K-BRO LINEN INCOME FUND

2007 ANNUAL REPORT

In 2007, K-Bro continued to successfully

execute its three-part strategic focus:

- ***Secure and Maintain Long-Term Contracts with Large Healthcare and Hospitality Customers***
- ***Extend Core Services To New Markets***
- ***Introduce Related Services***

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President's Message to our Stakeholders…………………………

By continuing to maintain our three part strategic focus since our initial public offering on February 3, 2005, we have once again achieved some significant growth for the benefit of our unitholders, set the stage for additional further future growth, maintained a conservative balance sheet and have made distributions to unitholders at a stable level in recognition of our results as well as the future opportunities and challenges we have in front of us.

In 2007, much of our focus was in Alberta as we negotiated a new long-term contract with the Calgary Health Region and commenced the build out of a larger, more efficient processing facility to handle the increased volumes from the new contract as well as provide us with the capacity needed to handle anticipated additional future volumes in a vibrant Alberta marketplace. We commenced processing under the terms of the new Calgary Health Region contract on March 1, 2008 and the transition into the new Calgary plant was substantially completed by March 31, 2008. This was a major undertaking that was accomplished by our dedicated and experienced team without any significant disruption to our customers.

This vibrant Alberta economy also continues to give us one of our largest challenges in terms of the costs of labor in our Alberta plants. Significant cost increases were experienced in 2007. With a more efficient Calgary plant and our ongoing labor initiatives, such as availing ourselves of the temporary foreign worker program, we are starting to see some positive results on this most important component of our operations.

However, Alberta wasn't our only focus as we also continued to extend services into new markets as we pursued and negotiated the purchase of the business and assets of Buanderie HMR Inc. HMR is a leading laundry and linen service provider located in Québec City, Québec and the acquisition was finalized on January 31, 2008. K-Bro believes that HMR has a strong market position in the hospitality and commercial sectors, with excellent brand name recognition. Its large customer base ranges in size from major hotels to family operated restaurants. Similar to our acquisition of Premier Linen in Victoria in 2006, HMR provides us with an accretive acquisition upon which we can hopefully leverage our health care expertise to expand the services provided to its marketplace.

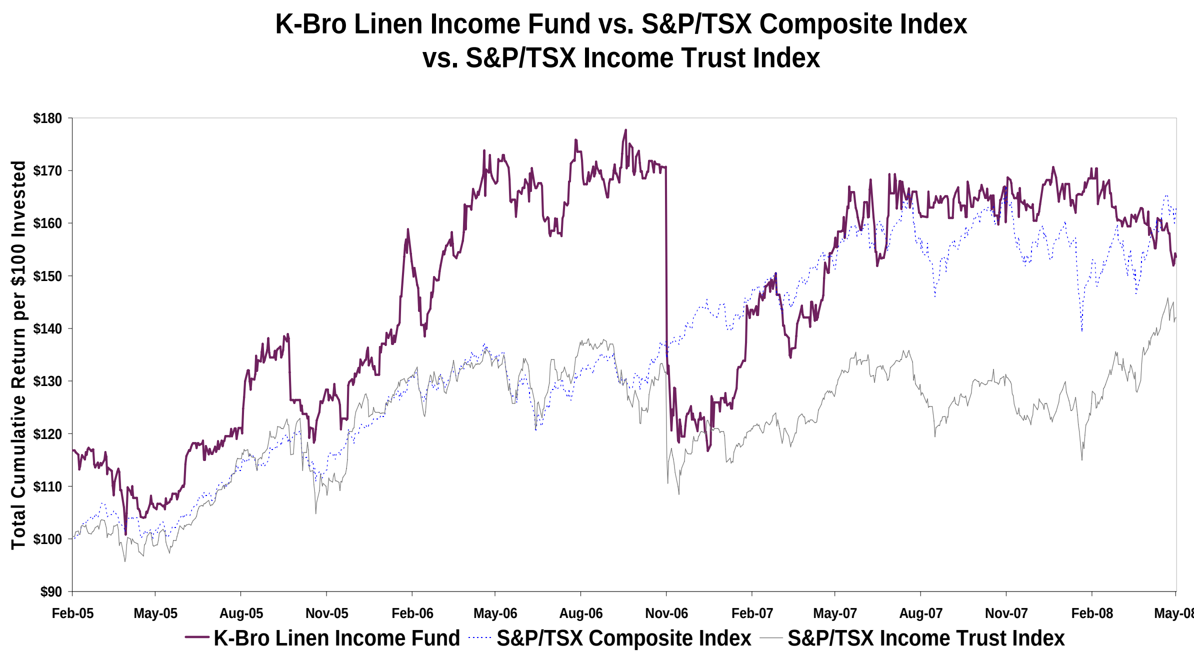
While our overall revenue growth of 14% in 2007 was satisfying, as was our EBITDA growth of 10%, our 2007 Q4 and our 2008 Q1 were challenging quarters. However, we anticipate that 2008 as a whole will show a meaningful increase in revenue and EBITDA compared to 2007 with an overall payout ratio that falls within acceptable levels. This anticipation is based on: the new Calgary Health Region contract and operating efficiencies expected from the new Calgary plant; the anticipated positive impact of contractual price adjustments and continued organic growth from major customers in the last three quarters of the year; the expected contribution from our recent acquisition in Québec City; and, the anticipated positive impact of the foreign worker and other labour initiatives that is expected to be fully realized as the year progresses.

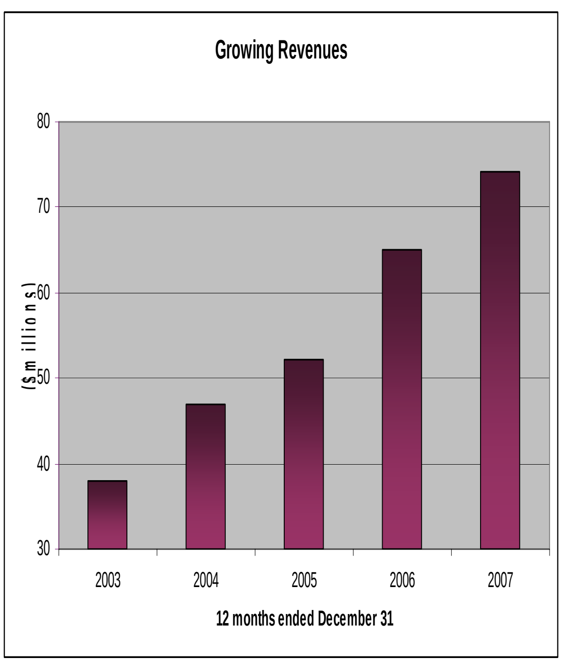
We remain focused on providing our existing customers with the service quality they deserve. We are pursuing additional growth opportunities in existing and new markets. With our successful equity financing in Q1, 2008 that raised net cash proceeds of $18.1 million, we have the financial capacity to pursue these opportunities aggressively but intelligently. With the continued support of our customers, our 1,000 employees, our Board and our unitholders, we look forward to 2008 with optimism and enthusiasm.

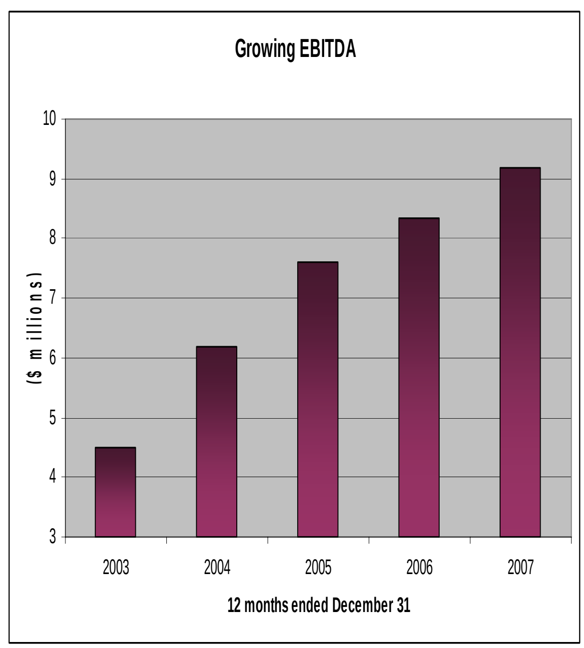
Linda McCurdy
President and Chief Executive Officer

K-Bro's Strategic Focus Continues to Provide……………………..

INCOME







and K-Bro's Strategic Focus Continues to Provide…………………..

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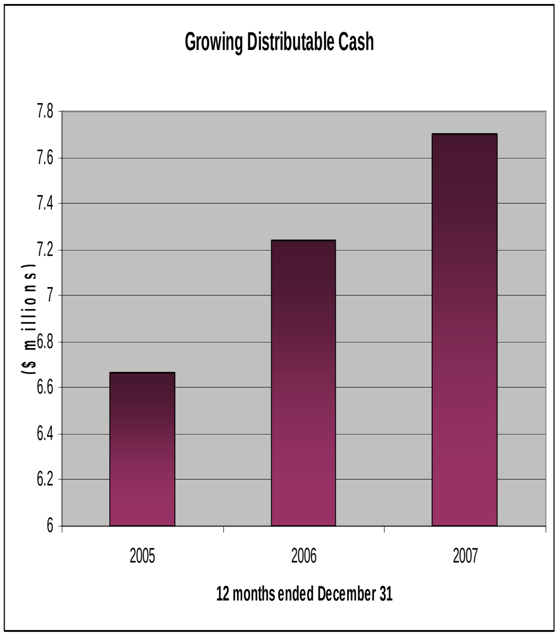

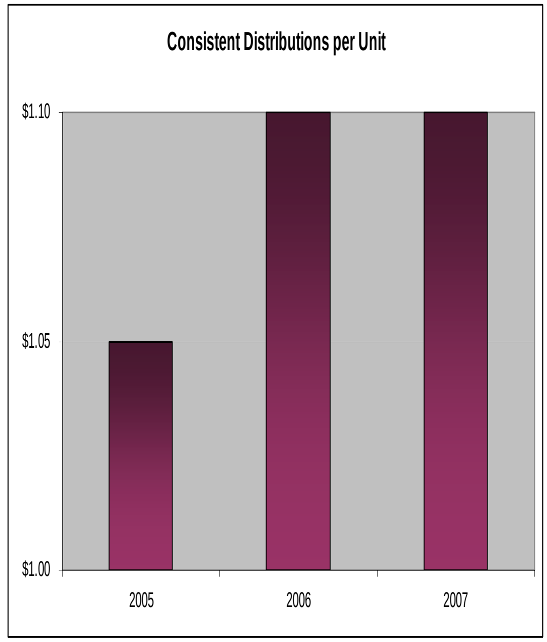

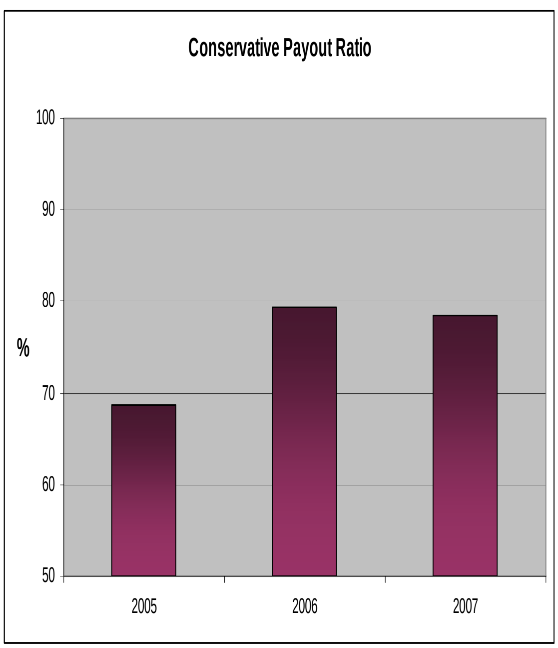

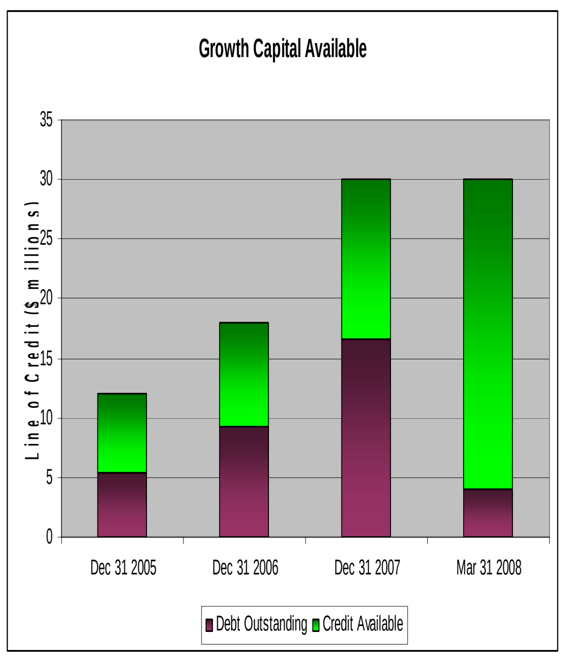

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

March 6, 2008

The following management's discussion and analysis is supplemental to, and should be read in conjunction with, the audited consolidated financial statements of K-Bro Linen Income Fund ("the Fund") for the years ended December 31, 2007 and 2006. These financial statements and other documents filed with regulatory authorities can be found on SEDAR at www.sedar.com. The Fund's financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Fund's reporting currency is the Canadian dollar. The Fund and its subsidiary K-Bro Linen Systems Inc. will collectively be referred to as "K-Bro" in this Management's discussion and Analysis.

Management is responsible for the information contained in this Management's Discussion and Analysis and its consistency with information presented to the Audit Committee and Board of Trustees. All information in this document has been reviewed and approved by the Audit Committee and Board of Trustees. This review was performed by Management with information available as of March 6, 2008.

In the interest of providing unitholders and potential investors of K-Bro with information regarding future plans and operations, this Management's Discussion and Analysis ("MD&A") contains forward-looking information that represents internal expectations, estimates or beliefs concerning, among other things, future activities or future operating results and various components thereof. The use of any of the words "anticipate", "continue", "expect", "may", "will", "project", "should", "believe", and similar expressions suggesting future outcomes or events are intended to identify forward-looking information. Statements regarding such forward-looking information reflect management's current beliefs and are based on information currently available to management.

These statements are not guarantees of future performance and are based on management's estimates and assumptions that are subject to risks and uncertainties, which could cause K-Bro's actual performance and financial results in future periods to differ materially from the forward-looking information contained in this MD&A. These risks and uncertainties include, among other things, (i) interruptions or delays in relocating K-Bro's Calgary plant, and any consequential interruption in customer service; (ii) risks associated with the acquisition of HMR, including additional expense associated with completing an acquisition and amortizing any acquired intangible assets; the difficulty of assimilating the operations and personnel of the acquired business; the possibility of undisclosed material liabilities; and the potential disruption of K-Bro's ongoing business and the distraction of management from its day-to-day operations; (iii) K-Bro's competitive environment; (iv) utility costs; (v) K-Bro's dependence on long-term contracts, (vi) increased capital expenditure requirements; (vii) reliance on key personnel; and (viii) the availability of future financing. Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking information include: (i) volumes and pricing assumptions; (ii) utility costs; (iii) expected contribution from new Calgary plant once it comes on-line in the latter part of Q1, 2008; (iv) expected impact of labour cost initiatives; (v) anticipated contribution from the HMR acquisition; and, (vi) the level of capital expenditures. *Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Certain statements regarding forward-looking information included in this MD&A may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this MD&A.*

All forward-looking information in this MD&A is qualified by these cautionary statements. Forward-looking information in this MD&A is presented only as of the date made. Except as required by law, K-Bro does not undertake any obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.

This MD&A also makes reference to certain non-GAAP measures to assist in assessing the Fund's financial performance. Non-GAAP measures do not have any standard meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. Please see "Non-GAAP Measures" for further discussion.

RECENT DEVELOPMENTS

Acquisition of Business and Assets of Buanderie HMR Inc. in Quebec City

On January 31, 2008, K-Bro completed the acquisition of the laundry business, linen, property and equipment of Buanderie HMR Inc. ("HMR") located in Quebec City, Quebec. The business acquisition will be accounted for using the purchase method, whereby the purchase consideration will be allocated to the fair values of the net assets acquired at January 31, 2008. The purchase price including estimated acquisition costs was approximately $3.8 million. Of the cash consideration payable to the vendor, $0.5 million was deposited into escrow with an escrow agent. The full amount of the funds held in escrow will be released to the vendor upon the determination that specified earnings before interest, income taxes and amortization were met in the twelve-month period subsequent to the acquisition. Goodwill will correspondingly be increased by the amount released.

HMR is a leading laundry and linen service provider located in Quebec City, Quebec. K-Bro believes that HMR has a strong market position in the hospitality and commercial sectors, with excellent brand name recognition. Its large customer base ranges in size from major hotels to family operated restaurants.

In its most recent fiscal year ended May 31, 2007, revenues from HMR's business were $3.8 million. Management estimates that HMR's EBITDA (see "Non-GAAP Measures"), after adjustments for expected non-recurring costs, was approximately $0.6 million for the fiscal year ended May 31, 2007. These operating results, combined with an expected low maintenance capital expenditure requirement, results in an acquisition that management believes will be immediately accretive to the Fund.

Equity Issuance

On February 6, 2008 the Fund announced it had entered into an agreement to sell 1,362,000 units of the Fund ("Units") at a price of $12.85 per Unit to raise gross proceeds of approximately $17.5 million on a bought deal basis. K-Bro also granted the Underwriters an Over-Allotment Option, exercisable in whole or in part for a period of 30 days following closing, to purchase up to an additional 204,300 Units at the same offering price. If the Over-Allotment Option is fully exercised, the total gross proceeds to K-Bro will be approximately $20.1 million. The offering was made by way of a short form prospectus in all of the provinces of Canada and closed on February 27, 2008 with the issuance of 1,362,000 Units.

The net proceeds of the offering will be used to repay indebtedness incurred on the acquisition of the assets of HMR, the retrofit and equipping of the new Calgary plant and for general corporate purposes.

Sustained Revenue Growth

Revenue increased in the fourth quarter of 2007 by 5.7% compared to the fourth quarter of 2006. For the year ended December 31, 2007, revenue increased by 13.8%. Of this 2007 revenue growth, approximately 2.0% is the result of the integration of the assets of Premier Linen Supply Ltd. ("Premier"), which were acquired on March 31, 2006, 3.1% is from the addition of new customers part way through 2006 and in 2007, 9.8% is growth from existing customers as a result of growing volumes and price increases and the loss or termination of existing customers accounted for a 1.1% reduction.

The strengthened Canadian dollar did not have a significant negative impact on hospitality revenues in the fourth quarter. This sector in fact grew by 0.8% in the quarter compared to 2006. There can be no assurance that this trend will continue as continued strengthening of the Canadian dollar may negatively impact our hospitality revenues if tourism decreases in the future.

Bank Line of Credit Increased

In August 2007, K-Bro's bank line of credit was increased from $18 million to $30 million. There were also some favorable adjustments to certain covenants regarding the total funded debt to EBITDA ratio (see "Non-GAAP Measures"), the working capital ratio and the interest coverage ratio (see "Liquidity and Financial Resources – Financing Activities").

Market Updates

Alberta

(i) Labour

Labour costs for plant staff in Alberta as a percentage of plant revenue increased for the fourth quarter from 53.0% in 2006 to 54.8% in 2007. For the year, these labour costs as a percentage of Alberta plant revenue increased from 51.5% in 2006 to 53.7% for 2007. An ongoing tight labour market in Alberta has resulted in these increased costs due to the requirement for significantly higher wage increases than in the past, overtime due to staff shortages and lower productivity resulting from increased turnover. Labour costs as a percentage of plant revenue over the last five quarters is as follows:

	2007				2006
	Q4	Q3	Q2	Q1	Q4
All plants	51.6%	50.8%	49.8%	49.2%	50.0%
Alberta plants	54.8%	54.6%	53.8%	51.6%	53.0%

A moderation of this is expected in 2008 with the new more efficient Calgary plant being brought on line, price adjustments on the Calgary Health Region contract and the impact of the temporary foreign worker program being implemented. In this regard, K-Bro has received approval to bring in a significant number of workers under the Temporary Foreign Worker Program. These people will be deployed between Edmonton and Calgary to fill current vacancies, reduce overtime and to fill future vacancies due to turnover. Management believes the positive impact of these additional workers will start to be realized in Q2 with improvements continuing gradually through 2008.

In addition to wage adjustments and the steps noted above, wherever possible, price increases from customers are being or will be sought. Given the long-term economic outlook for Alberta, there can be no assurance that these steps will be sufficient to stem the impact of these increasing labour costs.

(ii) Calgary Health Region Contract and Plant

K-Bro and the Calgary Health Region are finalizing a new ten year contract that commenced March 1, 2008 under an interim agreement. K-Bro's initial ten year contract expired February 29, 2008. The new contract encompasses all the long-term healthcare volume of the region previously processed by a competitor, in addition to the acute care volume that K-Bro currently processes. The Finance Committee of the Calgary Health Region approved the recommendation at their February 13 meeting and it was approved by their Board on February 19, subject to finalization of any outstanding contractual matters.

To perform under the new contract, K-Bro has entered into a ten year lease for a new 80,000 sq. ft. plant in Calgary. K-Bro's existing lease expires in 2008 and was not available for renewal. Full occupancy was received on January 31, 2008. The transition of volume from the current plant is taking place in stages and commenced in February 2008. This transition is expected to be completed by March 31, 2008.

The new facility is being equipped and retrofitted in order to operate as efficiently as possible in a continuing tight labour market, to be able to meet the growth plans of the Calgary Health Region and to be able to seize other available opportunities in a growing Calgary region. This equipment includes the purchase of an additional tunnel washer system that is a twin of the tunnel washer purchased for Calgary in 2006 as well as an overhead materials handling monorail system which does not exist in the current plant. The estimated total project cost is expected to be approximately $15 million. This cost was initially funded from the Fund's line of credit, which has now been paid down as a result of the equity issuance noted previously.

(iii) Market Opportunities

Significant growth in both the Calgary Health Region and Capital Health in Edmonton has been announced and the projects associated with that growth are underway. This growth in Edmonton includes the opening of the Mazankowski Heart Institute (2008), the Lois Hole Hospital for Women and the Centre for Cardiac Services (2009), the Orthopedic Surgery Centre (2009), the Strathcona Community Hospital (2009) and the Edmonton Clinic (2011). In Calgary, in addition to various expansions and renovations of existing facilities, the South Health Campus phase one is expected to be completed in 2011. These announced projects entail estimated costs of $2.5 billion to Capital Health in Edmonton and $2.2 billion to the Calgary Health Region in the period 2008 – 2011. The government has also approved $280 million for 832 continuing care beds to alleviate pressure in hospitals and meet the needs of an aging population.

Management believes that the expanded and more efficient new Calgary plant will provide additional opportunities in both the healthcare and hospitality sectors in that marketplace. In Edmonton, additional volume falling under the auspices of Capital Health continues to be added with the start of Leduc Hospital in January and Devon Hospital scheduled for a March start-up. Management believes that similar additional facilities may become available in the future.

The recently re-elected Progressive Conservative party put forth an election platform that included launching a made-in-Alberta immigration strategy to deal with labour shortages, establishing a Temporary Foreign Workers Advisory Office and increasing the duration of permits, reducing waiting lists by dealing with the shortages of healthcare professionals and have included health facilities in its 20–year strategic building plan to deal with anticipated growth and demand. It is anticipated that these initiatives, if enacted, would be of benefit to K-Bro.

British Columbia

(i) Bill 29 Update

In 2002, the British Columbia provincial government enacted the Health and Social Services Delivery Improvement Act, which, among other things, voided certain provision of existing collective agreements between public sector healthcare organizations and their employees. As a result, B.C. healthcare organizations were permitted to contract with outside service providers to perform certain services previously provided by their employees. The enactment of this legislation provided K-Bro with the opportunity to expand its operations by attracting new healthcare customers in the Vancouver region who wished to outsource their linen processing requirements to private sector laundries. Certain healthcare sector unions, associations of bargaining agents and employees affected by this legislation challenged its constitutionality in B.C. courts and before the Supreme Court of Canada.

On June 8, 2007, the Supreme Court of Canada found that certain sections of the B.C. legislation violated the freedom of association provision in the Canadian Charter of Rights and Freedoms, on the basis that they violated workers' right to engage in collective bargaining. The court ruled that B.C. health employers retained the right to contract out certain services, but that health care workers have a right to negotiate language in their collective agreements on issues as fundamental to their working lives as contracting out. The Supreme Court suspended its declaration until June 2008 to permit the B.C. government and the affected health unions to engage in meaningful consultations and good faith negotiations surrounding the implementation of the decision.

On January 25, 2008, the Facilities Bargaining Association reached a settlement agreement regarding the implementation of the Supreme Court decision with the B.C. Government and the Health Employers' Association of B.C.. The impact of the decision and the settlement agreement on the Fund is difficult to predict, but management considers the settlement a positive development in that it reduces regulatory uncertainty with respect to the Fund's current Vancouver contracts and may create opportunities for the Fund to attract new healthcare customers in B.C. The settlement agreement was approved by the Hospital Employees' Union on February 22, 2008.

(ii) BC Budget

On February 19 2008, the British Columbia Minister of Finance introduced the province's 2008 budget. The budget includes a carbon tax that is to be "revenue neutral". This tax will apply to fossil fuels including gasoline, diesel fuel and natural gas, all of which K-Bro uses in its operations. Based on the initial rate, it has been estimated that the tax will amount to 2.4 cents per litre of gasoline. The budget also includes reductions in corporate tax rates. The impact of these provisions on K-Bro is uncertain and is currently being examined by Management.

Quebec

Report of the Task Force on the Funding of the Health System

In February 2008, a report titled "Getting Our Money's Worth" was released in Quebec by a task force set up by the government in 2007 to make recommendations on how best to adequately fund the health care system. The Task Force considers that Quebec must secure the long-term viability of the public health care system by increasing its productivity and adjusting the growth in public health spending to the growth rate of Quebec's economy, while improving access to care and quality of services. As K-Bro has seen in Alberta and British Columbia, such proposals and initiatives have sometimes led to private sector involvement in non core activities such as laundry and linen services. There can be no guarantee that this will be the case in Quebec but K-Bro now has a presence in the Quebec marketplace with a processing facility following the HMR acquisition, which may be of benefit should any such opportunities arise.

Implementation of "Tax Fairness Plan"

On June 12, 2007, Bill C-52 Budget Implementation Act 2007, which contains legislation to tax publicly traded trusts in Canada, was substantively enacted by the Canadian Federal Government. As a result, a new 31.5 per cent tax will be applied to distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. There was no future income tax expense or recovery that needed to be recorded by the Fund as a result of this legislation as the Fund has no taxable temporary differences that would exist in 2011. Future income taxes are already recorded by the Fund's wholly-owned subsidiary K-Bro Linen Systems Inc.

See "Risks and Uncertainties" and "Income Tax Recovery" for further discussion of the potential impact of this proposed legislation.

Other Future Business Development Opportunities

K-Bro currently has several proposals out and has entered into discussions with potential new healthcare and hospitality customers. In addition, discussions are at various stages with potential acquisition candidates. The degree of likelihood of success with any of these proposals or potential acquisitions cannot be stated with any degree of accuracy at this time.

OUTLOOK

Although Management expects 2008 to start slowly from an EBITDA perspective with an anticipated payout ratio (see "Non-GAAP Measures") in the first quarter that is significantly higher than past performance, management anticipates that 2008 as a whole will show a meaningful increase in revenue and EBITDA compared to 2007 with an overall payout ratio that falls within acceptable levels.

This anticipation is based on:

- The new Calgary contract commencing March 1, 2008 with an anticipated increase in EBITDA contribution as a result of increased volumes, price adjustments and operating efficiencies expected from the new Calgary plant.
- The anticipated positive impact of contractual price adjustments from major customers in the last three quarters of the year.
- The expected contribution from the recent acquisition in Quebec City.
- The anticipated positive impact of the foreign workers and other labour initiatives that is expected to be fully realized as the year progresses.

The potential long-term impact of the Federal Government's implementation of its "Tax Fairness Plan" (see "Recent Developments") will continue to unfold as capital markets, investors and the minority government react to the new reality. The Fund continues to monitor the possible long term impact they will have on the Fund and its investors, and what, if any, steps to take in respect of the Fund. However, this legislation is not expected to have an immediate impact on the Fund's tax treatment or distribution policy or the tax treatment of distributions to investors. There can be no assurance that the Fund will be able to undertake any measures to minimize the long-term impact.

RESULTS OF OPERATIONS
(all amounts in $000's except per unit amounts)

Overall Performance

The fourth quarter of 2007 saw revenue increase by $1,013 or 5.7% over 2006 (increases of $8,993 and 13.8% for fiscal 2007 compared to 2006). This revenue increase was the result of the integration of Premier, which was acquired on March 31, 2006, additional volume, price increases and the addition of new accounts as discussed under "Recent Developments". However, the positive impact of this additional revenue was more than offset by operating costs that increased to 89.9% of revenue in the current quarter compared to 87.0% in 2006 (87.6% of revenue for fiscal 2007 compared to 87.2% in 2006). The causes of this are discussed later under "Operating Expenses".

EBITDA (see "Non-GAAP Measures") decreased in the current quarter by $416 (18.1%) over 2006 (but increased by $853 or 10.2% for fiscal 2007 compared to 2006) as a result of the increase in operating expenses, net of the additional revenue.

Selected Annual and Quarterly Financial Information (Unaudited)

The following table provides certain selected consolidated financial and operating data prepared by K-Bro management for the periods indicated:

Fiscal year	2007					2006				
	Total	Q4	Q3	Q2	Q1	Total	Q4	Q3	Q2	Q1
Revenue	74,101	18,725	19,059	18,560	17,757	65,108	17,712	17,024	16,362	14,010
Operating expenses	64,913	16,842	16,630	16,050	15,391	56,773	15,413	14,940	14,228	12,192
EBITDA[1]	9,188	1,883	2,429	2,510	2,366	8,335	2,299	2,084	2,134	1,818
EBITDA as a % of revenue	12.4%	10.1%	12.7%	13.5%	13.3%	12.8%	13.0%	12.2%	13.0%	13.0%
Amortization	5,755	1,408	1,443	1,447	1,457	5,118	1,411	1,372	1,288	1,047
Financial charges	880	318	230	154	178	554	194	150	68	142
Loss (gain) on disposal of equipment	(3)	(28)	-	28	(3)	(4)	(2)	-	(2)	-
Earnings before income taxes	2,556	185	756	881	734	2,667	696	562	780	629
Income tax recovery	1,558	859	262	220	217	1,211	269	727	90	125
Net earnings	4,114	1,044	1,018	1,101	951	3,878	964	1,289	870	755
Net earnings as a % of revenue	5.6%	5.6%	5.3%	5.9%	5.4%	6.0%	5.4%	7.6%	5.3%	5.4%
Basic & diluted earnings per Unit	0.75	0.19	0.19	0.20	0.17	0.74	0.17	0.24	0.16	0.17
Total assets	83,342	83,342	76,384	74,119	74,030	75,074	75,074	75,024	72,260	72,408
Total long term financial liabilities	21,948	21,948	18,335	14,576	12,693	14,591	14.591	15,276	12,159	10,061
Funds provided (used) by operations	6,942	2,966	207	124	3,645	4,558	2,926	860	(432)	1,204
Long-term debt, end of period	16,627	16,627	12,734	9,510	7,478	9,278	9,278	9,861	6,303	4,000

Note: (1) EBITDA is defined as revenue less operating expenses as reflected in the table above (which equates to net earnings before income tax recovery, gain on disposals, finance costs and amortization). See "Non-GAAP Measures".

Revenues

See previous discussion under "Sustained Revenue Growth" and "Overall Performance". Revenues by sector consist of:

Fiscal year	2007					2006				
	Total	**Q4**	**Q3**	**Q2**	**Q1**	**Total**	**Q4**	**Q3**	**Q2**	**Q1**
Sector										
Healthcare	57,393	14,806	14,318	14,261	14,008	50,152	13,826	12,446	12,181	11,699
Hospitality	16,708	3,919	4,741	4,299	3,749	14,956	3,886	4,578	4,181	2,311
Total	74,101	18,725	19,059	18,560	17,757	65,108	17,712	17,024	16,362	14,010

The increase in these sectors' revenues is accounted for as follows:

	Total		Healthcare		Hospitality	
Fiscal year ended December 31	2007	2006	2007	2006	2007	2006
Base revenues, beginning of year	65,108	52,198	50,152	43,680	14,956	8,518
Revenue from new customers in year	713	4,546	562	2,666	151	1,880
Revenue from new customers commenced during prior year	1,329	1,061	1,154	580	175	481
Revenue from new customers obtained by acquisition	1,332	3,970	70	211	1,262	3,759
Revenue growth from volume and price increases to existing customers	6,370	3,859	5,784	3,509	586	350
Lost or terminated customers	(751)	(526)	(329)	(494)	(422)	(32)
Base revenues, end of year	74,101	65,108	57,393	50,152	16,708	14,956

Operating Expenses

Compared to the fourth quarter of 2006, operating expenses increased by $1,429 (9.3%) in the fourth quarter of 2007 (increases of $8,140 or 14.3% for fiscal 2007 compared to 2006). These dollar increases are in large part attributable to the increase in revenue of 5.7% in the quarter (13.8% for the year). However, as a percentage of revenue, operating expenses increased by 2.9 percentage points in the quarter (0.4 percentage points in the year).

Labour costs as a percentage of revenue increased by 1.3 percentage points ($742) compared to the fourth quarter of 2006 (0.8 percentage points and $5,030 for fiscal 2007 compared to 2006) which was augmented by increased repairs and linen costs, resulting in the net increase in operating costs of 2.9 percentage points for the quarter (0.4 percentage points for the year). While some stabilization of the labour situation has occurred, we do not expect significant reductions in hourly labour costs given the current Alberta economy and labour market conditions. However, productivity gains and overtime reductions are anticipated from the new Calgary plant and the impact of the temporary foreign worker program.

The year to date increase in corporate expense of $450 is the result of: a $126 write-off in Q1 2007 with respect to costs associated with an abandoned acquisition; a $325 increase in executive salaries and provision for bonuses; and an increase in other costs of $36. Offsetting these was a reduction of $37 related to accruals for K-Bro's Long Term Incentive Plan ("LTIP") which was a recovery of $50 in the fourth quarter of 2007 compared to an expense of $14 in the fourth quarter of 2006 ($151 for fiscal 2007 compared to $188 for 2006).

In April, 2006, a trust (the "LTIP Trust") was formed to hold Units of the Fund on behalf of the participants of K-Bro's long-term incentive plan (the "LTIP"). K-Bro is neither a trustee nor a direct participant of the LTIP; however, under certain circumstances K-Bro may be the beneficiary of forfeited Units held by the LTIP Trust. Consequently, the LTIP Trust is considered a variable interest entity for accounting purposes and K-Bro has consolidated the LTIP Trust in accordance with the Canadian Institute of Chartered Accountants ("CICA") issued Accounting Guideline AcG-15. For a specific performance year, one-quarter of the Units held by the LTIP Trust vest to the participants of the LTIP thirty days after approval of the audited financial statements by the Trustees upon the participant signing a Participation Agreement and Confirmation and three-quarters will vest on the second anniversary of that date upon continued employment, except in limited circumstances. Compensation expense is recorded by K-Bro in the period earned. Distributions made by the Fund with respect to unvested Units held by the LTIP Trust are paid to LTIP participants. Unvested units held by the LTIP Trust are shown as a reduction of unitholders' equity.

Effects of Inflation

The majority of K-Bro's customer contracts have an annual price adjustment mechanism based on a published price index such as CPI. To the extent that such indices are impacted by inflation, this would be reflected in K-Bro's revenues and net income. K-Bro's operating costs may be affected by general inflation but to a much greater extent are impacted by labour market conditions, textile costs in a global environment and commodity prices impacting the cost of natural gas and electricity.

Amortization of Property and Equipment

Amortization of property and equipment represents the expense related to the appropriate matching of certain of K-Bro's long-term assets to the estimated useful life and period of economic benefit to K-Bro of those assets. Linen amortization expense is included in operating expenses and is accounted for in EBITDA. Amortization of plant and equipment has increased as a result of the acquisition of the Premier assets as well as the capital additions from 2006 related to the $6.4 million strategic capital expenditure program and the $1.9 million for the tunnel washer added in Calgary.

Amortization of Intangible Assets

Amortization of intangible assets represents the expense related with matching K-Bro's finite life intangible assets to the estimated useful life and period of economic benefit to K-Bro of those assets. As part of the valuation completed for purposes of the purchase price allocation for the K-Bro acquisition by the Fund and the Premier acquisition by K-Bro, total intangible assets were recognized on the balance sheet of K-Bro in the amount of $23,047, representing the value attributable to various contracts held. Amortization expense in the fourth quarter of 2007 was unchanged from 2006. Amortization expense for fiscal 2007 increased compared to 2006 as a result of the Premier acquisition on March 31, 2006.

Financial Charges

Financial charges in the current quarter increased by $124 over 2006 ($326 for the year) as a result of an increase in long-term debt (see "Liquidity and Capital Resources – Financing Activities").

Income Tax Recovery

Income tax recovery includes current and future income taxes based on taxable income and the temporary timing differences between the tax and accounting bases of assets and liabilities. Income tax recovery reflects the structure as an income trust whereby the Fund's unit holders bear the tax obligations with respect to distributions. The large income tax recovery in Q4 2007 was the result of substantively enacted income tax rates which were decreased from 31.1% to 27.9% resulting in an additional recovery of $550 being recorded in the fourth quarter of 2007.

On June 12, 2007, Bill C-52 Budget Implementation Act 2007, which contains legislation to tax publicly traded trusts in Canada, was substantively enacted by the Canadian Federal Government. As a result, a new 31.5 per cent tax will be applied to distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. There was no future income tax expense or recovery that needed to be recorded by the Fund as a result of this legislation as the Fund has no taxable temporary differences that would exist in 2011. Future income taxes are already recorded by the Fund's wholly-owned subsidiary K-Bro Linen Systems Inc.

Currently, the Fund is only taxable on amounts that are not distributed to Unitholders. If enacted in its current form, the proposed legislation will result in a change in which the earnings of the Fund will be subject to income tax regardless of whether amounts are distributed to the Unitholders or not.

LIQUIDITY AND CAPITAL RESOURCES ($000'S)

Cash Flow from Operating Activities

Cash provided by operating activities was $2,966 in the fourth quarter of 2007 ($6,942 for fiscal 2007), an increase of $40 from the funds provided by operating activities in the fourth quarter of 2006 (and an increase of $2,384 for the year). This $40 increase is attributable to a decreased working capital requirement of $578 in the quarter compared to the corresponding period in 2006 (a decrease of $1,857 for the year) as well as a decrease in cashflow from operations of $538 in the quarter (an increase of $527 for the year).

The decrease in the working capital requirement of $578 in the quarter compared to the fourth quarter of 2006 is the result of: increased accounts receivable requirement of $250 resulting from the timing of receipts from major customers; a decrease of linen purchases of $170 due to the timing of purchases and the requirement in 2006 to purchase linen for the major healthcare contract start ups in Toronto; and, funds used by a net decrease in accounts payable and prepaids of $658 as the result of timing differences in payments.

Financing Activities

On February 27, 2008, the Fund issued additional units and raised proceeds as described under "Recent Developments – Equity Issuance". On March 31, 2006, the Fund raised proceeds (net of offering costs before tax) of $14,312 from the issuance of 1,080,000 units in a private placement bought deal. These 2006 funds financed the acquisition of Premier ($8,310 including the escrowed funds) and $6,002 of the strategic capital expenditure program. No equity issues occurred in 2007.

During the quarter ended December 31, 2007, the Fund declared distributions to unitholders at an annualized rate of $1.10 per unit for a total amount of $1,512 ($6,046 for the year ended December 31, 2007). In the fourth quarter of 2006, K-Bro declared distributions to the unit holders in the amount of $1,511 (an annualized rate of $1.10) and $5,749 for the year ended December 31, 2007. The year-over-year increase in 2007 is reflective of the increased number of units outstanding as a result of the private placement on March 31, 2006.

Long-term debt at December 31, 2007 was $16,627 compared with $12,734 at September 30, 2007 and $9,278 at December 31, 2006. The increase from the third quarter of 2007 is the result of the purchase of additional strategic capital assets, primarily the Calgary plant, offset by a decrease in working capital requirements as previously discussed.

The existing long-term debt of $16,627 consists of draw downs on a secured revolving, interest only, credit facility of up to $30,000 (increased from $18,000 in August 2007). The facility is a two-year committed facility maturing February 28, 2009 and extendable annually for an additional year at the lender's option. It is subject to customary terms and conditions and is also subject to the maintenance of a maximum ratio of funded debt to EBITDA of 2.75 (changed from 2.50 in August 2007), and minimum ratios of 1.50 for the defined current ratio and 1.00 for fixed charge coverage. K-Bro is in compliance with all of its covenants.

On June 24, 2005, K-Bro entered into an interest rate swap arrangement whereby the interest rate paid on a notional amount of $4,000 of this debt has been fixed at 5.95% for a period of five years. The floating rate of interest that was swapped for this fixed rate is currently at 7.10%.

In the second quarter of 2007, the Fund entered into foreign exchange forward contracts at an average exchange rate of 1.085 Canadian per US dollar to cover its foreign exchange exposure with respect to its US $2.9 million commitment for equipment purchases in Calgary (see "Recent Developments- Calgary Update"). These foreign exchange forward contracts were done at a time when the Canadian dollar hit a 30 year high against the US dollar. The Canadian dollar has strengthened further which has resulted in a loss on derivative instruments being recorded in other comprehensive income.

Investing Activities

During the current quarter, K-Bro used $58 of funds for maintenance capital expenditures ($604 for the year) and $4,856 of funds for strategic capital expenditures ($7,691 for the year) for a total cash investment of $4,914 for the quarter ($8,295 for the year). Management defines maintenance capital expenditures as additions to, or replacements of, property and equipment to maintain K-Bro's current business operations. Management estimates that ongoing annual average maintenance capital expenditures are approximately $850. The modest level of maintenance capital expenditures is due to the long life of the majority of the processing equipment.

Expenditures on wear parts such as motors, belts and ironer pads are expensed as incurred. These expenditures and an extensive preventative maintenance program performed at each plant by a full complement of qualified maintenance engineers, has resulted in a repairs and maintenance expense (including personnel costs) totaling $1,161 in the fourth quarter of 2007 ($947 in 2006) which are included in the calculation of EBITDA. For the year ended December 31, 2007, these expenditures were $4,103 in 2007, compared with $3,644 in 2006 with the amount as a percentage of revenue down 0.1 percentage points.

Strategic capital expenditures are defined by management as those expenditures utilized for improvements to, and expansion of, K-Bro's property and equipment to enhance efficiencies and capacity to process incremental volumes. In addition to the $7,691 of cash invested in strategic capital assets in 2007, there were additional purchases of $3,091 included in accounts payable and $576 included in the lease inducement liability for a total investment of $11,358. Of this total, $10,064 is related to the new Calgary plant, $481 is related to the purchase of assets from the receiver for DoveCorp (a former competitor in Toronto), and $813 is related to the requirements of handling the increase in volume (primarily tubs and carts). Included in the $481 DoveCorp asset purchase was a complete 2006 Milnor tunnel washing system and various other washing, drying, finishing and boiler room equipment.

Contractual Obligations

At December 31, 2007, payments due under contractual obligations for the next five years and thereafter are as follows:

		Payments Due by Period			
	Total	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Operating leases and utility commitments	18,973	3,843	6,207	3,496	5,427
Linen purchase obligations	2,741	2,741	-	-	-
Equipment purchase commitments	126	126	-	-	-

The source of funds for these commitments will be from operating cash flow and the undrawn portion of the revolving credit facility.

Financial Position

Capital Structure at December 31		
	2007	2006
Long-term debt	16,627	9,278
Unitholders' equity	48,243	50,164
Total capitalization	64,870	59,442
Debt to total capitalization	25.6%	15.6%

For the year ended December 31, 2007, the Fund had a payout ratio (see "Non-GAAP Measures") of 78.5%, a debt to total capitalization of 25.6%, an unused line of credit of $12,938 and was in compliance with all debt covenants. Based on this and the 2008 equity issuance previously discussed, management believes that K-Bro has sufficient liquidity and is able to generate sufficient amounts of cash to meet its planned growth and has access to the equity market to fund additional growth as acquisition opportunities arise.

DISTRIBUTIONS FOR THE PERIOD

Fiscal year		2007		2006	
Period	**Payment Date**	**Per Unit Distribution**	**Distribution Amount ($)**	**Per Unit Distribution**	**Distribution Amount ($)**
Fund Units					
First quarter		$0.27501	$1,491,617	$0.27501	$1,194,606
Second quarter		$0.27501	$1,491,617	$0.27501	$1,491,615
Third quarter		$0.27501	$1,491,617	$0.27501	$1,491,615
October	November 15	$0.09167	$497,205	$0.09167	$497,205
November	December 14	$0.09167	$497,205	$0.09167	$497,205
December	January 15	$0.09167	$497,204	$0.09167	$497,205
Fourth quarter		$0.27501	$1,491,614	$0.27501	$1,491,615
Year to date		$1.10004	$5,966,465	$1.10004	$5,669,451
Exchangeable Shares					
First quarter		$0.27501	$19,913	$0.27501	$19,913
Second quarter		$0.27501	$19,913	$0.27501	$19,915
Third quarter		$0.27501	$19,913	$0.27501	$19,915
October	November 15	$0.09167	$6,639	$0.09167	$6,638
November	December 14	$0.09167	$6,639	$0.09167	$6,639
December	January 15	$0.09167	$6,638	$0.09167	$6,638
Fourth quarter		$0.27501	$19,916	$0.27501	$19,915
Year to date		$1.10004	$79,655	$1.10004	$79,658
Total Distributions		**$1.10004**	**$6,046,120**	**$1.10004**	**$5,749,109**

For the year ended December 31, 2007, the Fund distributed $1.10 per unit compared with Distributable Cash (see "Non-GAAP Measures") per unit of $1.40. The actual payout ratio was 78.5%.

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practices considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. All such distributions are discretionary. Distributions are declared payable each month in equal amounts to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid by the 15th of the following month.

DISTRIBUTABLE CASH (see "Non-GAAP Measures")
(000's except per unit amounts and percentages)

The Fund's source of cash for distributions is cash provided by operating activities. Distributable cash, reconciled to cash provided by operating activities as calculated under GAAP, is presented as follows:

Fiscal year[(1)]	2007					2006				
	Total	**Q4**	**Q3**	**Q2**	**Q1**	**Total**	**Q4**	**Q3**	**Q2**	**Q1**
Per consolidated financial statements:										
Cash provided (used) by operating activities	$6,942	$2,966	$207	$124	$3,645	$4,558	$2,926	$860	$(432)	$1,204
Add (deduct):										
Net changes in non-cash working capital items[(2)]	1,366	(1,398)	1,991	2,231	(1,458)	3,223	(820)	1,074	2,497	472
Maintenance capital expenditures[(3)]	(604)	(58)	(150)	(170)	(226)	(539)	(75)	(205)	(110)	(149)
Distributable Cash	**$7,704**	**$1,510**	**$2,048**	**$2,185**	**$1,961**	**$7,242**	**$2,031**	**$1,729**	**$1,955**	**$1,527**
Distributable Cash per weighted average diluted Units outstanding	**$1.40**	**$0.26**	**$0.38**	**$0.40**	**$0.36**	**$1.39**	**$0.37**	**$0.32**	**$0.36**	**$0.34**
Distributions Declared[(4)]	$6,046	$1,511	$1,512	$1,511	$1,512	$5,749	$1,511	$1,512	$1,512	$1,214
Distributions Declared per Unit (see "Non-GAAP Measures")	**$1.10**	**$0.27**	**$0.28**	**$0.28**	**$0.27**	**$1.10**	**$0.27**	**$0.28**	**$0.28**	**$0.27**
Payout Ratio (see "Non-GAAP Measures")[(4)]	**78.5%**	**100.0%**	**73.8%**	**69.2%**	**77.1%**	**79.3%**	**74.3%**	**87.4%**	**77.8%**	**79.5%**
Weighted Average Units Outstanding During the Period- Basic	5,464	5,459	5,459	5,465	5,476	5,219	5,476	5,476	5,482	4,428
Weighted Average Units Outstanding During the Period- Diluted	5,498	5,493	5,493	5,498	5,488	5,227	5,490	5,490	5,490	4,428
12-month trailing										
Distributable cash		7,704	8,225	7,906	7,676		7,242	6,729	6,842	6,744
Distributions		6,046	6,046	6,046	6,047		5,749	5,396	5,044	4,692
Payout ratio		78.5%	73.5%	76.5%	78.8%		79.3%	80.2%	73.7%	69.6%
Cumulative since IPO February 3, 2005										
Distributable cash		21,111	19,601	17,553	15,368		13,407	11,376	9,647	7,692
Distributions		16,018	14,507	12,995	11,484		9,972	8,461	6,949	5,437
Payout ratio		75.9%	74.0%	74.0%	74.7%		74.4%	74.4%	72.0%	70.7%

1 Following the revised Staff Notice 52-306 issued by the Canadian Securities Administrators on distributable cash presentation, we adopted their recommendations retroactive to February 3, 2005 in order to disclose comparable results.

2 Net changes in non-cash working capital is excluded from the calculation as it would introduce significant cash flow variability and affect underlying cash flow from operating activities. Significant variability can be caused by such things as the timing of receipts (which individually are large because of the nature of K-Bro's customer base and timing may vary due to the timing of customer approval, vacations of customer personnel, etc.) and the timing of disbursements (such as the payment of large volume rebates done once annually). As well, large increases in working capital are generally required when contracts with new customers are signed as linen is purchased and accounts receivable increase. Management feels that this amount should be excluded from the distributable cash figure which is used as the basis for determining the distributions to be paid.

3 Maintenance capital expenditure is discussed under "Investing Activities".

4 The level of distributions paid compared to distributable cash is reviewed periodically to take into account the current and prospective performance of the business and other items considered to be prudent.

OUTSTANDING UNITS

At December 31, 2007, the Fund had 5,423,862 Fund Units outstanding and 72,411 Special Trust Units outstanding (unchanged from December 31, 2006). The basic and the diluted weighted average number of units outstanding for fiscal 2007 was 5,464,487 and 5,498,318 respectively (5,219,225 and 5,227,474 respectively for 2006).

In accordance with the LTIP agreement and in conjunction with the performance of the Fund in the prior fiscal year, the Compensation, Nominating and Corporate Governance Committee of the Trustees of the Fund in 2007 approved LTIP compensation of $0.3 million (2006 - $0.4 million) and approved the funding and transfer of $0.3 million (2006 - $0.4 million) of cash to the LTIP Trust in April 2007 and 2006 respectively in order to fund the purchase of Units by the LTIP Trust. In the second quarter of 2007, the LTIP Trust purchased 22,647 Units of the Fund (2006 – 27,113). As at December 31, 2007, 12,436 Units held by the LTIP Trust have vested (December 31, 2006 – 6,779). The weighted average units outstanding and net earnings per unit calculation exclude the unvested units held by the LTIP Trust.

RELATED PARTY TRANSACTION

The Fund has incurred expenses in the normal course of business for advisory consulting services provided by a Trustee relating to acquisitions. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the year ended December 31, 2007, the Fund incurred such fees totaling $46,000 (2006 - $74,000). Of the total 2007 amount, $38,000 is included in prepaid expenses to be recognized as an acquisition cost related to the assets of HMR and $8,000 is included in equipment costs related to the acquisition of equipment from a receivership. For 2006, $40,000 is included in acquisition costs related to the assets of Premier and $34,000 is included in Corporate expenses.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements, in conformity with GAAP, requires management of K-Bro to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Management regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances. This involves varying degrees of judgment and uncertainty and, therefore, amounts currently reported in the financial statements could differ in the future.

Linen in Service

Linen in service is recorded at cost. Operating room linen is amortized on a straight-line method over an estimated service life of 24 months. General linen is amortized based on usage which results in an estimated service life of the linen equal to 24 months. Based on past experience, management believes that a service life of 24 months is representative of the average service life of linen and would not expect a material deviation to the balance of Linen in Service or Linen expense.

Revenue and Volume Rebates

Revenue from linen management and laundry services is largely based on written service agreements whereby K-Bro has agreed to collect, launder, deliver and replenish linens. K-Bro recognizes revenue in the period in which the services are provided. Volume rebates, where applicable, are recorded based on annualized expected volumes when it is determined that they are likely to be met. Based on past experience, management believes that volumes utilized for any estimates are reasonable and would not expect a material deviation to the balance of accrued liabilities or Revenue.

Property and Equipment

Property and equipment are recorded at cost. Amortization is provided over the estimated useful lives of the assets, based on past experience, on a declining basis using the following annual rates:

Laundry equipment	15%
Office and delivery equipment	20%
Computers and software	30%
Leasehold improvements	straight line over the lease period
Asset under development	at applicable rates and methods when put into service

The carrying value of property and equipment is evaluated whenever significant circumstances indicate impairment in value is likely. The carrying value of property and equipment and amortization expense is affected by these estimates.

Goodwill

Goodwill is not amortized and K-Bro assesses goodwill for impairment on an annual basis, or more frequently if changes in circumstances indicate a potential impairment. Any potential impairment is identified by comparing the fair value of the business to its carrying value. If the fair value exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value exceeds its fair value, a more detailed goodwill impairment assessment would have to be undertaken. Any resulting impairment would be charged to earnings in the period in which the impairment is identified and would affect the carrying value of goodwill but such charges do not result in a cash outflow and would not affect K-Bro's liquidity. No impairment was incurred upon completion of management's 2007 and 2006 assessments. The possible impact of the proposed "Tax Fairness" legislation has been taken into account in K-Bro's review for impairment of goodwill.

Intangible Assets

Intangible assets with a finite life which relate to contracts K-Bro has with certain customers are recorded at cost and are amortized over the remaining life of the contract plus one renewal period. Impairment is evaluated if there are significant changes in circumstances affecting the carrying value of intangible assets by comparing the fair value of the finite life intangible asset with its carrying value. Management has determined that no such significant change has occurred in 2007 or 2006 that would impact the carrying value of intangible assets.

NON-GAAP MEASURES

EBITDA

We report on our EBITDA (Earnings before interest, taxes, depreciation and amortization) because it is a key measure used by management to evaluate performance. EBITDA is utilized in measuring compliance with debt covenants and in making decisions relating to distributions to unitholders. We believe EBITDA assists investors in assessing our performance on a consistent basis without regard to depreciation and amortization, which are non-cash in nature and can vary significantly depending on accounting methods or non-operating factors such as historical cost.

EBITDA is not a calculation based on GAAP and is not considered an alternative to net earnings in measuring K-Bro's performance. EBITDA does not have a standardized meaning and is therefore not likely to be comparable with similar measures used by other issuers. For reconciliation with GAAP, please refer to "Selected Annual and Quarterly Information". EBITDA should not be used as an exclusive measure of cash flow since it does not account for the impact of working capital changes, capital expenditures, debt changes and other sources and uses of cash, which are disclosed in the consolidated statements of cash flows.

Distributable Cash

Distributable cash is a non-GAAP measure generally used by Canadian income trusts as an indicator of financial performance but it should not be seen as a measurement of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. Management believes that this measure is commonly used by investors, management and other stakeholders to evaluate the ongoing performance of K-Bro. For a reconciliation with GAAP, please refer to the "Distributable Cash" section.

Cash Distributions per Unit and Payout Ratios

We report on cash distributions per unit and payout ratios (actual cash distribution divided by distributable cash) because they are believed to be key measures used by investors to value K-Bro, assess its performance and provide an indication of the sustainability of distributions. Cash distributions per unit and the payout ratio depend on the amount of distributable cash generated and the Fund's distribution policy.

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practices considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. Distributions are declared payable each month to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid by the 15th of the following month. All distributions are discretionary. We periodically review cash distributions taking into account our current and prospective performance.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

The CICA has issued five new accounting standards:

(i) Financial instruments – recognition and measurement

On January 1, 2007, the Fund adopted Section 3855 of the CICA Handbook, "Financial Instruments – Recognition and Measurement". It describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value.

The Fund has made the following classifications:

- Cash and temporary investments will be classified as financial assets held for trading and measured at fair value. Gains and losses related to periodical revaluation are recorded in net income.

- Accounts receivable are classified as loans and receivables and are initially measured at fair value and subsequent periodical revaluations are recorded at amortized cost using the effective interest rate method.

- Accounts payable and accrued liabilities, distribution payable and long-term debt are classified as other liabilities and are initially measured at fair value and subsequent periodical revaluations are recorded at amortized cost using the effective interest rate method.

The adoption of this Section was done retroactively without restatement of the consolidated financial statements of prior periods. As at January 1, 2007 and December 31, 2007, there was no impact on the consolidated financial statements from these classifications.

The impact on the consolidated balance sheet of measuring hedging derivatives at fair value as at January 1, 2007 was an increase in other current assets and accumulated other comprehensive income of $28,085. Prior periods were not restated.

An embedded derivative is a component of a financial instrument or another contract of which the characteristics are similar to a derivative. The Fund has no significant embedded derivatives.

(ii) Comprehensive income

On January 1, 2007, the Fund adopted Section 1530 of the CICA Handbook, "Comprehensive Income". It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in unitholders' equity, which results from transactions and events from sources other than the Fund's unitholders. These transactions and events include unrealized gains and losses resulting from changes in fair value of certain financial instruments.

As a result of the adoption of this Section, the Fund now presents a consolidated statement of comprehensive income as part of the consolidated financial statements.

(iii) Equity

On January 1, 2007, the Fund adopted Section 3251 of the CICA Handbook, "Equity", replacing Section 3250 "Surplus". It describes standards for the presentation of equity and changes in equity for a reporting period as a result of the application of Section 1530, "Comprehensive Income".

(iv) Hedges

On January 1, 2007, the Fund adopted Section 3865 of the CICA Handbook, "Hedges". The recommendations of this Section expand the guidelines required by Accounting Guideline 13 (AcG-13), "Hedging Relationships". This Section describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenue and expenses from the derivative financial instruments in the same period as for those related to the hedged item. This has been applied to the Fund's interest rate swap and foreign exchange forward contracts.

(v) Accounting changes

Effective January 1, 2007, the Fund adopted CICA Handbook Section 1506 "Accounting Changes". This section established criteria for changing accounting policies together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and the correction of errors.

It includes the disclosure, on an interim and annual basis, of a description and the impact on our financial results of any new primary source of GAAP that has been issued but is not yet effective.

The Fund has determined that there is no material impact on the consolidated financial statements from the adoption of Handbook Section 1506.

Future changes in accounting policies are:

(i) Capital disclosures

The CICA issued a new accounting standard, Section 1535 "Capital Disclosures", which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity's objectives, policies and processes for managing capital. This new section is effective for the Fund beginning January 1, 2008. Management does not expect that the adoption of this standard will have an impact on the consolidated financial statement as the standard relates to note disclosure.

(ii) Financial instruments-disclosure and Financial instruments-presentation

Two new accounting standards were issued by the CICA, Section 3862 "Financial Instruments-Disclosures", and Section 3863 "Financial Instruments – Presentation". These sections will replace Section 3861 "Financial Instruments – Disclosure and Presentation" once adopted. The objective of Section 3862 is to provide users with information to evaluate the significance of the financial instruments on the entity's financial position and performance, the nature and extent of risks arising from financial instruments, and how the entity manages those risks. The provisions of Section 3863 deal with the classification of financial instruments, related interest, dividends, losses and gains and the circumstances in which financial assets and financial liabilities are offset. These new sections are effective for the Fund beginning January 1, 2008. Management does not expect that the adoption of this standard will have an impact on the consolidated financial statement as the standard relates to note disclosure.

(iii) Inventories

In June 2007, the CICA issued a new accounting standard – Section 3031 "Inventories" which replaces the existing standard for inventories, Section 3030. The new Section is effective for the Fund beginning January 1, 2008. Application of the new Section is not expected to have a material impact on the financial statements.

(iv) Goodwill and intangible assets

In February 2008, the CICA issued a new accounting standard – Section 3064 "Goodwill and intangible assets" which replaces the existing standard for goodwill and other intangible assets, Section 3062 and research and development costs, Section 3450. The new Section is effective for the Fund beginning January 1, 2009; however, earlier adoption is encouraged. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. Standards with respect to intangible assets may have an impact on the Fund's treatment of certain costs associated with its new Calgary plant. Management is assessing the impact of these new standards on its consolidated financial statements.

International Financial Reporting Standards

The Accounting Standards Board of Canada has announced that accounting standards in Canada, as used by public companies, will be converged to International Financial Reporting Standards ("IFRS") effective January 1, 2011. The Fund will convert to these new standards according to the timetable set with these new rules. Management is currently assessing the future impact of these new standards on its consolidated financial statements.

FINANCIAL INSTRUMENTS

K-Bro's financial instruments consists of derivative financial instruments, accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders and long-term debt. Unless otherwise stated, the fair value of the financial instruments approximates their carrying value.

Derivative financial instruments are utilized by K-Bro to manage cashflow risk against the volatility in interest rates on its long-term debt and foreign exchange rates on its equipment purchase commitments. K-Bro does not utilize derivative financial instruments for trading or speculative purposes. K-Bro has floating interest rate debt and equipment purchase commitments in US dollars that gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in interest rates and foreign exchange rates. In order to manage these risks, K-Bro may enter into interest rate swaps, forward contracts or option contracts. K-Bro has entered into an interest rate swap arrangement and foreign exchange forward contracts as described under "Financing Activities".

It is K-Bro's policy to document all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. K-Bro also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair value or cash flows of hedged items. K-Bro's interest rate swaps, forward contracts or option contracts are designated as hedges when the underlying risks of the hedged and hedging instruments offset to manage K-Bro's exposure. Gains or losses relating to such contracts are accounted for in accordance with Section 3865 discussed above.

CRITICAL RISKS AND UNCERTAINTIES

Income Tax Matters

On October 31, 2006, the Minister of Finance (Canada) announced new tax proposals concerning the taxation of income trusts and other flow-through entities. The October 31, 2006 Proposal was followed by the release of draft legislation by the Department of Finance on December 21, 2006. The 2006 Proposed Amendments, if enacted as currently drafted, will subject the Fund to trust level taxation as of January 1, 2011. In addition, the taxable distributions received by investors from the Fund, would be treated as taxable dividends.

There can be no assurance that the Fund will be able to retain the benefit of the deferred application of the new tax regime until 2011. If K-Bro is deemed to have undergone "undue expansion" during the period from November 1, 2006 to December 31, 2010, as described in the Normal Growth Guidelines issued by the Department of Finance on December 15, 2006, the 2006 Proposed Amendments would become effective on a date earlier than January 1, 2011.

The Normal Growth Guidelines indicate that the Fund will not lose the benefit of the deferred application of the new tax regime to 2011 if the equity capital of the Fund does not grow as a result of issuances of new equity (which includes trust units, debt that is convertible into trust units, and potentially other substitutes for such equity) before 2011 by an amount that exceeds the greater of $50 million and an objective "safe harbour" amount based on a percentage of the Fund's October 31, 2006 Market Capitalization. The Normal Growth Guidelines provide for a "safe harbour" amount equal to 40% of the October 31, 2006 Market Capitalization for the period from November 1, 2006 to the end of 2007, and

20% for each of the 2008 to 2010 calendar years. These amounts of "safe harbour" are cumulative during the transition period. The Fund's October 31, 2006 Market Capitalization was approximately $81.4 million. It is therefore believed that, based upon the availability of $50 million of "safe harbour" per year, the Fund will not be subject to the 2006 Proposed Amendments until January 1, 2011.

However, in the event that K-Bro issues additional Units or convertible debentures (or other equity substitutes) in excess of the "safe harbour" amount on or before 2011, the Fund may become subject to the 2006 Proposed Amendments prior to 2011. No assurance can be given that the 2006 Proposed Amendments will not apply to the Fund prior to 2011. Loss of the benefit of the deferred application of the new tax regime until 2011 could have a material and adverse effect on the value of units of the Fund.

Competitive Environment

K-Bro experiences competition in its markets from its public and private sector competitors. The principal elements of competition include quality, service and price. While many competitors are independent and privately-owned, certain of K-Bro's competitors are public sector entities and may have greater financial and other resources. There can be no assurance that these competitors will not substantially increase the resources devoted to the development and marketing, including discounting, of products and services that compete with those offered by K-Bro.

In addition to competition provided by its laundry processor competitors, K-Bro also competes against suppliers of single-use disposable linens, particularly in its K-Bro Operating Room ("KOR") business of providing reusable surgical packs. Management estimates that suppliers of disposable packs currently control 80% of the overall market in Canada.

It is believed that these risks are managed primarily by entering into long-term contacts where possible, providing a comprehensive program of services that are difficult to replace, adhering to the highest possible quality and service standards and providing a cost effective service through the economies of large scale processing plants and purchasing power.

Acquisitions and Integration of Acquired Businesses

K-Bro's long-term growth strategy depends, in part, on its ability to acquire and successfully integrate and operate additional businesses. There can be no assurances that K-Bro can successfully integrate this new volume or successfully identify, negotiate, complete and integrate any future acquisitions. However, the size and scope of K-Bro's operations, the experience and reputation of its management team and its financial capacity may alleviate this risk.

Utility Costs

K-Bro's operations utilize natural gas, electricity and water that comprise approximately 8% of its operating expenses. K-Bro's energy costs are affected by various market factors including the availability of supplies of particular forms of energy, energy prices and local and national regulatory decisions. There can be no assurance that K-Bro will be protected against substantial changes in the price or availability of energy sources. K-Bro has entered into fixed price natural gas and electricity contracts with remaining terms of 2 years to fix the price on a significant portion of its natural gas and electricity requirements over this time period. Upon expiration of the contracts, K-Bro will be subject to prevailing market rates. K-Bro reviews its requirements and the forward pricing regularly to determine if it's feasible and desirable to lock in additional volumes or years.

K-Bro's Calgary and Edmonton facilities currently benefit from a natural gas rebate program sponsored by the Alberta provincial government. The winter rebate program runs from October through March, when gas prices are traditionally highest. During the program, when the price of gas on most Albertans' monthly bills is over $5.50/GJ, rebates are issued. The rebate program was originally set to terminate March 31, 2006 but was extended for a further three years to March 31, 2009. There can be no assurance that the program will be renewed upon its expiry. If the rebate program is not renewed and natural gas prices continue at their present levels, K-Bro's financial results could be negatively impacted.

Relocation of Calgary Plant

K-Bro is in the process of relocating from its current Calgary plant. Although Management expects to relocate in a cost-effective manner, any interruption or delay could cause the relocation to be more expensive than anticipated and could have an adverse effect on K-Bro's business. There can be no assurance that the relocation will be accomplished efficiently, that customer service will continue uninterrupted during the relocation process, or that K-Bro's operations, financial condition, liquidity and operating results will not be materially and adversely affected by such relocation.

Alberta Labour Market

Alberta currently has the highest employment rate in Canada. With the high employment and competition in the workplace, K-Bro is faced with a very competitive market for workers and the inability to recruit and retain sufficient workers to process increasing volumes of business could have an adverse impact on the operations. K-Bro has taken steps on many fronts including utilizing the Temporary Foreign Worker program, adjusting wage levels, reviewing benefits and working conditions to address this situation but there can be no assurance that these will be successful.

British Columbia Labour Legislation

See "Recent Developments – Market Updates – British Columbia – Bill 29 Update".

Credit Facility Imposes Numerous Covenants and Encumbers Assets

Covenants in the Credit Facility include, among others, ones that limit the ability of K-Bro to incur additional debt, make liens, dispose of assets, consolidate, merge or acquire other businesses, pay dividends or make other distributions (including on the K-Bro Common Shares and K-Bro Notes held by The Fund), and amend material contracts. These covenants restrict numerous aspects of the business of K-Bro. Moreover, financial performance covenants require K-Bro, among other things, to maintain up to a maximum total debt-to-EBITDA ratio, no less than a minimum ratio of current assets to current liabilities and up to a maximum total fixed charge coverage ratio. The failure to comply with the terms of the Credit Facility would entitle the Bank to accelerate all amounts outstanding under the Credit Facility, and upon such acceleration, the Bank would be entitled to begin enforcement procedures against the assets of K-Bro Linen Systems Inc. or the Fund, including accounts receivable, inventory and equipment. The Bank would then be repaid from the proceeds of such enforcement proceedings, using all available assets. Only after such repayment and the payment of any other secured and unsecured creditors would the holders of Units receive any proceeds from the liquidation of K-Bro's assets. K-Bro's ability to satisfy the restrictive covenants may be affected by events beyond its control. K-Bro monitors its compliance on an ongoing basis, including prospectively. K-Bro is in compliance with all bank covenants.

Environmental Matters

K-Bro's facilities are subject to federal, provincial and municipal laws and regulations relating to the protection of the environment and worker health and safety including those governing water waste discharges, management, recycling and disposal of hazardous materials and waste, cleanup of contamination, and worker exposure to hazardous materials. K-Bro is attentive to the environmental concerns surrounding and the environmental laws regulating the disposal of its waste materials and has through the years continued to make significant investments in properly handling and disposing of these materials. K-Bro does not use toxic materials or produce hazardous waste in its laundry facilities. All waste water is discharged through the municipal sewer system in compliance with applicable regulations. Each plant's waste water is regularly tested by the relevant municipal authorities to ensure compliance with local by-laws. Compliance with environmental laws and regulations has not and is not expected to give rise, in the aggregate, to any material adverse financial or operational effects upon K-Bro's business. Environmental laws and regulations and their interpretation, however, have changed rapidly over the years and may continue to do so in the future.

CONTROLS AND PROCEDURES

In order to ensure that information with regard to reports filed or submitted under securities legislation present fairly in all material respects the financial information of K-Bro, management including the President and Chief Executive Officer and the Vice-President and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures, as well as internal control over financial reporting.

Disclosure Controls and Procedures

In fiscal 2007, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Multilateral Instrument 52-109 was performed under the supervision of the President and Chief Executive Officer and the Vice President and Chief Financial Officer who attested that the design and operation of these disclosure controls and procedures were effective, as at December 31, 2007. K-Bro’s management can therefore provide reasonable assurance that material information relating to the Fund is reported to it in a timely manner so that it can provide investors with complete and reliable information.

Internal Controls over Financial Reporting

K-Bro undertook the documentation and assessment of the design of internal controls over financial reporting for its operating and accounting processes. Similar to the evaluation of disclosure controls and procedures referred to above, the design of internal controls over financial reporting was evaluated as defined in Multilateral Instrument 52-109. Based on the results of this evaluation, the President and Chief Executive Officer and the Vice President and Chief Financial Officer attested that the internal controls over financial reporting are designed to provide reasonable assurance that its financial reporting is reliable and that K-Bro’s consolidated financial statements were prepared in accordance with Canadian GAAP.

Management also concluded that during the quarter and year ended December 31, 2007, no changes were made to internal controls over financial reporting that would have materially affected, or would be reasonably considered to materially affect, these controls.

CORPORATE OVERVIEW

Core Business

The Fund is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc.

K-Bro is the largest owner and operator of laundry and linen processing facilities in Canada. K-Bro provides a comprehensive range of general linen and operating room linen processing, management and distribution services to healthcare institutions, hotels and other commercial accounts. K-Bro currently has processing facilities in six Canadian cities: Toronto, Edmonton, Calgary, Vancouver, Victoria, and Quebec City.

Industry and Market

K-Bro provides laundry and linen services to Canadian healthcare, hospitality and other commercial customers. Typical services offered by K-Bro include the processing, management and distribution of general and operating room linens, including sheets, blankets, towels, surgical gowns and drapes and other linen. Other types of processors in K-Bro's industry in Canada include independent privately-owned facilities (i.e. typically small single facility companies), public sector central laundries and public and private sector on-premise laundries (known as “OPLs”). Participants in other sectors of the laundry and linen services industry, such as uniform rental companies (which own and launder uniforms worn by their customers' employees) and facilities management companies (which manage public sector central laundries and OPLs), typically do not offer services that significantly overlap with those offered by K-Bro.

Management believes that the healthcare and hospitality sectors of the laundry and linen services industry represent a stable base of annual recurring business with opportunities for growth as additional healthcare beds and funds are made available to meet the needs of an aging demographic.

Industry Characteristics and Trends

Management believes that the industry exhibits the following characteristics and trends:

Stable Industry with Moderate Cyclicality--as evidenced by the stability in the number of approved hospital beds in the healthcare system and hotel rooms in the hospitality industry. Service relationships are typically formalized through contracts in the healthcare sector that are typically long term (from seven to ten years), while contracts in the hospitality sector typically range from two to five years.

Significant Barriers to Entry--establishing new laundry facilities involves significant up-front investment in equipment, linen, facilities and labour. In addition, customer contracts are typically long-term, making it more difficult for new entrants to access new accounts other than upon the expiry of a contract's term.

Outsourcing and Privatization--there are often advantages to healthcare institutions in outsourcing the processing of healthcare linen to private sector laundry companies such as K-Bro because of the economies of scale and significant management expertise that can be provided on a more comprehensive and cost-effective basis than customers can achieve in operating their own laundry facilities.

Fragmentation--most Canadian cities have at least one and sometimes several private sector competitors operating in the healthcare and hospitality sectors of the laundry and linen services industry. Management believes that the presence of these operators provides acquisition and consolidation opportunities for larger industry participants with the financial means to complete acquisitions.

Customers and Product Mix

K-Bro's customers include some of the largest healthcare and hospitality institutions in Canada. Healthcare customers include acute care hospitals and long-term care facilities. Most of K-Bro's hospitality customers (typically 250+ rooms) generate between 500,000 and 3,000,000 pounds of linen per year. Most healthcare customers generate between 500,000 pounds of linen per year for a hospital and up to 20,000,000 pounds of linen per year for a healthcare region.

VISION

Management believes that K-Bro can grow in existing and new markets by capitalizing on its strengths and competitive advantages which include:

Long-Term Contracts--K-Bro's contracts with its healthcare customers typically range from seven to ten years. Contracts in the hospitality sector typically range from two to five years. With finalization of a new ten year contract with the Calgary Health Region, (see "Recent Developments"), approximately 87% of K-Bro's current healthcare revenues will be under contract until at least December 2010. K-Bro is the exclusive provider of laundry and linen services to most of its customers. These long standing relationships, customer knowledge, quality services and value added services may bode well when contract renewals are due.

Strong Institutional Customer Base--K-Bro's customers include a number of leading hospitals, health authorities, continuing care facilities and hotels in Canada. Healthcare customers include: Calgary Health Region (the central healthcare organization in Calgary); The Hospital For Sick Children, Mount Sinai Hospital and St. Michael's Hospital in Toronto; Vancouver Coastal Health and Fraser Health (the central healthcare organizations for the greater Vancouver region) and Capital Health (the central healthcare organization for the Edmonton region). K-Bro's hospitality customers include major hotels from such well known groups as Fairmont, Westin, Delta and Hyatt. This customer base provides a strong reference list for entry into new markets or expanding services in existing markets.

Modest Maintenance Capital Expenditure Requirements--laundry equipment can, with proper ongoing maintenance, remain operative for long periods of time. For example, the useful life of a high capacity, energy efficient tunnel washer can extend beyond 20 years. This allows for competitive pricing for existing and new customers, as well as margin improvement as additional volumes are processed without additional capital expenditure. The longevity of equipment is enhanced by having a full complement of qualified maintenance engineers at each plant performing a comprehensive on-going preventative maintenance program.

National Brand-Name Recognition and Strong Reputation--K-Bro is the largest owner and operator of laundry and linen processing plants in Canada and the only service provider with a large operation in several of Canada's largest cities. Management believes that K-Bro's size and presence in multiple markets provide it with enhanced credibility when competing for new accounts in existing markets. As well, opportunity for growth in new markets through acquisitions or new builds is also enhanced. Management believes that this reputation is also enhanced through well established "green programs' including: an extensive reusable operating room linen program (K-Bro's "KOR" program); effective energy use and re-use through direct fired water heaters, heat exchangers and efficient tunnel washer systems; plastic recycling programs; and, replacement of chlorine bleach with more environmentally friendly hydrogen peroxide where feasible.

Experienced Management Team and Effective Organizational Structure--the general managers at K-Bro's six laundry facilities have each been in the industry from 14 to 20 years, and four began their careers at K-Bro in other positions before being promoted to their current positions. K-Bro's organizational structure has been developed to enable the general managers of its plants to focus on growth and operations in their individual markets, while enabling aggressive business development and tight management controls through K-Bro's separate corporate team.

Scalable Business Model--each of K-Bro's plants is highly automated and has a cost structure with a significant fixed cost component. This allows the Company to generate economies of scale as volumes increase.

STRATEGY

K-Bro maintains the following three-part strategic focus:

Secure and Maintain Long-Term Contracts with Large Healthcare and Hospitality Customers--K-Bro's core service is providing high quality laundry and linen services at competitive prices to large healthcare and hospitality customers under long-term contracts. K-Bro's contracts in the healthcare sector typically range from seven to ten years in length. Contracts in the hospitality sector typically range from two to five years.

Extend Core Services To New Markets--Management has demonstrated its ability to successfully expand K-Bro's business into new markets from its established base in Edmonton and Toronto. K-Bro entered the Calgary market in 1998, the Vancouver market in 2003, the Victoria market in 2006 and the Quebec market in 2008. These new markets have contributed significantly to K-Bro's growth. Management believes that new outsourcing opportunities will continue to arise in the near to medium-term and that K-Bro is well-positioned for continued growth, particularly as healthcare and hospitality institutions continue to increase their focus on core services and confront pressures for capital and cost savings.

Management may in the future expand its core services to new markets either through acquisitions or by establishing new facilities. Its choice of areas for expansion will depend on the availability of suitable acquisition candidates, the volume of healthcare linen to be processed and the policies of applicable governments.

Introduce Related Services--in addition to focusing on its core services, K-Bro also attempts to capitalize on attractive business opportunities by introducing closely-related services that enable it to provide more complete solutions to the K-Bro's healthcare customers. These related service offerings include K-Bro Operating Room Services ("KOR") and on-site services. For the Mount Sinai Hospital and St. Michael's Hospital contracts in Toronto, K-Bro introduced the sterilization of operating room linen packs to its menu of services.

MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the financial information presented in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in this annual report is consistent with that shown in the accompanying consolidated financial statements.

Management maintains a system of internal controls to provide reasonable assurance at to the reliability of financial information and the safeguarding of assets. The consolidated financial statements include amounts that are based on the best estimates of management.

The Board of trustees is responsible for ensuring management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee, which consists solely of non-management trustees, reviews the consolidated financial statements and recommends them to the Board for approval. The fund's auditors PricewaterhouseCoopers LLP have full and unrestricted access to the Audit Committee and meet periodically with them (and separately, in the absence of management) to discuss audit, financial reporting and related matters.

Linda McCurdy
President and Chief Executive Officer

Doug Thomson, FCA
Vice President and Chief Financial Officer

AUDITORS' REPORT

March 6, 2008

To the Unitholders of K-Bro Linen Income Fund

We have audited the consolidated balance sheets of **K-Bro Linen Income Fund** as at December 31, 2007 and 2006 and the consolidated statements of earnings and deficit, comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

Edmonton, Canada

K-Bro Linen Income Fund

Consolidated Balance Sheets

	As at December 31, 2007 $	2006 $
Assets		
Current assets		
Accounts receivable	**9,141,721**	7,441,178
Linen in service	**8,560,077**	8,493,301
Prepaid expenses and deposits	**837,212**	496,360
	18,539,010	16,430,839
Restricted escrow funds (note 3)	**-**	1,000,000
Property and equipment (note 4)	**31,864,330**	23,633,367
Intangible assets (note 5)	**17,373,196**	19,444,380
Goodwill (note 3)	**15,565,799**	14,565,799
	83,342,335	75,074,385
Liabilities and Unitholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	**12,540,726**	8,705,514
Distribution payable to unitholders	**503,843**	503,843
Future income taxes (note 9)	**106,603**	1,110,450
	13,151,172	10,319,807
Long-term debt (note 6)	**16,627,107**	9,278,429
Unamortized lease inducements (note 8)	**576,376**	-
Future income taxes (note 9)	**4,744,968**	5,312,391
	35,099,623	24,910,627
Contingencies and commitments (note 10)		
Unitholders' Equity		
Exchangeable shares (note 11)	**724,110**	724,110
Fund units (note 11)	**52,210,472**	52,210,472
Fund units held in trust by LTIP (note 12)	**(533,603)**	(313,561)
Contributed surplus (note 11)	**413,671**	184,635
Deficit	**(4,573,837)**	(2,641,898)
Accumulated other comprehensive income (note 11)	**1,899**	-
	48,242,712	50,163,758
	83,342,335	75,074,385

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

Approved on behalf of the Fund

K-Bro Linen Income Fund

Consolidated Statements of Earnings and Deficit

	Year ended December 31	
	2007	2006
	$	$
Revenue	74,100,941	65,108,094
Expenses		
Wages and benefits	37,334,778	32,240,036
Linen	9,396,962	8,134,865
Utilities	5,728,452	5,292,785
Delivery	2,780,344	2,571,692
Occupancy costs	2,405,533	2,310,667
Materials and supplies	2,465,795	2,144,746
Repairs and maintenance	2,227,415	1,954,158
Corporate	2,573,468	2,123,874
	64,912,747	56,772,823
Earnings before the undernoted	9,188,194	8,335,271
Other income (expenses)		
Amortization of property and equipment	(3,684,034)	(3,126,036)
Amortization of intangible assets	(2,071,184)	(1,992,509)
Financial charges (note 7)	(879,747)	(553,747)
Gain on disposal of equipment	2,838	4,486
	(6,632,127)	(5,667,806)
Earnings before income taxes	2,556,067	2,667,465
Income tax recovery (note 9)	1,558,114	1,210,663
Net earnings for the year	4,114,181	3,878,128
Deficit – beginning of year	(2,641,898)	(770,917)
Distributions to unitholders (note 13)	(6,046,120)	(5,749,109)
Deficit– end of year	(4,573,837)	(2,641,898)
	$	$
Net earnings per unit		
Basic	0.75	0.74
Diluted	0.75	0.74
	#	#
Weighted average number of units outstanding (note 11)		
Basic	5,464,487	5,219,225
Diluted	5,498,318	5,227,474

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

K-Bro Linen Income Fund

Consolidated Statements of Comprehensive Income

	Year ended December31	
	2007	**2006**
	$	**$**
Net earnings for the year	**4,114,181**	3,878,128
Other comprehensive loss		
Loss on derivative instruments designated as cash flow hedges, net of future income taxes of $13,156	**(26,186)**	-
Other comprehensive loss for the period	**(26,186)**	-
Comprehensive income for the year	**4,087,995**	3,878,128

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

K-Bro Linen Income Fund

Consolidated Statements of Cash Flows

	Year ended December31	
	2007	**2006**
	$	**$**
Cash provided by (used in)		
Operating activities		
Net earnings for the year	**4,114,181**	3,878,128
Items not affecting cash		
Amortization of property and equipment	**3,684,034**	3,126,036
Amortization of intangible assets	**2,071,184**	1,992,509
Gain on disposal of equipment	**(2,838)**	(4,486)
Future income taxes	**(1,558,114)**	(1,210,663)
	8,308,447	7,781,524
Net change in non-cash working capital items (note 14)	**(1,366,321)**	(3,223,401)
Cash provided by operating activities	**6,942,126**	4,558,123
Financing activities		
Fund units issued – net of offering costs	**-**	14,317,046
Distributions paid to Unitholders	**(6,046,120)**	(5,631,690)
Increase in revolving line of credit	**7,348,678**	3,876,970
Cash provided by financing activities	**1,302,558**	12,562,326
Investing activities		
Purchase of property and equipment	**(8,294,811)**	(8,822,756)
Business acquisition (note 3)	**-**	(7,310,033)
Escrow funds (note 3)	**-**	(1,000,000)
Proceeds from disposition of property and equipment	**50,127**	12,340
Cash used in investing activities	**(8,244,684)**	(17,120,449)
Change in cash	**-**	-
Cash - beginning of year	**-**	-
Cash–end of year	**-**	-
Supplementary cash flow information		
Interest received	**-**	-
Interest paid	**820,751**	521,364
Non-cash financing and investing activities		
Distribution included in distribution payable	**-**	117,419
Equipment purchases included in accounts payable	**3,091,099**	825,715
Leasehold improvements included in lease inducements	**576,376**	-

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

1 Business description

K-Bro Linen Income Fund (the "Fund") is a limited purpose trust established under the laws of Alberta pursuant to the Amended and Restated Fund Declaration of Trust dated February 3, 2005. The Fund was created for the purpose of acquiring, directly or indirectly, all of the issued and outstanding securities of K-Bro Linen Systems Inc. K-Bro Linen Systems Inc. provides a range of services to healthcare institutions, hotels and other commercial accounts. These services include the processing, management and distribution of linen.

2 Significant accounting policies

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The precise determination of many assets and liabilities is dependent upon future events. Accordingly, the preparation of financial statements for a reporting period necessarily involves the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. These consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

a) Basis of presentation

These consolidated financial statements include the Fund, its wholly owned subsidiary K-Bro Linen Systems Inc. and the LTIP Trust, a variable interest entity (note 12). All material intercompany balances and transactions have been eliminated upon consolidation. These consolidated financial statements are for the years ended December 31, 2007 and 2006.

b) Linen in service

Linen in service is recorded at cost. Operating room linen is amortized using the straight-line method over the estimated service life of 24 months. General linen is amortized based on usage which results in an estimated average service life of 24 months.

c) Revenue recognition

Revenue from linen management and laundry services is largely based on written service agreements whereby the Fund agrees to collect, launder, deliver and replenish linens. The Fund recognizes revenue in the period in which the services are provided.

d) Property and equipment

Property and equipment are recorded at cost. Amortization is provided over the estimated useful life of the asset using the following annual rates and methods:

Laundry equipment	15% declining balance
Office and delivery equipment	20% declining balance
Computers and software	30% declining balance
Leasehold improvements	Straight-line over the lease period
Asset under development	At applicable rates and methods when put into service

e) Intangible assets

Intangible assets with a finite life, which relate to contracts the Fund has with certain customers, are recorded at cost and are amortized using the straight-line method over the remaining life of the contract plus one renewal period, ranging from 25 months to 171 months.

f) Impairment of long-lived assets

The Fund assesses impairment of its long-lived assets (property and equipment and finite life intangible assets) when events or changes in circumstances cause the carrying value of an asset to exceed the total undiscounted cash flows expected from its use and eventual disposition. An impairment loss, if any, is determined as the excess of the carrying value of the asset over its fair value.

g) Future income taxes

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is currently only taxable on any amount not distributed to Unitholders and income tax liabilities relating to distributions of the Fund are taxed in the hands of the Unitholders. As substantially all taxable income is distributed to the Unitholders, no provision for current income taxes on earnings of the Fund is made in the financial statements. On June 12, 2007, the Canadian federal government substantively enacted legislation whereby the income tax rules applicable to publicly traded trusts was significantly modified. In particular, income earned by a trust will be taxed in a manner similar to income earned and distributed by a corporation. The legislation is effective for the 2007 taxation year, but the application of the rules is delayed to the 2011 taxation year with respect to trusts that were publicly traded prior to November 1, 2006 within certain guidelines. For the Fund, only temporary differences expected to reverse after January 1, 2011 are taken into account in the determination of the provision for income taxes.

The incorporated subsidiary of the Fund calculates income taxes using the liability method of accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax liabilities or assets. Future income tax liabilities or assets are calculated using substantively enacted tax rates applicable to the period that the temporary differences are expected to reverse. Future income tax assets are only recognized to the extent that, in the opinion of management, they will more likely than not be utilized. The effect on future income tax assets or liabilities is recognized in income in the period that the change occurs.

Income tax obligations relating to distributions of the Fund are the obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of the assets and liabilities of the Fund. The enactment of the new legislation did not have a significant impact on the Fund's consolidated financial statements.

h) Goodwill

Goodwill represents the excess of the cost of business acquisitions over the fair value of net identifiable assets acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. Goodwill will be written down when the carrying value exceeds the fair value. Management has determined that there was no goodwill impairment at December 31, 2007 or 2006.

i) Volume rebates

Certain customers receive a rebate based on specified annual processing volumes. A volume rebate liability is recognized at the time it is expected that the customer will meet the specified annual volume levels.

j) Adoption of new accounting policies:

(i) Financial instruments – recognition and measurement

On January 1, 2007, the Fund adopted Section 3855 of the Canadian Institute of Chartered Accountants' ("CICA") Handbook, "Financial Instruments – Recognition and Measurement". It describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial statements. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value.

The Fund has made the following classifications:

Cash and temporary investments will be classified as financial assets held for trading and measured at fair value. Gains and losses related to periodical revaluation are recorded in net income.

Accounts receivable are classified as loans and receivables and are initially measured at fair value and subsequent periodical revaluations are recorded at amortized cost using the effective interest rate method.

Accounts payable and accrued liabilities, distribution payable and long-term debt are classified as other liabilities and are initially measured at fair value and subsequent periodical revaluations are recorded at amortized cost using the effective interest rate method.

The adoption of this Section was done retroactively without restatement of the consolidated financial statements of prior periods. As at January 1, 2007 and December 31, 2007, there was no impact on the consolidated financial statements from these classifications.

The impact on the consolidated balance sheet of measuring hedging derivatives at fair value as at January 1, 2007 was an increase in other current assets and accumulated other comprehensive income of $28,085. Prior periods were not restated.

An embedded derivative is a component of a financial instrument or another contract of which the characteristics are similar to a derivative. The Fund has no significant embedded derivatives.

(ii) Comprehensive income

On January 1, 2007, the Fund adopted Section 1530 of the CICA Handbook, “Comprehensive Income”. It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in unitholders’ equity, which results from transactions and events from sources other than the Fund’s unitholders. These transactions and events include unrealized gains and losses resulting from changes in fair value of certain financial instruments.

As a result of the adoption of this Section, the Fund now presents a consolidated statement of comprehensive income as part of the consolidated financial statements.

(iii) Equity

On January 1, 2007, the Fund adopted Section 3251 of the CICA Handbook, “Equity”, replacing Section 3250 “Surplus”. It describes standards for the presentation of equity and changes in equity for a reporting period as a result of the application of Section 1530, “Comprehensive Income”.

(iv) Hedges

On January 1, 2007, the Fund adopted Section 3865 of the CICA Handbook, “Hedges”. The recommendations of this Section expand the guidelines required by Accounting Guideline 13 (AcG-1 3), “Hedging Relationships”. This Section describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenue and expenses from the derivative financial instruments in the same period as for those related to the hedged item. This has been applied to the Fund’s interest rate swap and foreign exchange forward contracts.

(v) Accounting changes

Effective January 1, 2007, the Fund adopted CICA Handbook Section 1506 “Accounting Changes”. This section established criteria for changing accounting policies together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and the correction of errors.

It includes the disclosure, on an interim and annual basis, of a description and the impact on our financial results of any new primary source of GAAP that has been issued but is not yet effective. The Fund has determined that there is no material impact on the consolidated financial statements from the adoption of Handbook Section 1506.

k) Future changes in accounting policies

(i) Capital disclosures

The CICA issued a new accounting standard, Section 1535 “Capital Disclosures”, which requires the disclosure of both qualitative and quantitative information that provides users of financial statements with information to evaluate the entity’s objectives, policies and processes for managing capital. This new section is effective for the Fund beginning January 1, 2008. Management does not expect that the adoption of this standard will have an impact on the consolidated financial statement as the standard relates to note disclosure.

(ii) Financial instruments-disclosure and Financial instruments-presentation

Two new accounting standards were issued by the CICA, Section 3862 “Financial Instruments-Disclosures”, and Section 3863 “Financial Instruments – Presentation”. These sections will replace Section 3861 “Financial Instruments – Disclosure and Presentation” once adopted. The objective of Section 3862 is to provide users with information to evaluate the significance of the financial instruments on the entity’s financial position and performance, the nature and extent of risks arising from financial instruments, and how the entity manages those risks. The provisions of Section 3863 deal with the classification of financial instruments, related interest, dividends, losses and gains and the circumstances in which financial assets and financial liabilities are offset. These new sections are effective for the Fund beginning January 1, 2008. Management does not expect that the adoption of this standard will have an impact on the consolidated financial statement as the standard relates to note disclosure.

(iii) Inventories

In June 2007, the CICA issued a new accounting standard – Section 3031 “Inventories” which replaces the existing standard for inventories, Section 3030. The new Section is effective for the Fund beginning January 1, 2008. Application of the new Section is not expected to have a material impact on the financial statements.

(iv) Goodwill and intangible assets

In February 2008, the CICA issued a new accounting standard – Section 3064 “Goodwill and intangible assets” which replaces the existing standard for goodwill and other intangible assets, Section 3062 and research and development costs, Section 3450. The new Section is effective for the Fund beginning January 1, 2009; however, earlier adoption is encouraged. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. Standards with respect to intangible assets may have an impact on the Fund’s treatment of certain costs associated with its new Calgary plant. Management is assessing the impact of these new standards on its consolidated financial statements.

l) International Financial Reporting Standards

The Accounting Standards Board of Canada has announced that accounting standards in Canada, as used by public companies, will be converged to International Financial Reporting Standards ("IFRS") effective January 1, 2011. The Fund will convert to these new standards according to the timetable set with these new rules. Management is currently assessing the future impact of these new standards on its consolidated financial statements.

3 Business acquisition

On March 31, 2006, the Fund completed the acquisition of the business, linen and equipment of Premier Linen Supply Ltd. located in Victoria, British Columbia. The business acquisition has been accounted for using the purchase method, whereby the purchase consideration was allocated to the fair values of the net assets acquired at March 31, 2006.

The purchase price allocated to the net assets acquired was as follows:

	$
Consideration	
Purchase price including acquisition costs	8,362,919
Less	
Assumption of accrued liability	(52,886)
Restricted escrow funds	(1,000,000)
Net cash consideration	7,310,033
Net assets acquired	
Linen	355,000
Laundry equipment and vehicles	1,600,000
Intangible assets	3,147,000
Goodwill	2,208,033
	7,310,033

Of the cash consideration payable to the vendor, $1 million was deposited into escrow with an escrow agent. The full amount of the funds held in escrow were released to the vendor in 2007 upon the determination that specified earnings before interest, income taxes and amortization were met in the twelve-month period subsequent to the acquisition. Goodwill was correspondingly increased by the amount released.

4 Property and equipment

			2007
	Cost $	**Accumulated amortization $**	**Net $**
Equipment			
Laundry	**25,740,872**	**6,925,484**	**18,815,388**
Office	**219,308**	**86,151**	**133,157**
Delivery	**433,578**	**158,466**	**275,112**
Computers and software	**845,624**	**420,855**	**424,769**
Leasehold improvements	**3,413,524**	**1,261,552**	**2,151,972**
Asset under development-new Calgary plant(1)	**10,063,932**	**-**	**10,063,932**
	40,716,838	**8,852,508**	**31,864,330**

(1) Of this total, $3,091,099 is included in accounts payable and $576,376 is included in unamortized lease inducements.

			2006
	Cost $	**Accumulated amortization $**	**Net $**
Equipment			
Laundry	24,282,273	3,989,592	20,292,681
Office	223,008	61,259	161,749
Delivery	440,490	99,163	341,327
Computers and software	755,906	284,228	471,678
Leasehold improvements	3,106,058	740,126	2,365,932
	28,807,735	5,174,368	23,633,367

5 Intangible assets

			2007
	Cost $	Accumulated amortization $	Net $
Finite life intangible assets			
Healthcare contracts	15,700,000	3,290,328	12,409,672
Operating room contracts	3,500,000	1,424,418	2,075,582
Hospitality contracts	3,847,000	959,058	2,887,942
	23,047,000	5,673,804	17,373,196

			2006
	Cost $	Accumulated amortization $	Net $
Finite life intangible assets			
Healthcare contracts	15,700,000	2,162,216	13,537,784
Operating room contracts	3,500,000	936,046	2,563,954
Hospitality contracts	3,847,000	504,358	3,342,642
	23,047,000	3,602,620	19,444,380

6 Long-term debt

K-Bro Linen Systems Inc. has a revolving credit facility of up to $30,000,000 (increased from $18,000,000 as of August 2007) of which $17,062,107 is drawn (including letters of credit totalling $435,000 per note 10(a)). The facility is a two-year committed facility maturing February 28, 2009. It is extendable annually for another year at the lender’s option. Interest payments only are due during the term of the facility.

A general security agreement over all assets, a mortgage against all leasehold interests, insurance policies and an assignment of material agreements have been pledged as collateral.

Drawings under the revolving credit facility are available by way of Bankers’ Acceptances, Canadian prime rate loans, letters of credit or standby letters of guarantee. Drawings under the revolving credit facility bear interest at a floating rate, plus an applicable margin based on certain financial performance ratios. For Bankers’ Acceptances the margin will vary from 2.00% to 3.00%, for Canadian prime rate loans, the margin will vary from 0.50% to 1.50%.

The balance consists of:

	2007 $	2006 $
Bankers' Acceptances, 7.10% (2006 -6.34%)	**4,000,000**	4,000,000
Prime rate loan, 7.00% (2006- 6.50%)	**12,627,107**	5,278,429
	16,627,107	9,278,429

7 Financial charges

	Year ended December 31 2007 $	2006 $
Interest on long-term debt	**820,751**	521,364
Other charges	**58,996**	32,383
	879,747	553,747

8 Unamortized lease inducements

Lease inducements are received from certain of the Fund's landlords, primarily in the form of leasehold improvements and rent-free periods. Lease inducements are recorded as a liability when credited or received and will be amortized on a straight-line basis as a reduction of rent expense over the term of the related lease. For lease contracts with escalating lease payments, total rent expense for the lease term is expensed on a straight-line basis over the lease term. The difference between rent expensed and amounts paid will be recorded as an increase or reduction in deferred lease inducements.

The Fund entered into a ten year lease for a new facility in Calgary in 2007 which included certain lease inducements. These inducements totalling $585,748 include leasehold improvements and a rent-free period. The lease term commenced on November 1, 2007 and the amortization commenced on a straight-line basis over the term of the lease. Accumulated amortization at December 31, 2007 is $9,372.

9 Income taxes

A reconciliation of the expected income tax recovery (expense) to the actual income tax recovery (expense) is as follows:

	Year ended December 31	
	2007	**2006**
	$	**$**
Canadian statutory rates (federal and provincial)	**33.4%**	33.7%
Expected provision for income taxes	**(853,726)**	(898,402)
Increase (decrease) from		
Non-deductible items	**(24,235)**	(28,143)
Impact of substantively enacted rates and other	**559,529**	532,175
Income of the Fund allocated to unitholders	**1,876,546**	1,605,033
Actual provision for income tax recovery	**1,558,114**	1,210,663

Future income taxes have been provided as follows:

	Year ended December 31	
	2007	**2006**
	$	**$**
Linen in service	**299,969**	1,287,351
Accounts payable and accrued liabilities	**(193,366)**	(176,901)
	106,603	1,110,450
Property and equipment	**1,022,216**	1,091,996
Intangible assets and goodwill	**4,304,982**	5,059,722
Offering costs and other	**(582,230)**	(839,327)
	4,744,968	5,312,391
	4,851,571	6,422,841

The benefit of deductible temporary differences of $600,000 (December 31, 2006 - $900,000) relating to offering costs borne directly by the Fund have not been recorded. The amount of goodwill deductible for tax purposes is $3,208,033 (2006 - $2,208,033).

10 Contingencies and commitments

a) Contingencies

Letters of credit

The Fund has outstanding letters of credit issued as part of normal business operations in the amounts of $185,000 (2006 - $185,000) expiring January 21, 2009 and $250,000 (2006 - $250,000) expiring January 24, 2009.

b) Commitments

Operating leases and utility commitments

Minimum lease payments for operating leases on buildings and equipment and estimated natural gas and electricity commitments for the next five calendar years are as follows:

	$
2008	**3,842,976**
2009	**3,807,240**
2010	**2,399,151**
2011	**1,784,292**
2012	**1,711,894**
Subsequent	**5,427,296**

Linen commitments

At December 31, 2007, the Fund was committed to linen expenditure obligations in the amount of $2,741,266 (December 31, 2006 - $5,987,689). This is the result of an annual tendering process whereby purchase orders are issued to successful bidders for the anticipated requirements for the ensuing year.

Equipment purchase commitments

The Fund has commitments to purchase equipment totaling $126,000 at December 31, 2007 (December 31, 2006 - nil).

11 Unitholders' equity

a) Authorized

The declaration of trust provides that an unlimited number of units and an unlimited number of Special Trust Units may be issued.

b) Issued and outstanding

Fund Units	**#**	**$**
Issued on initial public offering	4,343,862	43,438,620
Offering costs	-	(5,775,195)
Balance at December 31, 2005	4,343,862	37,663,425
Issued on March 31, 2006 pursuant to a private placement at $13.90 per Unit	1,080,000	15,012,000
Offering costs – net of future tax recovery of $230,000	-	(464,953)
	1,080,000	14,547,047
Balance at December 31, 2007 and 2006	**5,423,862**	**52,210,472**
	#	**$**
Exchangeable shares		
	72,411	**724,110**
Total Fund Units and Exchangeable shares issued	**5,496,273**	

The exchangeable shares were issued by the Fund's subsidiary to certain members of management and are exchangeable on a one-to-one basis for Fund Units. The risks and privileges of these shares are the same as for Fund Units. The exchangeable shares of the Fund's subsidiary are synonymous with the Special Trust Units of the Fund.

c) Contributed surplus

	Year ended December 31	
	2007	**2006**
	$	**$**
Balance, beginning of year	**184,635**	-
Net stock based compensation recorded during the year	**229,036**	184,635
Balance, end of year	**413,671**	184,635

d) Accumulated other comprehensive income

	Year ended December 31	
	2007	**2006**
	$	$
Balance, beginning of year, as previously reported	**-**	-
Financial instruments – recognition and measurement (note 2)	**28,085**	-
Restated balance, beginning of year	**28,085**	-
Other comprehensive income during the year	**(26,186)**	-
Balance, end of year	**1,899**	-

e) Weighted average number of units outstanding

	Year ended December 31	
	2007	**2006**
	$	$
Weighted average unit calculation		
Basic		
Units - opening	**5,496,273**	4,416,273
Weighted average units issued during the year	**-**	816,658
Weighted average unvested units purchased for LTIP	**(31,786)**	(13,706)
	5,464,487	5,219,225
Diluted		
Basic weighted average units- opening	**5,464,487**	5,219,225
Dilutive effect of LTIP units	**33,831**	8,249
	5,498,318	5,227,474

12 Long Term Incentive Plan

In April, 2006, a trust (the "LTIP Trust") was formed to hold Units of the Fund on behalf of the participants of the Fund's long-term incentive plan (the "LTIP"). The Fund is neither a trustee nor a direct participant of the LTIP; however, under certain circumstances the Fund may be the beneficiary of forfeited Units held by the LTIP Trust. Consequently, the LTIP Trust is considered a variable interest entity for accounting purposes and the Fund has consolidated the LTIP Trust in accordance with the CICA issued Accounting Guideline AcG-15. For a specific performance year, one-quarter of the Units held by the LTIP Trust vest to the participants of the LTIP thirty days after approval of the audited financial statements by the Trustees upon the participant signing a Participation Agreement and Confirmation and three-quarters will vest on the second anniversary of that date upon continued employment, except in limited circumstances. Compensation expense is recorded by the Fund in the period earned. Distributions made by the Fund with respect to unvested Units held by the LTIP Trust are paid to LTIP participants. Unvested units held by the LTIP Trust are shown as a reduction of unitholders' equity.

In accordance with the LTIP agreement and in conjunction with the performance of the Fund in the prior fiscal year, the Compensation, Nominating and Corporate Governance Committee of the Trustees of the Fund in 2007 approved LTIP compensation of $0.3 million (2006 - $0.4 million) and approved the funding and transfer of $0.3 million (2006 - $0.4 million) of cash to the LTIP Trust in April 2007 and 2006 respectively in order to fund the purchase of Units by the LTIP Trust. In April 2007, the LTIP Trust purchased 22,647 Units of the Fund (2006 - 27,113). As at December 31, 2007, 12,436 Units held by the LTIP Trust have vested (2006 - 6,779).

The basic net earnings per unit calculation exclude the unvested units held by the LTIP Trust.

13 Distributions to Unitholders

The Fund's policy is to make distributions to unitholders of its available cash to the maximum extent possible consistent with good business practice considering requirements for capital expenditures, working capital, growth capital and other reserves considered advisable by the Trustees of the Fund. All such distributions are discretionary. Distributions are declared payable each month to the Fund unitholders and exchangeable shareholders on the last business day of each month and are paid by the 15th of the following month. Distributions declared during the years ended December 31, 2007 and 2006 are as follows:

			2007
Period	**# of Units**	**Per Unit Per Month $**	**Amount $**
Fund Units			
January 1 – December 31, 2007	**5,423,862**	**0.09167**	**5,966,465**
Exchangeable shares			
January 1 – December 31, 2007	**72,411**	**0.09167**	**79,655**
			6,046,120

			2006
Period	**# of Units**	**Per Unit Per Month $**	**Amount $**
Fund Units			
January 1 – March 31, 2006	4,343,862	0.09167	1,194,605
April 1 – December 31, 2006	5,423,862	0.09167	4,474,849
Exchangeable shares			
January 1 – December 31, 2006	72,411	0.09167	79,655
			5,749,109

14 Net change in non-cash working capital items

	Year ended December 31	
	2007	2006
Cash provided (used) by changes in	$	$
Accounts receivable	(1,700,543)	(1,806,078)
Linen in service	(66,776)	(1,784,587)
Prepaid expenses and deposits	(316,792)	(193,401)
Accounts payable and accrued liabilities	717,790	560,665
	(1,366,321)	(3,223,401)

15 Financial instruments

The Fund's financial instruments consist of accounts receivable, accounts payable and accrued liabilities, and long-term debt.

Financial risk management

The Fund's activities are exposed to a variety of financial risks: price risk, credit risk, liquidity risk and cash flow risk. The Fund's overall risk management program focuses on the unpredictability of financial and economic markets and seeks to minimize potential adverse effects on the Fund's financial performance. Risk management is carried out by financial management in conjunction with overall Fund governance.

Price risk

There are three types of price risk:

Currency risk – Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar. The Fund is not significantly exposed to foreign currency risk as all revenues are received in Canadian dollars and minimal expenses are incurred in foreign currencies. For large capital expenditure commitments denominated in a foreign currency, the Fund will enter into foreign exchange forward contracts (see below) if considered prudent to mitigate this risk.

Interest rate risk – The Fund's long-term debt is subject to interest rate fluctuations and the degree of volatility in these rates. The Fund currently has in place a financial instrument in the form of an interest rate swap agreement (see below) to mitigate a portion of this risk. Management does not believe that the impact of interest rate fluctuations will be significant

Market risk – The Fund's exposure to financial market risk is limited since there are no significant financial instruments which fluctuate as a result of changes in market prices.

Credit risk

The Fund is exposed to credit risk in the event of non-performance by customers, but does not anticipate such non-performance due to the nature of its customers. The maximum credit risk is the fair value of the accounts receivable.

Liquidity risk

The Fund manages liquidity risk through the availability of an adequate committed line of credit (see note 6).

Cash flow risk

As the Fund has no interest bearing assets, the Fund's income and operating cash flows are substantially independent of changes in market interest rates.

Fair value

The carrying value of accounts receivable, and accounts payable and accrued liabilities approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Fund's long-term debt is estimated based on market prices for same or similar instruments and approximates carrying value.

Interest rate swap agreement

The Fund entered into an interest rate swap agreement on June 24, 2005 through its Canadian chartered bank to fix the interest rate on a portion of its debt by exchanging a notional amount of $4,000,000 of existing debt from a floating rate to a fixed interest rate for five years at 5.95%. The difference between the amounts paid and received is accrued and accounted for as an adjustment to interest expense. For the years ended December 31, 2007 and 2006 there was no gain or loss recorded as the result of hedge ineffectiveness.

Foreign exchange contracts

The Fund, in 2007, entered into foreign exchange contracts through its Canadian chartered bank to hedge its foreign denominated equipment purchase commitments. At December 31, 2007, a foreign exchange forward option contract was outstanding to purchase $385,000 US at a rate of 1.084 which is exercisable in April, 2008.

16 Segmented information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through five operating segments in Vancouver, Victoria, Calgary, Edmonton and Toronto. The services offered and the economic characteristics associated with these segments are similar, therefore these segments have been aggregated into one reportable segment which operates exclusively in Canada.

Total revenue derived from the healthcare and hospitality sectors are as follows:

	Year ended December 31, 2007	
	$	%
Healthcare	**57,393,080**	**77.5**
Hospitality	**16,707,861**	**22.5**
Total	**74,100,941**	**100.0**

	Year ended December 31, 2006	
	$	%
Healthcare	50,151,631	77.0
Hospitality	14,956,463	23.0
Total	65,108,094	100.0

In Edmonton, the Fund is the significant supplier of laundry and linen services to the entity which manages all major healthcare facilities in the region. This contract expires on December 31, 2010. In Calgary, the major customer is contractually committed to February 28, 2008 and the Fund is in the process of finalizing a new ten year contract upon that termination. In Vancouver the major customer is contractually committed to January 15, 2013.

For the year ended December 31, 2007, the Fund has recorded revenue of $42.8 million (December 31, 2005 - $37.8 million) from these three major customers, representing 58% (December 31, 2005 - 58%) of total revenue.

17 Related party transaction

The Fund has incurred expenses in the normal course of business for advisory consulting services provided by a Trustee relating to acquisitions. The amounts charged are recorded at their exchange amounts and are subject to normal trade terms. For the year ended December 31, 2007, the Fund incurred such fees totaling $46,000 (2006 - $74,000). Of the total 2007 amount, $38,000 is included in prepaid expenses to be recognized as an acquisition cost related to the assets of Buanderie HMR Inc. (see note 18) and $8,000 is included in equipment costs related to the acquisition of equipment from a receivership. For 2006, $40,000 is included in acquisition costs related to the assets of Premier Linen Supply Ltd. (see note 3) and $34,000 is included in Corporate expenses.

18 Subsequent events

a) Business acquisition

On January 31, 2008, the Fund completed the acquisition of the laundry business, linen, property and equipment of Buanderie HMR Inc. located in Quebec City, Quebec. The business acquisition will be accounted for using the purchase method, whereby the purchase consideration will be allocated to the fair values of the net assets acquired at January 31, 2008.

The purchase price including estimated acquisition costs was approximately $3.8 million. Of the cash consideration payable to the vendor, $0.5 million was deposited into escrow with an escrow agent. The full amount of the funds held in escrow will be released to the vendor upon the determination that specified earnings before interest, income taxes and amortization were met in the twelve-month period subsequent to the acquisition and goodwill will correspondingly be increased by the amount released.

b) Equity issuance:

On February 27, 2008 the Fund completed the issuance of 1,362,000 Units at a price of $12.85 per Unit. Net proceeds to the Fund after commission and expenses, net of tax, are approximately $16.7 million. The underwriters have also been granted an over – allotment option, exercisable in whole or in part for a period of 30 days following closing, to purchase up to an additional 204,300 units at the same offering price. If the over– allotment option is fully exercised, additional net proceeds to K-Bro will be approximately $2.5 million.

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Trading Symbol KBL.UN

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Steven Matyas
Michael Percy

Compensation, Nominating and Corporate Governance Committee
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Doug Thomson, FCA
Vice President and Chief Financial Officer

Jerry Ostrzyzek
Vice President Eastern Operations & General Manager

Ron Graham
General Manager Vancouver

Jeff Gannon
General Manager Calgary

Annual General Meeting
The Annual General Meeting of the Unitholders will be held at the Sheraton Centre Hotel, Peel Room, in Toronto on Thursday, June 12, 2008 at 2 o'clock in the afternoon. All Unitholders are cordially invited to attend.

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