were offset against the Tax Distributions of \$6.9 million paid by the Partnership on February 27, 2015.

### 16 Income taxes

The Partnership is not a tax paying entity for the years ended December 31, 2014 and December 31, 2013. The taxable income (loss) from the Partnership flows to the partners, Kruger Inc., KPGP and KPT. However, the Partnership's subsidiaries KP USA, KTG, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L are corporate entities and, therefore, are subject to tax.

The consolidated income tax recovery for the Partnership of \$1.8 million for the year ended December 31, 2014 (December 31, 2013 – recovery of \$10.9 million) related to KP USA, KTG, TAD Canco Inc. and GTM.

The components of income taxes were as follows:

	December 31, 2014	December 31, 2013
	\$	\$
Current tax expense	2,038	1,507
Deferred tax credit	(3,878)	(12,447)
	<u>(1,840)</u>	<u>(10,940)</u>

Details of the provision for income taxes and the reconciliation of the consolidated Canadian federal and provincial statutory income tax rates to the effective tax rate on earnings were as follows:

	December 31, 2014		December 31, 2013	
	\$	%	\$	%
Combined federal and provincial income tax rates after manufacturing and processing credits	5,018	26.1	9,914	26.1
Income taxed in partners' hands	(6,238)	(32.4)	(15,145)	(39.9)
Difference in statutory income tax rate of foreign operations	(526)	(2.7)	(2,078)	(5.5)
Investment tax credits	(118)	(0.7)	(3,611)	(9.5)
Permanent and other	24	0.1	(20)	-
	<u>(1,840)</u>	<u>(9.6)</u>	<u>(10,940)</u>	<u>(28.8)</u>

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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

Components of the deferred income tax (asset) liability were as follows:

	December 31, 2014	December 31, 2013
	\$	\$
Property, plant and equipment	35,999	13,319
Net operating losses	(45,860)	(23,229)
Long term debt and deferred financing charges	(6,068)	(261)
Inventory and accrued liabilities	(2,524)	(3,183)
Other	(1,112)	(787)
	<u>(19,565)</u>	<u>(14,141)</u>

The analysis of the deferred tax (assets) and liabilities was as follows:

	December 31, 2014	December 31, 2013
	\$	\$
Deferred tax (asset) liability to be recovered within 12 months	(2,640)	(387)
Deferred tax (asset) liability to be recovered after 12 months	(16,925)	(13,754)
	<u>(19,565)</u>	<u>(14,141)</u>

In addition to the above, the Partnership has deferred tax assets of \$13.4 million related to net operating loss carry-forwards which have not been recognized in the consolidated financial statements.

The Partnership had the following net operating loss carry-forwards available as of December 31, 2014:

	U.S. Federal		U.S. State		Canada	
	\$	Expiry date	\$	Expiry date	\$	Expiry date
2003	5	2023	-	2018	-	
2004	4,657	2024	1,166	2019	-	
2005	24	2025	-	2020	-	
2006	5,142	2026	5,140	2021	-	
2009	1,415	2029	-	2025	-	
2011	555	2031	105	2026	871	2031
2012	2,456	2032	2,133	2027	8,067	2032
2013	51,781	2033	27,496	2028	17,601	2033
2014	<u>60,259</u>	2034	<u>31,762</u>	2029	<u>18,486</u>	2034
	<u>126,294</u>		<u>67,802</u>		<u>45,025</u>	

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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

The Partnership had the following U.S. State tax credits available for carry-forward as of December 31, 2014:

	<b>U.S. State</b>	
	<b>\$</b>	<b>Expiry date</b>
2002	60	2017
2003	46	2018
2004	41	2019
2005	55	2020
2006	8	2021
2007	118	2022
2008	123	2023
2009	48	2024
2010	92	2025
2011	155	2026
2012	3,514	2027
2013	11,385	2028
2014	<u>750</u>	2029
	<u><u>16,395</u></u>	

These credits are available to reduce future Tennessee excise tax and franchise tax otherwise payable by its subsidiary, KTG.

### 17 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 year ended December 31, 2014 were \$1.7 million (December 31, 2013 - \$4.8 million). Sales of goods to subsidiaries of Kruger Inc. for the year ended December 31, 2014 were \$0.2 million (December 31, 2013 - \$0.6 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 year ended December 31, 2014 were \$28.1 million (December 31, 2013 - \$28.6 million). Purchases of goods and services from subsidiaries of Kruger Inc. for the year ended December 31, 2014 were \$14.2 million (December 31, 2013 - \$9.5 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 in the consolidated statement of comprehensive income. During the year ended December 31, 2014, management fees of \$4.1 million (December 31, 2013 - \$4.0 million) were paid to Kruger Inc. for management services provided to the Partnership.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

Balances due to and from related parties were as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
		\$
Receivables from Kruger Inc.	220	1,255
Receivables from subsidiaries of Kruger Inc.	28	174
Receivables from KPT	53	-
	<u>301</u>	<u>1,429</u>
Payables to Kruger Inc.	2,978	3,472
Payables to subsidiaries of Kruger Inc.	1,409	1,662
	<u>4,387</u>	<u>5,134</u>

The receivables from and payables to related parties are due two months after the date of sale or purchase. 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 December 31, 2014 and December 31, 2013. There were no loans outstanding with related parties as of December 31, 2014 and December 31, 2013.

The Partnership has distributions payable to its related parties as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	\$	\$
Distribution payable to Kruger Inc.	8,179	7,871
Distribution payable to KPGP	1	1
Distribution payable to KPT	1,601	1,583
Total distribution payable	<u>9,781</u>	<u>9,455</u>

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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

	<b>2014</b>			
	<b>Tax distributions</b>	<b>Advances</b>	<b>Partnership unit distributions</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Paid to Kruger Inc. <sup>(a)</sup>	2,890	2,890	15,877	21,657
Paid to KPGP	1	-	3	4
Paid to KPT	459	584	6,350	7,393
Total paid	<u>3,350</u>	<u>3,474</u>	<u>22,230</u>	<u>29,054</u>

	<b>2013</b>			
	<b>Tax distributions</b>	<b>Advances</b>	<b>Partnership unit distributions</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Paid to Kruger Inc. <sup>(a)</sup>	-	-	12,475	12,475
Paid to KPGP	-	-	3	3
Paid to KPT	-	-	5,058	5,058
Total paid	<u>-</u>	<u>-</u>	<u>17,536</u>	<u>17,536</u>

- a) During the years ended December 31, 2014 and December 31, 2013, Partnership unit distributions were paid to Kruger Inc. net of the DRIP reinvestment. During the year ended December 31, 2014, Kruger Inc.'s DRIP reinvestment was \$15.9 million (December 31, 2013 - \$12.5 million).

### 18 Commitments and contingencies

Non-cancellable operating lease commitments related to land, buildings, IT services, vehicles and other machinery and equipment are as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Less than 1 year	14,802	13,040
Between 1 and 5 years	47,728	46,017
More than 5 years	<u>52,254</u>	<u>57,444</u>
	<u>114,784</u>	<u>116,501</u>

Operating lease expense recognized in the consolidated statement of comprehensive income during the year ended December 31, 2014 was \$13.8 million (December 31, 2013 - \$12.3 million).

As of December 31, 2014, the Partnership had commitments under service contracts of \$1.6 million for 2015 and \$0.4 million for 2016.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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The Partnership has committed to incurring the costs associated with the installation of underground hydro lines to supply the Gatineau Plant, which will be capitalized and amortized over their estimated life.

From time to time, the Partnership is involved in various litigation matters arising in the ordinary course of its business. The Partnership has no reason to believe the disposition of any such current matter could reasonably be expected to have a material adverse impact on the Partnership's financial position, results of operations or its ability to carry on any of its business activities.

As of December 31, 2014, the Partnership had irrevocable letters of credit outstanding of \$29.6 million (December 31, 2013 - \$32.4 million), which included letters of credit for the pension plans disclosed in note 11.

### 19 Expenses by nature

	2014	2013
	\$	\$
Materials and production costs	365,572	318,879
Wages and other employee benefit expenses	230,701	214,054
Maintenance materials and labour	39,923	45,954
Energy costs	77,869	62,701
Depreciation and amortization	37,698	34,142
Freight and distribution	127,376	111,095
Marketing, selling and administrative expenses	82,625	86,720
<b>Total expenses by nature</b>	<b>961,764</b>	<b>873,545</b>

Classified in the consolidated statement of comprehensive income were:

	2014	2013
	\$	\$
Cost of sales	879,139	786,825
SG&A expenses	82,625	86,720
	<b>961,764</b>	<b>873,545</b>

### 20 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, 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.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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

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.

				2014
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	842,635	184,263	19,270	1,046,168
Segment operating profit (loss)	123,606	1,687	(3,657)	121,636
Depreciation and amortization				37,698
Interest expense				44,730
Change in amortized cost of Partnership units liability				13,759
Gain on sale of fixed assets				(135)
Restructuring costs				2,835
Unrealized foreign exchange loss				3,522
Income before income taxes				19,227
Income taxes				(1,840)
Net income for the year				21,067

				2013
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	792,670	154,304	8,372	955,346
Segment operating profit (loss)	110,342	6,608	(722)	116,228
Depreciation and amortization				34,142
Interest expense				42,251
Recovery of non-financial assets				(1,789)
Change in amortized cost of Partnership units liability				(723)
Gain on sale of fixed assets				(5)
Restructuring costs				1,372
Unrealized foreign exchange loss				2,992
Income before income taxes				37,988
Income taxes				(10,940)
Net income for the year				48,928



# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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### Geographic segments

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

	<b>2014</b>			
	<b>Canada</b>	<b>US</b>	<b>Mexico</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Revenue	699,996	316,738	29,434	1,046,168
Property, plant and equipment	299,127	353,635	-	652,762
Goodwill	160,939	-	-	160,939
Intangible assets	14,052	-	-	14,052

	<b>2013</b>			
	<b>Canada</b>	<b>US</b>	<b>Mexico</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Revenue	688,173	239,225	27,948	955,346
Property, plant and equipment	292,561	324,126	-	616,687
Goodwill	152,021	-	-	152,021
Intangible assets	13,483	-	-	13,483

### 21 Compensation of key management

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
Compensation awarded to key management included		
Salaries and other short-term employee benefits	5,431	5,749
Post-employment benefits	374	350
Other long-term benefits	51	469
	<b>5,856</b>	<b>6,568</b>

Key management includes the Partnership's senior executives.

### 22 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.

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

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As of December 31, 2014, the classification of the financial instruments, as well as their carrying amounts and fair values, was as follows:

	<b>Classification</b>	<b>Measurement</b>	<b>Carrying amount \$</b>	<b>Fair Value \$</b>
Cash and cash equivalents	loans and receivables	amortized cost	51,788	51,788
Trade and other receivables	loans and receivables	amortized cost	107,092	107,092
Receivables from related parties	loans and receivables	amortized cost	301	301
Advances to partners	loans and receivables	amortized cost	3,474	3,474
Embedded derivative	fair value through profit or loss	fair value	2,431	2,431
Available-for-sale investment	fair value through other comprehensive income or loss	fair value	1,198	1,198
Trade and other payables	financial liabilities	amortized cost	(173,228)	(173,228)
Payables to related parties	financial liabilities	amortized cost	(4,387)	(4,387)
Distributions payable	financial liabilities	amortized cost	(9,781)	(9,781)
Long-term debt	financial liabilities	amortized cost	(367,525)	(393,318)
Partnership units liability	financial liabilities	amortized cost	(128,123)	(128,123)

The following table details the fair value hierarchy of financial instruments carried at fair value by level as of December 31, 2014:

	<b>Level 1 \$</b>	<b>Level 2 \$</b>	<b>Level 3 \$</b>	<b>Total \$</b>
Embedded derivative	-	2,431	-	2,431
Available-for-sale investment	1,198	-	-	1,198

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

	<b>Classification</b>	<b>Measurement</b>	<b>Carrying amount \$</b>	<b>Fair Value \$</b>
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	(188,503)	(188,503)
Payables to related parties	financial liabilities	amortized cost	(5,134)	(5,134)
Distributions payable	financial liabilities	amortized cost	(9,455)	(9,455)
Long-term debt	financial liabilities	amortized cost	(350,289)	(377,295)
Partnership units liability	financial liabilities	amortized cost	(117,839)	(117,839)

# Kruger Products L.P.

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(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 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, advances to partners, trade and other payables, payables to related parties and distributions payable are short-term financial instruments whose fair value approximates the carrying amount, given they will mature in the near future. As of December 31, 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 \$38.2 million and \$163.9 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 December 31, 2014, the fair value of the loans payable was \$2.2 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.

The fair value of the available-for-sale investment is based on quoted market price in the active market. Unrealized gains were not significant as of December 31, 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 (see note 4).

### *Objectives and policies relating to financial risk management*

The Partnership's activities result in exposure to a variety of financial risks, including risks related to credit, currency, liquidity and interest rate risks.

### *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. The Partnership's financial instruments exposed to credit risk include cash and cash equivalents, trade and other receivables, receivables from related parties and advances to partners. The Partnership places its cash and cash equivalents with financial institutions of high creditworthiness.

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

# Kruger Products L.P.

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

	December 31, 2014	December 31, 2013
	\$	\$
Trade receivables	102,555	90,782
Less: Allowance for doubtful accounts	(672)	(353)
Total trade receivables, net	<u>101,883</u>	<u>90,429</u>
Trade receivables, net		
0 to 60 days	100,724	90,132
61 to 90 days	1,066	299
Over 90 days	765	351
Less: Allowance for doubtful accounts	(672)	(353)
	<u>101,883</u>	<u>90,429</u>

In accordance with the Partnership agreement, advances made to the partners are settled when the Partnership declares the Tax Distribution. Accordingly, the exposure to credit risk in respect of the advances to the partners is limited.

### *Currency risk*

Currency risk is the risk the Partnership's earnings may fluctuate due to changes in Canadian to U.S. dollar exchange rates.

The Partnership sells certain of its products in U.S. dollars at prevailing U.S. dollar prices. A majority of the currency exposure is naturally offset by U.S. dollar expenses and the U.S. dollar denominated debt.

As of December 31, 2014, the Partnership has net liabilities denominated in U.S. dollars of \$42.2 million (December 31, 2013 - \$50.0 million). Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the hypothetical result on income before income taxes for the year ended December 31, 2014 would have been an increase/decrease of \$2.1 million (December 31, 2013 - \$2.5 million).

### *Liquidity risk*

The purpose of liquidity risk management is to maintain sufficient cash and cash equivalents and to ensure the Partnership has sufficient authorized credit facilities to finance operations. The Partnership had unused lines of credit available of \$95.4 million as of December 31, 2014 (December 31, 2013 - \$92.6 million). The Partnership prepares projections to ensure it has sufficient funds to fulfill its obligations. Refinancing risks are minimized by ensuring the credit facility will not mature for two years. The ability to pay its obligations relies on the Partnership collecting its trade receivables in a timely manner and by maintaining sufficient cash and cash equivalents in excess of anticipated needs. The Partnership's trade and other payables of \$173.2 million (December 31, 2013 - \$188.5 million) are all due for payment within 12 months of the dates of the consolidated statement of financial position.

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The Partnership's contractual obligations in respect of its financial instruments comprise the following:

	<b>December 31, 2014</b>		
	<b>Less than 1 year</b>	<b>1 to 5 years</b>	<b>Greater than 5 years</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Long-term debt <sup>(a)</sup>	35,143	436,112	-
Trade and other payables	173,228		
Payables to related parties	4,387		
Distributions payable	9,781		

(a) Long-term debt includes principal repayments and an estimate of interest based on current interest rates.

	<b>December 31, 2013</b>		
	<b>Less than 1 year</b>	<b>1 to 5 years</b>	<b>Greater than 5 years</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Long-term debt <sup>(a)</sup>	34,899	438,579	7,170
Trade and other payables	188,503		
Payables to related parties	5,134		
Distributions payable	9,455		

(a) Long-term debt includes principal repayments and an estimate of interest based on current interest rates.

The above table excludes the Partnership units liability. Payments on the Partnership units liability are made upon the declaration of the Tax Distribution, which for 2014 was \$6.9 million (2013 - \$3.5 million). The Partnership units liability is estimated based on expected future Tax Distributions and is an obligation that will continue into perpetuity (note 4).

### *Interest rate risk*

As of December 31, 2014, the Partnership had variable rate debts of nil (December 31, 2013 - nil). These loans bear interest at the Canadian prime rate, U.S. base rate, banker's acceptance or LIBOR plus the applicable margins. The applicable margin on the loans ranges between 0.20% and 2.50%. Accordingly, the Partnership is not exposed to changes in market interest rates.

## **23 Capital management**

The Partnership's policy is to maintain a sufficient capital base in order to maintain a strong consolidated statement of financial position and otherwise meet financial tests for the credit facilities.

Capital comprises net debt (long-term debt, less cash and cash equivalents) and equity (including the Partnership units classified as a liability). The Partnership monitors externally imposed debt covenants as established pursuant to its credit facility agreements. The requirements include a quarterly net funded debt to capitalization ratio, debt to EBITDA ratio, EBITDA to fixed charge coverage ratio and working capital ratio. The covenants were agreed to with the lenders upon the creation of the credit facilities.

## **24 Environmental costs**

The Partnership is subject to extensive regulation by various federal and provincial agencies concerning compliance with environmental control statutes and regulations. These regulations impose limitations on the discharge of materials into the environment and require the Partnership to operate in compliance with the conditions of permits and other

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

governmental authorizations. Future environmental expenditures will depend on the emergence of new regulations and technological developments.

### 25 Economic dependence

The Partnership manufactures, distributes and sells a wide range of disposable tissue paper and related products primarily in Canada and the U.S. As of December 31, 2014, the Partnership had three major customers, which represented 42.2% (December 31, 2013 – 41.4%) of total revenues, and of these customers, one represented 18.5% (December 31, 2013 – 19.0%) of the total revenues and another represented 10.7% (December 31, 2013 – 11.8%). The Partnership's concentration of credit risk primarily arises from exposure to these three customers and amounted to approximately 26.4% of the trade receivables as of December 31, 2014 (December 31, 2013 – 31.8%). These customers are included in the consumer segment.

### 26 Non-cash working capital

The change in non-cash working capital on the consolidated statement of cash flows comprised the following:

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
Decrease (increase) in trade and other receivables	(9,173)	2,951
Decrease (increase) in receivables from related parties	1,173	(78)
Decrease (increase) in inventories	8,736	(32,039)
Increase in prepaid expenses	(84)	(320)
Increase in other assets	(206)	(1,183)
Decrease (increase) in income taxes	(39)	39
Increase (decrease) in trade and other payables	(12,114)	282
Decrease in payables to related parties	(747)	(3,923)
	<b>(12,454)</b>	<b>(34,271)</b>

# Kruger Products L.P.

## Notes to Consolidated Financial Statements

December 31, 2014 and December 31, 2013

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

### 27 Reclassifications in the financial statements

The following items were reclassified in the 2013 consolidated statement of comprehensive income to conform to current year presentation:

	As presented	Adjustments	Recast presentation
<b>Revenue</b>	955,346	-	955,346
<b>Expenses</b>			
Cost of sales	675,730	111,095	786,825
Operating expenses <sup>(a)</sup>	199,794	(113,074)	86,720
Recovery of non-financial assets	(1,789)	-	(1,789)
Restructuring costs	1,372	-	1,372
<b>Operating income</b>	80,239	1,979	82,218
Interest expense	42,251	-	42,251
Other expense	-	1,979	1,979
<b>Income before income taxes</b>	37,988	-	37,988
<b>Income taxes</b>	(10,940)	-	(10,940)
<b>Net income for the year</b>	48,928	-	48,928

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

The reclassifications had no impact on the reported net income for the year ended December 31, 2013. Other items remain unchanged.

Certain items were reclassified in the consolidated statement of financial position and the consolidated statement of cash flows to conform to current year presentation.

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.



**KP TISSUE INC.**

**AUDITED FINANCIAL STATEMENT**

**FOR THE YEARS ENDED DECEMBER 31, 2014 AND DECEMBER 31, 2013**



March 11, 2015

## **Independent Auditor's Report**

**To the Shareholders of  
KP Tissue Inc.**

We have audited the accompanying financial statements of KP Tissue Inc., which comprise the statement of financial position as at December 31, 2014 and December 31, 2013 and the statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the financial statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's responsibility**

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of KP Tissue Inc. as at December 31, 2014 and December 31, 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

**(signed) PricewaterhouseCoopers LLP**

**Chartered Professional Accountants, Licensed Public Accountants**  
Toronto, Ontario

# KP Tissue Inc.

## Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	December 31, 2014	December 31, 2013
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Distributions receivable	1,601	1,583
<b>Non-current assets</b>		
Investment in associate (note 5)	153,732	161,584
<b>Total Assets</b>	<b>155,333</b>	<b>163,167</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Dividend payable (note 7)	1,601	1,583
Payable to Partnership	53	-
Advances from Partnership (note 6)	584	-
Income taxes payable	495	580
	2,733	2,163
<b>Non-current liabilities</b>		
Deferred income taxes (note 6)	2,005	3,033
<b>Total liabilities</b>	<b>4,738</b>	<b>5,196</b>
<b>Equity</b>		
Common shares (note 7)	10,138	9,068
Contributed surplus (note 7)	144,819	144,819
Retained earnings (deficit)	(12,220)	709
Accumulated other comprehensive income	7,858	3,375
<b>Total equity</b>	<b>150,595</b>	<b>157,971</b>
<b>Total liabilities and equity</b>	<b>155,333</b>	<b>163,167</b>
<b>Subsequent events (note 7)</b>		

Approved by the Board of Directors

/s/ James Hardy \_\_\_\_\_  
Director

/s/ Alexandre Patte \_\_\_\_\_  
Director

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

**KP Tissue Inc.**  
**Statement of Comprehensive Income (Loss)**  
For the years ended December 31, 2014 and December 31, 2013

(tabular amounts are in thousands of Canadian dollars, except share and per share amounts)

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
<b>Equity income (loss) (note 5)</b>	(2,379)	1,113
<b>Gain on remeasurement of over allotment option (note 5)</b>	-	375
<b>Dilution gain (note 7)</b>	<u>102</u>	<u>240</u>
<b>Income (loss) before income taxes</b>	(2,277)	1,728
<b>Income tax expense (recovery) (note 6)</b>		
Current	1,136	580
Deferred	<u>(895)</u>	<u>1,433</u>
	<u>241</u>	<u>2,013</u>
<b>Net loss for the year</b>	<u>(2,518)</u>	<u>(285)</u>
<b>Other comprehensive income (loss)</b>		
<b>net of tax expense (recovery) (note 8)</b>		
<b>Items that will not be reclassified to net loss:</b>		
Remeasurements of pensions	(3,692)	8,130
Remeasurements of post-retirement benefits	(351)	88
<b>Items that may be subsequently reclassified to net loss:</b>		
Available-for-sale investment	2	10
Cumulative translation adjustment	<u>4,481</u>	<u>3,178</u>
<b>Total other comprehensive income for the year</b>	<u>440</u>	<u>11,406</u>
<b>Comprehensive income (loss) for the year</b>	<u>(2,078)</u>	<u>11,121</u>
<b>Basic loss per share</b>	<u>(0.29)</u>	<u>(0.03)</u>
<b>Weighted average number of shares outstanding</b>	<u>8,834,508</u>	<u>8,752,830</u>

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

# KP Tissue Inc.

## Statement of Changes in Equity

For the years ended December 31, 2014 and December 31, 2013

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

	<b>Common shares</b>		<b>Contributed surplus</b>	<b>Retained earnings (deficit)</b>	<b>Accumulated other comprehensive income</b>	<b>Total equity</b>
	<b>#</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>As of January 1, 2013</b>	8,000,001	140,000	-	(583)	187	139,604
Issuance of common shares (note 7)	792,973	13,887	-	-	-	13,887
Dividends payable	-	-	-	(1,583)	-	(1,583)
Dividends paid	-	-	-	(5,058)	-	(5,058)
Reduction in legal stated capital (note 7)	-	(144,819)	144,819	-	-	-
Remeasurements of pensions	-	-	-	8,130	-	8,130
Remeasurements of post-retirement benefits	-	-	-	88	-	88
Available-for-sale investment	-	-	-	-	10	10
Cumulative translation adjustment	-	-	-	-	3,178	3,178
Net loss for the year	-	-	-	(285)	-	(285)
<b>As of December 31, 2013</b>	<b>8,792,974</b>	<b>9,068</b>	<b>144,819</b>	<b>709</b>	<b>3,375</b>	<b>157,971</b>
<b>As of January 1, 2014</b>	8,792,974	9,068	144,819	709	3,375	157,971
Issuance of common shares (note 7)	69,005	1,070	-	-	-	1,070
Dividends declared	-	-	-	(1,601)	-	(1,601)
Dividends paid	-	-	-	(4,767)	-	(4,767)
Remeasurements of pensions	-	-	-	(3,692)	-	(3,692)
Remeasurements of post-retirement benefits	-	-	-	(351)	-	(351)
Available-for-sale investment	-	-	-	-	2	2
Cumulative translation adjustment	-	-	-	-	4,481	4,481
Net loss for the year	-	-	-	(2,518)	-	(2,518)
<b>As of December 31, 2014</b>	<b>8,861,979</b>	<b>10,138</b>	<b>144,819</b>	<b>(12,220)</b>	<b>7,858</b>	<b>150,595</b>

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

# KP Tissue Inc.

## Statement of Cash Flows

For the years ended December 31, 2014 and December 31, 2013

(tabular amounts are in thousands of Canadian dollars)

	<b>2014</b>	<b>2013</b>
	\$	\$
<b>Cash flows from (used in) operating activities</b>		
Net loss for the year	(2,518)	(285)
Items not affecting cash		
Equity loss (income)	2,379	(1,113)
Gain on remeasurement of over allotment option	-	(375)
Dilution gain	(102)	(240)
Income taxes	241	2,013
Total items not affecting cash	2,518	285
Tax payments	(1,043)	-
Tax distribution received	459	-
Advances received	584	-
<b>Net cash from (used in) operating activities</b>	<b>-</b>	<b>-</b>
<b>Cash flows from (used in) investing activities</b>		
Investment in associate (note 5)	(1,070)	(13,887)
Partnership unit distributions received	6,350	5,058
<b>Net cash from (used in) investing activities</b>	<b>5,280</b>	<b>(8,829)</b>
<b>Cash flows from (used in) financing activities</b>		
Issuance of common shares (note 7)	1,070	13,887
Dividends paid	(6,350)	(5,058)
<b>Net cash from (used in) financing activities</b>	<b>(5,280)</b>	<b>8,829</b>
<b>Increase (decrease) in cash and cash equivalents during the year</b>	<b>-</b>	<b>-</b>
<b>Cash and cash equivalents - Beginning of year</b>	<b>-</b>	<b>-</b>
<b>Cash and cash equivalents - End of year</b>	<b>-</b>	<b>-</b>

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

# KP Tissue Inc.

## Notes to Financial Statements

### December 31, 2014 and December 31, 2013

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(tabular amounts are in thousands of Canadian dollars)

#### 1 General information

KP Tissue Inc. (KPT or the Corporation) was incorporated by articles of incorporation under the Canadian Business Corporations Act on October 1, 2012. As of December 31, 2014, the Corporation held a 16.5% (December 31, 2013 – 16.7%) interest in Kruger Products L.P. (KPLP or the Partnership), whose principal business is to produce, distribute, market and sell a wide range of disposable tissue products, including bathroom tissue, facial tissue, paper towels and napkins for both the consumer and away-from-home markets in North America. The Corporation's headquarters are located in Mississauga, Ontario, Canada.

#### 2 Basis of presentation

The financial statements have been prepared in accordance with International Financial Reporting Standards, 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. The financial statements have been prepared using the historical cost convention. The financial statements were approved by the board of directors on March 11, 2015.

#### 3 Summary of significant accounting policies

The significant accounting policies used in the preparation of these financial statements are as follows:

##### (a) *Investments in associates*

Associates are entities over which the Corporation has significant influence but not control. The Corporation accounts for its investment in associates using the equity method. Under the equity method, the investment is initially recognized at cost and the carrying amount is adjusted for the Corporation's share of profits or losses of associates recognized in the statement of income and its share of other comprehensive income (loss) of associates included in other comprehensive income.

Unrealized gains on transactions between the Corporation and an associate are eliminated to the extent of the Corporation's interest in the associate. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Dilution gains and losses arising from changes in interests in investments in associates are recognized in the statement of income.

The Corporation assesses at each year-end whether there is any objective evidence that its interests in investments in associates are impaired. If so, the carrying value of the Corporation's share of the underlying assets of associates is written down to its net recoverable amount (being the higher of fair value, less cost to sell and value in use) and the loss is charged to the statement of income in other gains and losses (net).

##### (b) *Income tax*

Income tax comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in other comprehensive income or directly in equity, in which case the income tax is also recognized directly in other comprehensive income or equity, respectively.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax is not recognized if it arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction

**KP Tissue Inc.**  
**Notes to Financial Statements**  
**December 31, 2014 and December 31, 2013**

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(tabular amounts are in thousands of Canadian dollars)

other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the Corporation and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset is realized or liability is settled. Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

Deferred income tax assets and liabilities are presented as non-current.

*(c) Share capital*

Incremental costs directly attributable to the issuance of common shares are recognized as a deduction from equity.

*(d) Earnings per share*

Basic earnings per share (EPS) is calculated by dividing the net income (loss) for the period attributable to equity owners of the Corporation by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method. The Corporation does not currently have any potentially dilutive instruments.

*(e) Accounting standards implemented for the year ended December 31, 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 the financial statements.

*(f) Accounting standards issued but not yet applied*

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2015, except as noted below, with earlier application permitted. The Corporation continues to assess the impact of these standards and amendments and has not yet determined whether it will early adopt them.

- (i) 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 the financial statements.

**KP Tissue Inc.**  
**Notes to Financial Statements**  
**December 31, 2014 and December 31, 2013**

(tabular amounts are in thousands of Canadian dollars)

- (ii) IAS 1, Presentation of Financial Statements. In December 2014, the IASB issued amendments to clarify guidance in IAS 1 on materiality and aggregation, the presentation of subtotals, the structure of financial statements and the disclosure of accounting policies. The amendments form a part of the IASB's Disclosure Initiative, which explores how financial statement disclosures can be improved. The mandatory effective date of IAS 1 would be annual periods beginning on or after January 1, 2016, with early adoption permitted. Management is evaluating the standard and has not yet determined the impact on the financial statements.

#### **4 Critical accounting estimates and judgments**

The preparation of these financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the disclosure of contingencies at the date of the statement of financial position, and the reported amounts of revenues and expenses during the reporting period. On a regular basis and with the information available, management reviews its estimates and judgments, including those related to fair value and the basis of accounting. Actual results could differ from those estimates. When adjustments become necessary, they are reported in earnings in the period in which they occur.

##### *Equity method of accounting*

The equity method of accounting is being applied by the Corporation 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 the Corporation. Based on the Corporation having three of nine seats on the board of directors of KPGP Inc. (KPGP), management has concluded that the Corporation has the ability to exercise significant influence over KPLP.

##### *Income taxes*

The Corporation 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, the Corporation 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.

#### **5 Investment in associate**

Changes in the carrying amount of the investment were as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Opening balance	161,584	139,499
Investment in associate	1,070	13,887
Share of income	3,500	8,220
Depreciation of fair value increments	(5,879)	(7,107)
Share of other comprehensive income	307	13,111
Gain on exercise of overallotment option	-	375
Dilution gain	102	240
Tax distribution	(584)	-
Partnership unit distributions	(6,368)	(6,641)
Closing balance	<u>153,732</u>	<u>161,584</u>



**KP Tissue Inc.**  
**Notes to Financial Statements**  
**December 31, 2014 and December 31, 2013**

(tabular amounts are in thousands of Canadian dollars)

The equity income (loss) was comprised of the following components:

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
Share of income	3,500	8,220
Depreciation of fair value increments	(5,879)	(7,107)
	<u>(2,379)</u>	<u>1,113</u>

The following summarizes financial information about the assets, liabilities, revenue and net income of KPLP, in which the Corporation holds a 16.5% interest as of December 31, 2014 (December 31, 2013 – 16.7%). The financial information was derived from the financial statements of KPLP for the year ended December 31, 2014. The assets and liabilities disclosed include the fair value adjustments made to the carrying amount of the assets and liabilities of the associate on its acquisition.

	<b>December 31, 2014</b>		
	<b>KPLP basis of accounting</b>	<b>FV increment</b>	<b>KPT basis of accounting</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Current assets	321,636	-	321,636
Non-current assets	870,365	586,516	1,456,881
Liabilities to non-unitholders	716,375	8,800	725,175
Partnership units liability	128,123	-	128,123
Net assets	347,503		
	<b>Year ended December 31, 2014</b>		
	<b>\$</b>		
Revenue	1,046,168		
Net income	21,067		
Other comprehensive loss	(5,361)		
Total comprehensive income	15,706		

**KP Tissue Inc.**  
**Notes to Financial Statements**  
**December 31, 2014 and December 31, 2013**

(tabular amounts are in thousands of Canadian dollars)

	<b>December 31, 2013</b>		
	<b>KPLP basis of accounting</b>	<b>FV increment</b>	<b>KPT basis of accounting</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Current assets	340,804	-	340,804
Non-current assets	820,732	621,512	1,442,244
Liabilities to non-unitholders	690,411	11,238	701,649
Partnership units liability	117,839	-	117,839
Net assets	353,286		
	<b>Year ended December 31, 2013</b>		
	<b>\$</b>		
Revenue	955,346		
Net income	48,928		
Other comprehensive income	72,642		
Total comprehensive income	121,570		

The following shows the reconciliation of KPT's portion of KPLP equity to the investment recorded in KPT:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
KPLP consolidated equity	347,503	353,286
Add back: Inception value of Partnership units liability	118,562	118,562
Less: Equity pertaining to Kruger Inc. and KPGP	<u>(311,673)</u>	<u>(314,767)</u>
Equity pertaining to KPT	154,392	157,081
Investment in associate recorded in KPT	<u>153,732</u>	<u>161,584</u>
Reconciling difference	660	(4,503)
Reconciling items since inception:		
Equity issuance costs	(11,110)	(11,110)
Depreciation of FV increments	14,142	8,263
Currency translation adjustment in fair value increments	(2,239)	(1,041)
Tax distribution	584	-
Gain on exercise of over-allotment option	(375)	(375)
Dilution gain	<u>(342)</u>	<u>(240)</u>
	<u>-</u>	<u>-</u>

With respect to KPT's investment in KPLP, KPT does not have any guarantees, or contractual obligations for KPLP's borrowing arrangements.

On January 10, 2013, the underwriters exercised their over-allotment option and the Corporation issued an additional 750,000 common shares. The proceeds of \$13.1 million received from the issuance were used to acquire 750,000 additional partnership units of KPLP. As a result of the remeasurement of the over-allotment option entitling the Corporation to acquire additional partnership units of KPLP, a gain of \$0.4 million was recorded during the year ended December 31, 2013.

**KP Tissue Inc.**  
**Notes to Financial Statements**  
**December 31, 2014 and December 31, 2013**

(tabular amounts are in thousands of Canadian dollars)

On January 15, 2014, April 15, 2014, July 15, 2014, and October 15, 2014, in connection with the Corporation's Distribution Reinvestment Plan (DRIP), the portion of the distributions received by the shareholders were used to acquire an additional 69,005 units of KPLP for proceeds of \$1.1 million (note 7).

**6 Income taxes**

The Corporation is required to pay income tax on its share of the taxable income of KPLP. The Corporation 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, the Corporation is tracking the temporary differences that were subject to the initial recognition exemption and recognizes newly created temporary differences as they arise.

Details of the provision for income taxes were as follows:

	<b>Year ended December 31, 2014</b>	<b>Year ended December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Income tax at statutory rate of 26%	(592)	449
Permanent differences and other	110	97
Gain on the remeasurement of overallotment option and dilution gain	(26)	(160)
Taxed in hands of subsidiaries	121	397
Realization of previously unrecognized tax attributes	1,493	1,333
Change in basis of investment in associate	(865)	(103)
	<u>241</u>	<u>2,013</u>

Components of the deferred income tax liability were as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Deferred tax liability (asset)		
Investment in associate	751	1,577
Pension	(267)	-
Deferred finance fees	(36)	(37)
Property, plant and equipment	2,226	1,516
Other	(669)	(23)
	<u>2,005</u>	<u>3,033</u>

The analysis of deferred tax liability was as follows:

	<b>December 31, 2014</b>	<b>December 31, 2013</b>
	<b>\$</b>	<b>\$</b>
Deferred tax liabilities to be realized greater than 12 months	<u>2,005</u>	<u>3,033</u>
	<u>2,005</u>	<u>3,033</u>

**KP Tissue Inc.**  
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(tabular amounts are in thousands of Canadian dollars)

The movement in the deferred tax liability was as follows:

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
Opening balance	3,033	(105)
Charge to net income	(895)	1,433
Charge to other comprehensive income		
- remeasurements of cumulative translation adjustment	669	475
Charge to other comprehensive income		
- remeasurements of post-retirement benefits	(225)	13
Charge to other comprehensive income		
- remeasurements of pensions	(577)	1,215
Charge to other comprehensive income		
- mark-to-market on Available-for-sale investment	-	2
	<b>2,005</b>	<b>3,033</b>

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). On February 28, 2014, KPT received a Tax Distribution of \$0.6 million from KPLP for purposes of settling its obligation for federal and provincial taxes.

For the year ended December 31, 2014, pursuant to the Tax Distribution as defined in the Partnership Agreement, KPT received an advance from KPLP of \$0.6 million to pay the monthly tax instalments. The advance is non-interest bearing and non-recourse and will be settled when the Tax Distribution is declared annually. On February 27, 2015, KPT received a tax distribution of \$1.2 million from KPLP for purposes of settling its obligation for federal and provincial taxes, for fiscal 2014.

## **7 Dividends**

On January 15, 2014, the Corporation paid a dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation's DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 15,244 common shares at a price of \$16.59. The proceeds were used to acquire additional units of KPLP.

On April 15, 2014, the Corporation paid a dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation's DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 20,712 common shares at a price of \$15.51.

On July 15, 2014, the Corporation paid a dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation's DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 19,844 common shares at a price of \$15.33.

On October 15, 2014, the Corporation paid a dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation's DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 13,205 common shares at a price of \$14.52.

On January 15, 2015, the Corporation paid a dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation's DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 11,863 common shares at a price of \$16.46.

Subsequent to December 31, 2014, the Corporation declared a dividend of \$0.18 per common share to shareholders, payable on April 15, 2015.

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As a result of the DRIP and Kruger's reinvestment of its distribution from KPLP in units of KPLP, a dilution gain of \$0.1 million was recorded during the year ended December 31, 2014 (December 31, 2013 - \$0.2 million)

**8 Income tax recovery (expense) on other comprehensive income (loss)**

Income tax recovery (expense) on other comprehensive income (loss) was as follows:

	<b>2014</b>	<b>2013</b>
	<b>\$</b>	<b>\$</b>
<b>Items that will not be reclassified to net income (loss):</b>		
Remeasurements of pensions	(4,269)	9,345
Income tax recovery (expense)	<u>577</u>	<u>(1,215)</u>
Net of income tax recovery (expense)	<u>(3,692)</u>	<u>8,130</u>
 Remeasurements of post-retirement benefits	 (576)	 101
Income tax recovery (expense)	<u>225</u>	<u>(13)</u>
Net of income tax recovery (expense)	<u>(351)</u>	<u>88</u>
<b>Items that may be subsequently reclassified to net income:</b>		
Available-for-sale investment	2	12
Income tax expense	<u>-</u>	<u>(2)</u>
Net of income tax expense	<u>2</u>	<u>10</u>
 Cumulative translation adjustment	 5,150	 3,653
Income tax expense	<u>(669)</u>	<u>(475)</u>
Net of income tax expense	<u>4,481</u>	<u>3,178</u>

# SHAREHOLDER INFORMATION

## CORPORATE ADDRESS

1900 Minnesota Court  
Suite 200  
Mississauga, Ontario L5N 5R5  
Telephone: 905-812-6900  
Fax: 905-812-6910  
[www.kptissueinc.com](http://www.kptissueinc.com)

## INVESTOR RELATIONS

Mike Baldesarra  
Director of Investor Relations  
Telephone: 905-812-6900  
[ir@kptissueinc.com](mailto:ir@kptissueinc.com)

## TRANSFER AGENT AND REGISTRAR

TMX Equity Transfer Services  
The Exchange Tower  
800 Victoria Square  
Montreal, Quebec H4Z 1A9  
Telephone: 514 395-5964  
Fax: 514 787-6690  
[www.tmxequitytransferservices.com](http://www.tmxequitytransferservices.com)

## STOCK EXCHANGE LISTING

Toronto Stock Exchange  
Stock Symbol: KPT

## AUDITORS

PricewaterhouseCoopers LLP  
PwC Tower  
18 York Street  
Suite 2600  
Toronto, Ontario M5J 0B2

## BOARD OF DIRECTORS

The Board of Directors of KPT consists of four members. In keeping with best practices of corporate governance, three directors (and all board committee members) are independent of management. They also represent an exceptionally strong base of experience in consumer products, business management, accounting and capital markets.

Susan J. McArthur (Chair Person and Independent Director)

<sup>(1)</sup> <sup>(3)</sup> <sup>(4)</sup> <sup>(5)</sup>

James Hardy (Independent Director) <sup>(1)</sup> <sup>(3)</sup> <sup>(4)</sup> <sup>(6)</sup>

Michel Letellier (Independent Director) <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup> <sup>(5)</sup>

David Spraley (Director) <sup>(2)</sup> <sup>(5)</sup>

<sup>(1)</sup> Member of the Corporation Audit Committee and the KPGP Audit Committee.

<sup>(2)</sup> Member of the KPGP Compensation Committee.

<sup>(3)</sup> Member of the Corporation Nominating Committee.

<sup>(4)</sup> Member of the KPGP Governance Committee.

<sup>(5)</sup> Member of the KPGP Environmental, Health and Safety Committee.

<sup>(6)</sup> Chair of the Corporation Audit Committee and the KPGP Audit Committee.

For complete information about Board Members and Corporate Governance, please visit [www.kptissueinc.com](http://www.kptissueinc.com)

## ANNUAL MEETING OF SHAREHOLDERS

Gallery Room  
TMX Broadcast Center  
130 King Street West  
Toronto, Ontario M5H 1A1  
June 17, 2015 at 2:00 p.m. (EST).

## DESIGNED AND WRITTEN BY

MaisonBrisson Communications





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Canadian  
Breast Cancer  
Foundation



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