dependable.

K-Bro Linen Inc.

Annual Report 2010

We are the largest linen processing company in Canada.

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location of plants

president's message

Dear fellow shareholders,

2010 marked another year of strong performance for K-Bro. Key fiscal financial accomplishments for 2010 included:

- total shareholder return of 43.9%, on top of the 50.0% return for 2009
- revenue of $104.5 million, an increase of 18.9% over the prior year
- distributable income of $15.6 million
- maintaining $1.10 per unit in dividends, a payout ratio of 49.5%
- market capitalization in excess of $125 million
- a renewed credit facility that was increased to $40 million, most of which is undrawn

This was a year of customer and volume growth for K-Bro. During the year we acquired a second Vancouver plant, adding additional capacity and new clients in the greater Vancouver and Whistler areas. We also were the successful proponent in Vancouver for millions of pounds of new volume from four of the health authorities. We extended our contracts with Alberta Health Services for the Edmonton area institutions for an additional two years, which will mark the 18th consecutive year that K-Bro has provided services to the Authority. We also earned the business from nine major new clients across Canada. At the end of the year we transitioned K-Bro from an income trust structure into a corporation.

We began the year with an economy that was recovering from a global economic collapse. Despite the stability provided by the long-term nature of much of our volume--approximately 70% of our revenue is under long-term contact with large publicly funded healthcare customers--we took a hard look at our business and began exploring opportunities to improve service and reduce costs. Our objectives included offering our customers a better value while also improving K-Bro's performance. Our improved 2010 performance was in-part a result of the improvements that we made to our business model during the year.

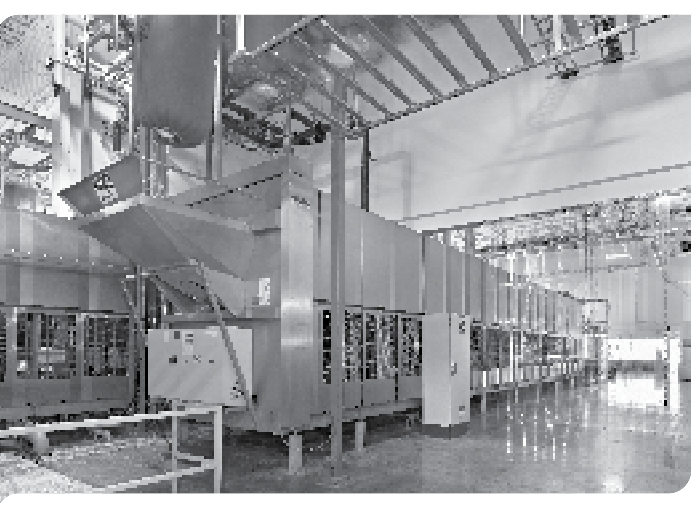
We are also so very grateful to K-Bro's dedicated and loyal employees who adapted quickly to the change in the economic environment and the changes we made to our business. The success we experienced in 2010 could not have been accomplished without their hard work and commitment. We have assembled an exceptional team of people with demonstrated capabilities in the commercial laundry industry, and we offer a large variety of sophisticated products and services for our clients that makes us unique in Canada.

We are also pleased with our performance as it relates to safety. We have taken significant steps to impart an even stronger culture of safety awareness throughout the organization. Operationally every plant saw improvements in their safety statistics during 2010. We will be striving to improve upon these strong safety metrics again in 2011.

The outlook for 2011 is for a continued return to economic growth across most regions of Canada. Our focus will be on growth in the years to come as we execute our strategy of expanding geographically and adding new services to our business mix. Your management team and board of directors are committed to building long-term shareholder value.

In closing, we would like to thank all of our employees, customers, shareholders and stakeholders for their commitment to and support of K-Bro during the past year and we look forward to continuing to earn your trust and respect.

Linda McCurdy
President and Chief Executive Officer

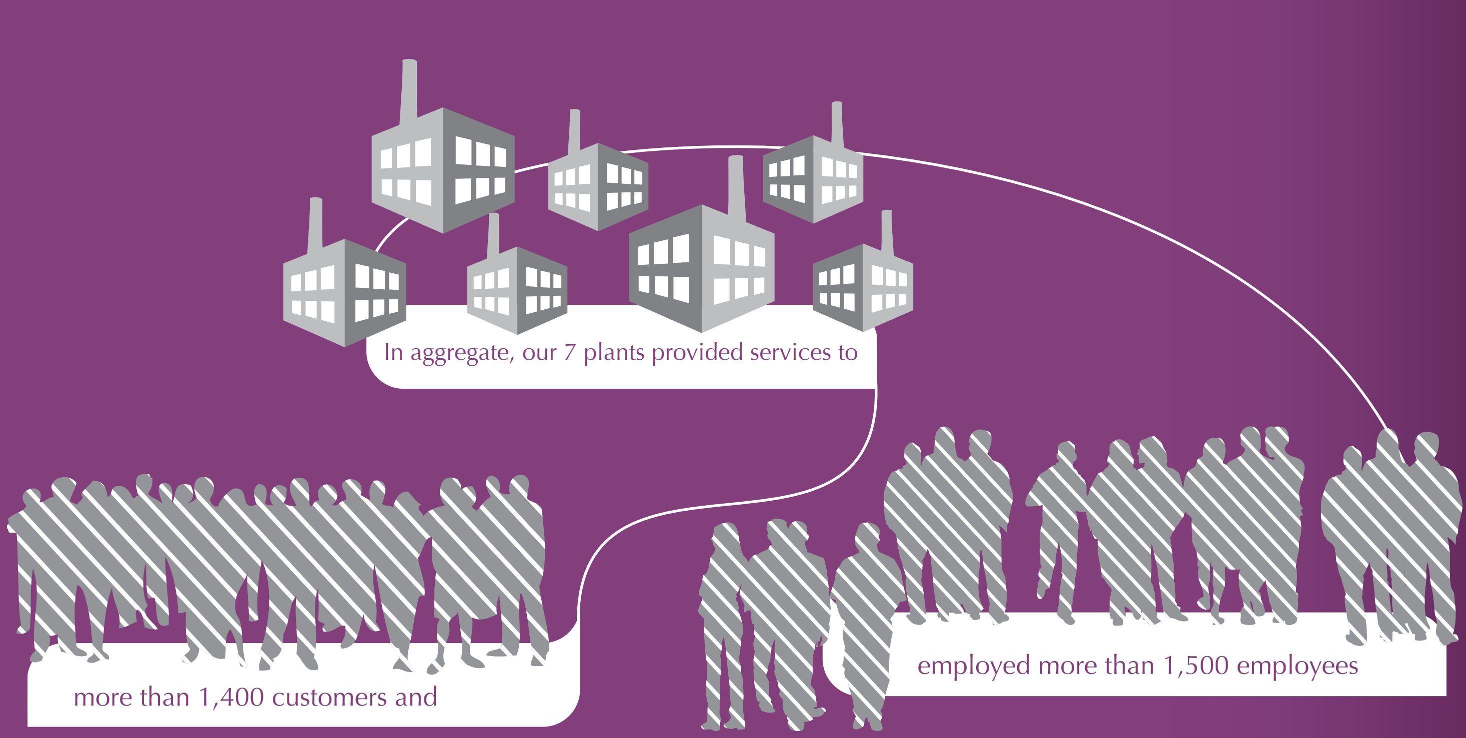


we are dependable.

Committed workforce – our corporate culture enables us to attract and retain laundry staff and our national presence provides opportunities for career advancement. Five members of our senior management team commenced their careers with K-Bro and have an average tenure in excess of 20 years.

We are where the industry is – today. Our full-service laundry and linen supply services and products are delivered through seven locations in Canada, all by a single company – K-Bro. Our core values are central to our reputation, our quality is industry-leading, and our ability to deliver on commitments to customers is second to none.

We are dependable.



total assets
$92 million

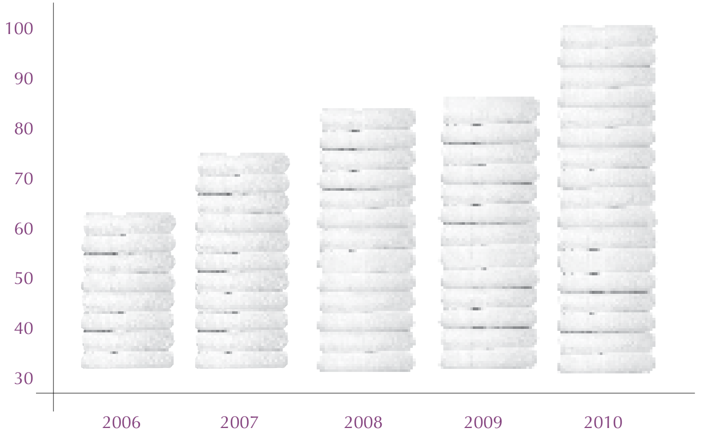
equity
$64 million

market capital
$125 million

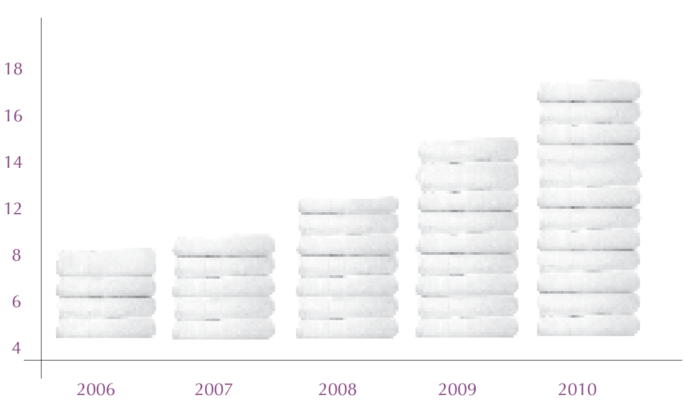
financial highlights

Revenue

The following unaudited financial data has been derived from K-Bro's consolidated financial statements, which have been audited by PricewaterhouseCoopers LLP. The informations set forth below should be read in conjunction with the management's Discussion & Analysis, Consolidated Financial Statements and Notes sections of this Annual Report.



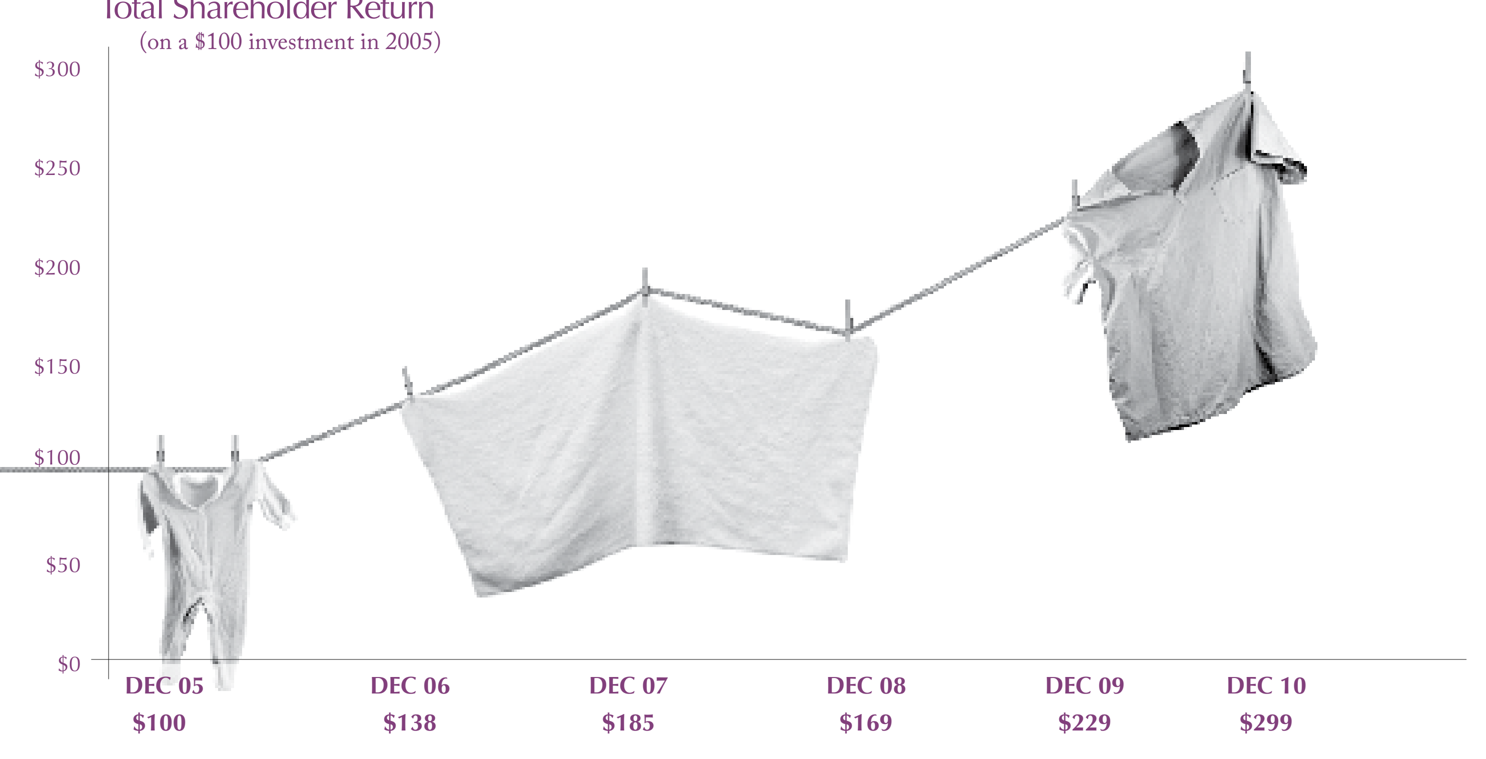
REVENUE (In millions of Canadian dollars) Years ended December 31



EBITDA (In millions of Canadian dollars) Years ended December 31

Total Shareholder Return

(on a $100 investment in 2005)



In order to be successful, a company must have a vision. We continue to be committed to remaining Canada's leading linen processing company. We focus on businesses that we know and understand – laundry and linen processing – in regions where we have an existing competitive advantage or can develop one. Long-term contracts supported by an experienced workforce and large scale assets are the priority – relationships coupled with assets that provide attractive and sustainable returns.

Over the past 10 years, K-Bro has made significant investments in high quality plants, investments that have allowed the company to move forward in achieving its vision. Today, we play a significant role in the provision of high quality healthcare and also in business and leisure travel markets.

We are the largest linen processing company in Canada **We are dependable**

In aggregate, our seven plants provided services to more than 1,400 customers and employed over 1,500 employees in 2010. At December 31, 2010, total assets were $92 million and market capitalization was $125 million.

Diversified and integrated services – we provide critical services, support and management of linen requirements that address each and every one of our customers' needs.

Strategically positioned – K-Bro has 7 plants in 6 Canadian cities, which ensures our ability to provide uninterrupted service in the wake of disasters, pandemics or other adversity.

Long-term stable contracts – by anticipating our customers' needs, delivering consistently dependable service and acting with integrity, K-Bro has developed long-term relationships with customers across Canada.

Committed workforce – our corporate culture enables us to attract and retain laundry staff and our national presence provides opportunities for career advancement. Five members of our senior management team commenced their careers with K-Bro and have an average tenure in excess of 20 years.

Single source for customers – K-Bro is able to deliver total linen management services, including laundering, drying, folding, quota cart development, sterilization, and more that focuses on efficiencies and cost savings. We are one of the largest consumers of linens and textiles in Canada. We leverage our market position to drive savings for our customers. K-Bro works in partnership with our clients to reduce linen usage at their facilities.

One of our key strategies for growth is to pursue opportunities for expansion through acquisition. We follow a strict set of criteria when evaluating another organization's potential, examining every facet of a target company – does it open up a new or strategically placed geographic market or market niche for us? Is there a potential for growth in the market it serves? Will we be able to build on relationships the company already has in place? Can we build on an already-existing base of business? Does it enhance our resources overall?

Taking advantage of relationships already in place includes maintaining the existing labour and management of a company. The ability and commitment demonstrated by staff members is a factor in our decision-making process for acquisitions.

The bottom line is that we want profitable, dependable operations where we can bring our expertise and resources to grow the existing base of business. We found these qualities in our second Vancouver plant. We completed the acquisition of the business, linen, and equipment in January 2010. The acquisition added new markets for us, including the highly popular Whistler village which was the site of the Vancouver 2010 Olympics.

The operations of the new plant complimented our current business base. Large customers who we served in other regions, such as Fairmont Hotels and Resorts, were being served in Vancouver and Whistler.

This Plant has been successfully integrated into our group and has been functioning well since the acquisition. The operations are meeting financial targets, and we are demonstrating signs of growth. Our purchase of a viable company with capable management and staff members and growth potential has benefited K-Bro and added value to our organization. We continue to review and pursue accretive opportunities in new markets and we believe that such opportunities may be available in the future to further add to our growth.

There are more ways to gain entry into new markets than acquisition. In our industry, we're dependent on our reputation, resources, and track record as we develop relationships with potential and new clients and compete for contracts. These factors are also critical in maintaining stable, responsive, and loyal relationships with our existing customers.

In 2010, we excelled at discovering and winning new opportunities and clients, building on the successes we've had in our decades of experience as leaders in our sector. We obtained significant new business from our competitors in important locations. In British Columbia, we added six major hospitality customers to our base, and in Alberta we added two more – our new clients include some of the finest hotels in the area.

K-Bro also won several new long-term contracts and extended past contracts:

- In Edmonton, the Alberta Health Services contracts were extended for an additional two years;
- In Toronto, we extended our relationship with Bridge-point Health;
- In Vancouver, we added 10 million pounds of new volume from four major health authorities.

Each of these sales was a victory for the entire K-Bro team and a reflection of the company as a whole, rather than any individual. The qualities that contribute to our success are the same ones that define us as leaders in customer service – an impeccable and dependable record, comprehensive service program, financial stability, competitive costs, experience in transitioning large accounts, and having the resources to support growth, including the ability to purchase linen and equipment in anticipation of higher volume.

Our policy at K-Bro has always been one of proactive response. In order to meet our goal of being the absolute best linen services supplier in the country, we continually review our service offerings, adding to our menu and providing more comprehensive service capabilities than other linen companies. We watch our industry and think ahead to strategically address the future needs of the markets we serve. Our established relationships and experience contribute to our thinking – our clients talk to us not only about their present needs, but about the directions they see themselves going in. They **depend** on the knowledge we've accumulated over our history.

K-Bro's value-added services provide a 'one-stop shop' for linen services, and currently include:

- Exchange cart preparation
- Delivery of carts to user wards and departments
- Reusable OR linen and pack rental (KOR services)
- Distribution and control of uniforms
- Personal clothing services
- Customer service programs
- Linen purchase and supply
- Linen inventory management reports and services
- Sterilization of operating room linen packs

At K-Bro, we will innovate and develop new processes and systems, and further refine business delivery and practices. When we launched our company on the public markets, we stated that we were ready for whatever lay ahead of us. As the events of the next five years unfolded, our readiness contributed to our success in dependability and growth. The hands-on nature of our management team and established relationships with open lines of communication with our customers is the very source of our advantage. **We are dependable.**

The following unaudited financial data has been derived from K-Bro's consolidated financial statements, which have been audited by PricewaterhouseCoopers LLP. The informations set forth below should be read in conjunction with the Management's Discussion & Analysis, Consolidated Financial Statements and Notes sections of this Annual Report.

(Thousands, except per unit data and percentages)	Years ended December 31 2010	2009	2008	2007	2006
INCOME STATEMENT DATA					
Revenue	104,051	87,533	85,113	74,101	65,108
EBITDA	17,170	15,547	12,395	9,188	8,335
EBITDA %	16.5	17.8	14.6	12.4	12.8
Net earnings	7,785	7,802	4,722	4,818	3,878
Net earnings per Unit	$ 1.11	$ 1.11	$ 0.70	$ 0.71	$ 0.74
BALANCE SHEET DATA					
Working capital	9,138	7,896	3,533	5,494	7,220
Long-term debt	10,763	4,043	4,061	16,627	9,278
OTHER FINANCIAL DATA					
Distributable cash per Unit	$ 2.22	$ 1.99	$ 1.63	$ 1.40	$ 1.39
Payout ratio (%)	49.5	55.1	68.4	78.5	79.0
Price to earnings multiple (12 month trailing)	16.5	12.1	13.9	18.0	14.8
Price to EBITDA multiple (12 month trailing)	7.4	6.1	5.2	8.1	6.5
Return on unitholders' equity (ROE) (%)	12.2	12.0	6.1	8.5	7.7
Total shareholder return, YTD (%)	43.9	50.0	-19.8	33.0	-5.3
Total shareholder return, 5 yrs (%)	146.7	87.5	38.9	65.6	29.4
Market capitalization	126,866	93,451	67,385	73,168	59,500
Unit price:					
High	19.29	13.84	13.65	14.75	15.91
Low	13.02	9.70	8.50	10.75	10.00
Close	18.30	13.48	9.72	13.49	10.97

As events have unfolded since entering the public market, our readiness has contributed to our success in dependability and growth.

management's responsibility for financial reporting

The consolidated financial statements of K-Bro Linen Income Fund (the "Fund") and the accompanying financial information presented on behalf of K-Bro Linen Inc. (the "Corporation"), the successor entity to the Fund are the responsibility of management of the Corporation and have been approved by its Board of Directors. In management's opinion, the consolidated financial statements have been prepared within reasonable limits of materiality in accordance with Canadian generally accepted accounting principles. The preparation of financial statements necessarily requires judgment and estimation when events affecting the current year depend on determinations to be made in the future. Management has exercised careful judgment where estimates were required, and these consolidated financial statements reflect all information available to March 14, 2011.

To discharge its responsibility for financial reporting, management maintains systems of internal controls designed to provide reasonable assurance that the Corporation's assets are safeguarded, that transactions are properly authorized and that reliable financial information is relevant, accurate and available on a timely basis. The internal control systems are monitored and evaluated by management, which are regularly reported on to the Audit Committee of the Board of Directors.

The consolidated financial statements have been examined by PricewaterhouseCoopers LLP, the Corporation's external auditors. The external auditors are responsible for examining the consolidated financial statements and expressing their opinion on the fairness of the consolidated financial statements in accordance with Canadian generally accepted accounting principles. The auditors' report outlines the scope of their audit examination and states their opinion.

The Board of Directors, through the Audit Committee, is responsible for oversight of management's fulfilment of its responsibilities for financial reporting and internal controls. The Audit Committee, which is comprised solely of independent directors, meets regularly with management and the external auditors to satisfy itself that each group is discharging its responsibilities with respect to internal controls and financial reporting. The Audit Committee reviews the consolidated financial statements and recommends their approval to the Board of Directors. The external auditors have full and open access to the Audit Committee, with and without the presence of management. The Audit Committee also recommends to the Board of Directors for nomination, the firm of external auditors, and such nomination on approval of the Board of Directors shall be confirmed annually by the shareholders of the Corporation.

On behalf of management,

management's discussion and analysis

This management's discussion and analysis ("MD&A") is K-Bro Linen Income Fund (the "Fund") management's analysis of its financial performance and significant trends or external factors that may affect future performance. The following MD&A is supplemental to, and should be read in conjunction with, the audited Consolidated Financial Statements of the Fund for the years ended December 31, 2010 and 2009, the MD&A for the year ended December 31, 2009 and the unaudited interim consolidated financial statements for the periods ended March 31, 2010, June 30, 2010 and September 30, 2010.

Management is responsible for the information contained in this MD&A and its consistency with information presented to the Audit Committee and Board of Directors of K-Bro Linen Inc. (the "Corporation"), the successor to the Fund following the conversion of the Fund from an income trust to a corporate entity. All information in this document has been reviewed and approved by the Audit Committee and Board of Directors of the Corporation. This review was performed by management with information available as of March 14, 2011.

In the interest of providing current shareholders ("Shareholders") of the Corporation and former unitholders ("Unitholders") of the Fund with information regarding future plans and operations, this 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.

All references to "K-Bro" or the "Corporation" in this MD&A includes K-Bro Linen Inc., together with the Fund and its subsidiaries, as applicable, including the operations controlled and consolidated by them, unless otherwise indicated. All references to "management" refer to directors and senior officers of the Corporation.

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) risks associated with acquisitions, including the possibility of undisclosed material liabilities; (ii) K-Bro's competitive environment; (iii) utility and labour costs; (iv) K-Bro's dependence on long-term contracts with the associated renewal risk, (v) increased capital expenditure requirements; (vi) reliance on key personnel; and (vii) 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 impact of labour cost initiatives; and (iv) 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 Canadian Generally Accepted Accounting Principles ("GAAP") and are therefore unlikely to be comparable to similar measures presented by other issuers. Please see "Terminology" for further discussion.

management's discussion and analysis

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introduction

Core Business

With a total capitalization of approximately $150 million, 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 seven processing facilities in six Canadian cities including Québec City, Toronto, Edmonton, Calgary, Vancouver and Victoria.

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.

Our partnerships with healthcare institutions and hospitality clients across Canada demonstrate K-Bro's commitment to build relationships that foster continuous improvement, provide flexibility to adjust to changing circumstances as required and which incorporate incentives, penalties and sharing of risks and rewards as circumstances warrant. As a result, clients across the country have entered into long-term relationships with us, with most having renewed their contracts several times.

In this competitive industry, K-Bro is distinctive in Canada in its ability to deliver products and services that provide exceptional value to our customers. 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 in which K-Bro operates 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 generally formalized through contracts in the healthcare sector that are typically long term (from seven to ten years), while contracts in the hospitality sector usually range from two to five years.

Outsourcing and Privatization – Healthcare institutions and regional authorities are facing funding pressures and must continually evaluate the allocation of scarce resources. Consequently 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 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 million pounds of linen per year. Most healthcare customers generate between 500,000 pounds of linen per year for a hospital and up to 30 million pounds of linen per year for a healthcare region.

strategy

K-Bro is results-focused with a goal to provide superior, long-term returns to Shareholders through risk-managed value creation. K-Bro takes a disciplined approach to growth and development initiatives and capital allocation. Our management uses their expertise to identify, analyze and assess potential opportunities that will lead to value creation for the Shareholder. 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 bases in Edmonton and Toronto. Over the past fifteen years K-Bro entered the Calgary, Vancouver, Victoria and Québec markets. A second plant in Vancouver was acquired in January, 2010. 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 ("KOR") services and on-site services. For three major hospitals in Toronto, K-Bro performs the sterilization of operating room linen packs.

fourth quarter overview

In the fourth quarter of 2010, revenue was $26.7 million which is 23.5% higher than the $21.6 million generated in the comparative period in 2009. This year-over-year increase was due to a combination of the acquisition of the second plant in Vancouver and the additional volume from the signings of the new healthcare contracts in Vancouver which commenced processing in Q4, 2010. EBITDA increased from $3.8 million in Q4, 2009 to $4.0 million in Q4, 2010, as increased profitability from the additional plant and incremental volume was offset by corporate costs.

Indirect and administrative expenses amounted to $1.8 million in the quarter, compared to $0.9 million in the comparable period of 2009. In Q4, 2010, the board of trustees of the Fund, along with Unitholders approved the conversion to a corporation from an income trust structure. Indirect and administrative costs increased as a result of professional fees associated with the conversion. Additionally, costs increased due to personnel and professional fees associated with K-Bro's conversion from GAAP to International Financial Reporting Standards ("IFRS").

selected annual financial information

Set out below is selected annual financial information for each of the last three years which have been prepared in accordance with Canadian GAAP.

($ Thousands, except per unit data)

	2010	2009	2008
Revenue	$ 104,051	87,533	85,113
Earnings before income taxes	8,134	7,677	3,998
Net earnings	7,785	7,802	4,818
Net earnings per unit:			
Basic	$ 1.13	$ 1.12	$ 0.72
Diluted	$ 1.11	$ 1.11	$ 0.71
Total assets	**92,129**	**82,816**	**85,926**
Long-term debt	10,763	4,043	4,061
Distributions declared to Unitholders	7,706	7,706	7,554
Distributions declared to Unitholders per Unit	$ 1.10	$ 1.10	$ 1.10
Number of units outstanding:			
Basic	6,905,369	6,946,495	6,719,305
Diluted	6,992,400	6,999,719	6,747,522

summary of 2010 results and key events

Financial Growth

K-Bro delivered strong financial results in 2010 driven by the operating results from all seven of its processing plants. Net earnings were $7.8 million or $1.13 per unit. Cash flow from operating activities was $17.1 million and distributable cash flow was $15.6 million.

Revenue increased in fiscal 2010 to $104.1 million or by 18.9% compared to 2009. This growth in the year is largely a result of the second plant acquisition in greater Vancouver (see discussion on page 6). EBITDA (see Terminology) increased in the year to $17.2 million from $15.5 million in 2009, which is an increase of 10.4% The EBITDA margin decreased to 16.5% in 2010 compared 17.8% in 2009. The decrease in margin is driven by increased corporate costs for the conversion from an income trust to a corporation, IFRS consulting fees, legal fees attributable to the refinancing of the credit facility and recruitment costs for new senior management. Additionally the margin decrease is related to the transition of the second Vancouver plant as the expected EBITDA margin is anticipated to be lower than the historical margins of our other plants due to the type and mix of volume that is processed in the facility.

Conversion to a Corporation

On January 1, 2011, the Fund effectively completed its conversion to a corporation from an income trust pursuant to a Plan of Arrangement (the "Arrangement") under Section 193 of the Business Corporations Act (Alberta) involving, among others, the Fund, K-Bro Linen Systems Inc., K-Bro Linen Ltd. and Unitholders of the Fund. Pursuant to the Arrangement, Unitholders of trust units of the Fund received one common share ("Common Share") of K-Bro Linen Inc. for each unit. In addition, holders of exchangeable shares of K-Bro Linen Systems Inc. ("Exchangeable Shares") received one common share for each Exchangeable Share. As a result of the Arrangement, on January 1, 2011 K-Bro had approximately seven million common shares issued and outstanding.

The Common Shares of K-Bro Linen Inc. commenced trading on the Toronto Stock Exchange (the "TSX") on January 6, 2011 under the trading symbol KBL. Beginning with the January 31, 2011 record date, Shareholders of K-Bro have received monthly payments in the form of dividends. K-Bro anticipates that it will maintain the monthly dividend payment at the same rate of $0.09167CAD per common share per month; however the actual amount of future dividends, if any, may vary depending upon production volumes, capital spending and costs. K-Bro cannot provide any assurances with regard to timing or amount of future dividend payments. K-Bro will utilize its available tax pools to mitigate its cash tax obligations but does expect to incur cash taxes in Canada in the year following the conversion. Prior to the conversion of the Fund to a corporation, distributions were paid to Unitholders.

Despite the change in legal structure from a trust to a dividend paying corporation, K-Bro's business activities and business strategy remain unchanged and all officers and trustees continued in their previous roles.

Because the consolidated financial statements for the year ended December 31, 2010 and this MD&A reflect the financial and operating performance for the year ended December 31, 2010, the majority of the references herein and in the financial statements are to the Fund, units, Unitholders and distributions. In the future, the consolidated financial statements and related financial information will be prepared on a continuity of interest basis, which recognizes K-Bro Linen Inc. as the successor entity to the Fund.

Contract Signings and Extensions in Vancouver and Edmonton

In June, 2010 K-Bro was selected as the successful proponent of a competitive RFP process and announced the signings of ten-year contracts with Vancouver Coastal Health Authority ("VCHA"), Fraser Health Authority ("FHA"), Provincial Health Services Authority and Providence Health Care Society. Service for the majority of the new volume from the former Tilbury Regional Hospital Laundry commenced in November, 2010. The contracts are renewable for a further five years at the customer's option. Certain existing contracts with VCHA and FHA were extended to November, 2015 as part of this process.

In November, 2010 K-Bro extended the Edmonton contracts with AHS for an additional two year period expiring January 31, 2013. These extensions continue the existing comprehensive laundry and linen service programs for all volume in the Edmonton area on similar terms and conditions.

Acquisition of Business

In January, 2010, the Fund completed the acquisition of the laundry business, linen, certain working capital and equipment of a plant located in Greater Vancouver, British Columbia. The acquired business consists of Vancouver healthcare institutions and hospitality customer contracts in Vancouver and Whistler, British Columbia. K-Bro acquired all assets of the owner's Vancouver linen business including the processing plant that operates from a leased facility.

Annual revenues from the acquired business were $14.4 million in its most recent fiscal year ended June 30, 2009. Management estimates that adjusted EBITDA was approximately $1.7 million for that fiscal year. These results, combined with operational synergies, resulted in an acquisition that was immediately accretive to the Fund.

Revolving Credit Facility Increased

In March, 2010, K-Bro increased its revolving credit facility to a limit of $40 million. The term of the agreement was extended to June 30, 2012 and the working capital covenant was removed. The facility remained an interest-only arrangement.

Labour Cost Transitional Effects

Labour costs for plant staff as a percentage of revenue increased in the fourth quarter from 44.9% in 2009 to 46.2% in 2010. Excluding the impact of the lower margin realized in the new Vancouver plant, labour costs as a percentage of revenues are comparable to Q4, 2009.

Market Activities and Opportunities

Activities of significance in K-Bro's markets in 2010 have included:

British Columbia – Processing commenced for a total of six new hotel accounts during the year in addition to securing the volume from the outsourcing of the Tilbury laundry. Along with the new volume, K-Bro also commenced on-site linen management services for 14 locations. There were no other significant wins or losses in this market during the year ended December 31, 2010. During the year K-Bro renegotiated and extended the collective bargaining agreement with the Teamsters union to fiscal 2017.

Alberta – Processing commenced for two new hotel accounts during the year, and the contracts for another 12 hospitality customers were extended. K-Bro's Edmonton contracts with AHS were renewed for an additional two-year period expiring January 31, 2013.

Toronto – During the year, K-Bro was successful in renewing the contract with Bridgepoint Health which was obtained through a competitive RFP process. The collective agreement with the Teamsters union was renegotiated with an expiry date of 2012; the collective agreement with the United Food and Commercial Workers union is presently under negotiation.

Québec – Processing commenced for one new hotel account and the contracts for several other hospitality customers were extended.

The new hotel customers noted above will generate estimated annual revenues of $2.1 million. K-Bro currently has several proposals pending and has entered into discussions with potential new healthcare and hospitality customers. In addition, K-Bro continues to seek potential acquisition candidates. Neither the timing nor the degree of likelihood of success of any of these proposals or potential acquisitions can be stated with any degree of accuracy at this time.

Effects of Economic Volatility and Uncertainty

K-Bro feels that it is positioned to withstand market volatility and uncertainty given that:

- Approximately 68.7% of our revenues are from large publicly funded healthcare customers, and are geographically diversified across four provinces;
- K-Bro's payout ratio was 49.5% for the year ended December 31, 2010. The undistributed portion of cashflow provides K-Bro with funds for future growth and a safeguard against economic downturns;
- K-Bro has fixed a portion of certain variable cost components such as natural gas and electricity through forward contracts. K-Bro routinely enters into natural gas and electricity contracts and typically tries to align commodity supply contract terms with existing linen processing contract terms; and,
- At December 31, 2010, K-Bro had unutilized borrowing capacity of $29.0 million or 72.5% of the credit line available. K-Bro's revolving credit facility is secured by a major Canadian bank and expires on June 30, 2012 with an option to renew for an additional year.

Overall fiscal 2010 was a very busy year for K-Bro as it completed a strategic acquisition and thereby securing additional processing volume with national accounts, transitioned a major central laundry into an existing plant and concluded the conversion into a corporate structure. K-Bro has and continues to take a long-term view of its business that is based on the strategic nature of the services provided to the healthcare and hospitality industries.

key performance drivers

K-Bro's key performance drivers focus on growth, profitability, stability and cost containment in order to maintain distributions and maximize Shareholder value. The following outlines our results in each of these areas:

Category	Indicator	Q4, 2010	Q4, 2009	2010	2009
Growth	EBITDA (%)	5.4	14.4	10.4	25.4
	Revenue (%)	23.5	0.4	18.9	2.87
	Distributable cash (%)	12.8	17.3	11.2	26.7
Profitability	EBITDA	$ 4,011	$ 3,805	$ 17,170	$ 15,546
	EBITDA margin (%)	15.0	17.8	16.5	17.8
	Net income	$ 1,687	$ 1,947	$ 7,785	$ 7,802
Stability	Debt to total capitalization (%)	14.5	6.0	14.5	6.0
	Unutilized line of credit	$ 28,987	$ 25,707	$ 28,987	$ 25,707
	Payout ratio (%)	48.6	54.9	49.5	55.1
	Distributions per unit	$ 0.275	$ 0.275	$ 1.100	$ 1.100
Cost Containment	Wages and benefits (%)	46.2	44.9	46.0	45.1
	Utilities (%)	8.2	7.5	8.0	7.2
	Operating expenses (%)	85.0	82.4	83.4	82.2

[1] *EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, gain or loss on disposals, financial charges and amortization). See Terminology.*

outlook

Management's outlook for 2011 is for a continued but gradual return to economic growth across most regions of Canada. K-Bro's focus is on growth in the years to come as we execute our strategy of expanding geographically and adding new services for our customers. K-Bro is committed to building Shareholder value. Management believes that fiscal 2011 will show a modest increase in revenue, earnings and EBITDA compared to 2010. This belief is predicated on:

- a low inflation rate will help moderate certain expenses but will also result in lower price adjustments for customers with contracts subject to an annual consumer price index ("CPI") adjustment factor;
- a decline in the unemployment rates in several of areas in which K-Bro operates processing plants;
- overall volume will grow as a result of the new long-term contracts secured from the transition of the Tilbury laundry;
- organic growth from existing customers may moderate as cost savings initiatives are implemented by them;
- continued focus on innovative development within our internal processes resulting in operating efficiencies; and,
- elimination of non-recurring corporate costs incurred in 2010 related to the Conversion and recruitment of senior management.

In 2010 there were opportunities and risks that were confronted and certain items will continue to challenge the business in 2011. Management believes that these include:

- an economy that has moderated in its recovery which will continue to experience limited growth and expansion may impact our hospitality business volumes;
- a labour market in Western Canada, and specifically Alberta, that has seen employment rates increase throughout the past year due to rising energy and commodity prices;
- deficit positions that are forcing various provincial governments to re-examine healthcare costs and evaluate additional outsourcing of non-core activities (such as laundry services), which has been experienced in Alberta and British Columbia;
- all healthcare costs (operating and capital) and processes are being examined and some changes could negatively impact K-Bro;
- a low consumer price index ("CPI") which is positive from a labor, materials and interest rate perspective but, which is negative from a revenue perspective for those customer contracts encompassing a price adjustment based on CPI;
- a relatively high unemployment rate which is positive from a labor supply perspective but could negatively impact such programs as the Temporary Foreign Worker program; and,
- demand for certain commodities which are crucial to K-Bro's business resulting in increased costs of natural gas, electricity and cotton; K-Bro has mitigated this risk through forward utility contracts and long-term linen supply agreements to hedge these costs.

In 2011, while K-Bro expects revenues to increase, margins may decline from record levels experienced in 2010 and 2009. Nonetheless, profitability is expected to remain robust and exceed recently attained levels. Consequently, management believes that the current dividend policy is sustainable for the Corporation in fiscal 2011.

results of operations

Overall Performance

For the three month period ended December 31, 2010, K-Bro's revenue was $26.7 million, compared to $21.6 million in the comparable period of the prior year. The second Vancouver facility, transition of the Tilbury laundry contracts and increased volume from existing customers contributed to this revenue increase.

Net income in the fourth quarter of 2010 decreased 13.4% to $1.7 million, from $1.9 million for the same period in 2009. EBITDA increased in the current quarter by $206 (5.4%) over the fourth quarter of 2009.

Quarterly Financial Information

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

($ Thousands, except per unit data and percentages)	2010				2009			
	Q4	**Q3**	**Q2**	**Q1**	**Q4**	**Q3**	**Q2**	**Q1**
Heathcare revenue	18,833	17,839	17,646	17,137	16,662	16,524	16,723	16,937
Hospitality revenue	7,886	9,659	8,256	6,795	4,976	6,135	5,023	4,556
Total revenue	**26,719**	**27,498**	**25,902**	**23,932**	**21,635**	**22,659**	**21,746**	**21,493**
Operating expenses	22,708	22,571	21,578	20,024	17,830	18,521	17,635	18,001
EBITDA	4,011	4,927	4,324	3,908	3,805	4,138	4,111	3,492
EBITDA as a % of revenue	15.0	17.9	16.7	16.3	17.6	18.3	18.9	16.2
Depreciation and amortization	2,030	2,059	2,084	2,033	1,856	1,885	1,870	1,892
Financial charges	153	174	189	127	96	60	64	91
Loss on disposal of equipment	26	104	57	-	50	1	-	3
Earning before income taxes	1,802	2,590	1,994	1,748	1,803	2,192	2,176	1,506
Income tax recovery (expense)	(115)	(229)	(29)	24	145	(97)	(8)	85
Net earnings	1,687	2,361	1,965	1,772	1,948	2,095	2,168	1,591
Net earnings as a % of revenue	6.3	8.6	7.6	7.4	9.0	9.2	10.0	7.4
Basic earnings per unit	0.237	0.340	0.290	0.260	0.280	0.300	0.310	0.230
Diluted earnings per unit	0.243	0.340	0.280	0.250	0.270	0.300	0.310	0.230
Total assets	92,129	92,932	93,279	95,103	82,816	83,565	84,639	86,344
Total long-term financial liabilities	14,996	14,813	18,094	20,145	8,500	9,676	11,263	11,536
Funds provided by (used in) operations	3,557	5,180	4,538	3,830	3,549	5,568	3,539	(796)
Long-term debt	10,763	11,097	13,863	15,912	4,043	5,107	6,735	7,210
Distributions declared per unit	0.275	0.275	0.275	0.275	0.275	0.275	0.275	0.275

[1] *EBITDA is defined as revenue less operating expenses (which equates to net earnings before income tax, gain or loss on disposals, financial charges and amortization). See Terminology.*

Revenue, Earnings and EBITDA

For the year ended December 31, 2010, K-Bro's revenue was $104.1 million, compared to $87.5 million in the prior year. This represents an 18.9% increase in revenue and was primarily the result of the acquisition of the second plant in the Greater Vancouver area, but also additional volume from new and existing clients. In 2010 approximately 68.7% of K-Bro's revenue was generated from healthcare institutions compared to 76.4% in 2009. The addition of a second Vancouver plant predominantly hospitality focused altered the relative mix in K-Bro's revenue segments.

Net earnings were unchanged totaling $7.8 million for both 2010 and 2009. Net earnings as a percentage of revenue declined to 7.5% compared to 8.9% in 2009. This margin decrease was due predominately to an increase in corporate administration costs including income trust and IFRS conversion expenses, long-term incentive compensation and recruiting fees as well as increased amortization of capital and intangible assets and interest carrying costs on the long-term debt both of which are directly related to the acquisition of the second Vancouver facility.

EBITDA was $17.2 million in 2010, compared to $15.5 million in 2009. This 10.4% improvement was a result of the acquisition in Vancouver, offset by corporate administration costs noted above.

Operating Expenses

Wages and benefits increased to $47.8 million or 46.0% of revenue compared to 45.1% in 2009. Excluding the impact of the lower margin realized in the new Vancouver plant, labour costs as a percentage of revenues are comparable to 2009. Linen expenses as a percentage of revenue decreased in the year from 11.6% in 2009 to 10.2% in 2010 due to a higher percentage of hospitality revenue in 2010 compared 2009 (31.3% versus 23.6%) which is largely due to revenue profile of the second plant in Vancouver where hospitality customers generally own their linen supply.

Utility costs increased from 7.2% in 2009 to 8.0% as a percentage of revenue in 2010, a portion of which is attributable to higher per unit rates in the new Vancouver plant. The remaining increase is due to higher natural gas, electricity and water rates. While K-Bro has executed natural gas and electricity hedges in order to lock in future variable costs, approximately 30% of the commodity is acquired at the current market rates.

Delivery, occupancy, repairs and maintenance, and materials and supplies expenses as a percentage of revenue remained stable in 2010 compared to 2009.

Corporate costs increased in 2010 by $1.8 million over fiscal 2009. This is primarily attributable to an increase in the accrual for the Long Term Incentive Plan as a result of exceeding pre-established performance targets. LTIP expenses recorded for the 2010 were $1.4 million compared to $0.9 million in 2009. In addition corporate costs increased due to incremental salary and benefit costs related to additional corporate office management, and professional fees related to recruiting of senior management, and conversion to IFRS and from an income trust.

Depreciation of property, plant and equipment and amortization of intangible assets 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 of those assets. Depreciation of property, plant and equipment and amortization of intangibles assets has increased from the comparable period in 2009 primarily due to the Vancouver plant acquisition in January, 2010 and other budgeted additions. Included in intangible assets are software expenses relating to the IT upgrade.

Financial charges in 2010 increased by $0.3 million compared to 2009 as a result of an increased long-term debt balance offset somewhat by lower market interest rates.

Income tax 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 expense reflects the structure as an income trust whereby the Fund's Unitholders bear the tax obligations with respect to distributions.

The Fund would have only been taxable on amounts that were not distributed to Unitholders. If the Unitholders had not approved the Conversion plan from an income fund to a corporation, the Fund would have been subject to the new rules under Bill C-52 commencing in fiscal 2011, regardless of whether amounts were distributed to the Unitholders. Given the Conversion from an income trust, the Corporation became taxable on January 1, 2011 and expects to incur cash taxes in 2011.

liquidity and capital resources

Cash provided by operating activities was $17.1 million, compared to $11.9 million of cash generated from operations during 2009. The change in cash from operations is primarily due to the changes in the working capital accounts year-over-year.

The decreased working capital requirements are the result of: an increase in accounts receivable and linen in service due to a combination of additional receivables and linen from the new plant in Vancouver and growth in revenues; an increase in accounts payable and accrued liabilities due to the new plant in Vancouver and the accruals relating to volume rebates, cost accruals with respect to the conversion and IFRS transitions.

During 2010, cash used in financing activities amounted to $1.6 million compared to cash used in financing of $7.7 million in 2009. Financing activities in 2010 included $6.2 million in net repayments of long term debt, $12.9 million used to fund the acquisition and $8.3 million in distributions paid to Unitholders. During 2010, the final year of the Fund, the distribution of $0.642 million declared in December, which is normally paid in January, was paid on December 31, 2010 resulting in a use of cash in 2010 despite the Fund only paying $7.7 million in distributions from an income perspective.

Investing activities resulted in a use of cash of $15.5 million during 2010, which compares with $4.1 million in 2009. The cash was invested in the acquisition of property, plant and equipment ($2.3 million) and the acquisition of the second Vancouver facility ($12.9 million) in January, 2010.

K-Bro continued to advance its information technology infrastructure upgrade that commenced in the first quarter of 2009. Total cost of software for phase one of this two-phase project was estimated to be $1.0 million, of which $0.9 million has been incurred to date. This investment is recorded in intangible assets but treated as a maintenance capital expenditure for purposes of calculating Distributable Cash (see *Terminology*)

Contractual Obligations

At December 31, 2010, payments due under contractual obligations for the next five years and thereafter are as follows:

	Payments due by Period				
	Total	**<1 Year**	**1–3 Years**	**4–5 Years**	**>5 Years**
Long-term debt	10,763	–	10,763	–	–
Operating leases and utility commitments	16,620	6,022	6,407	2,407	1,788
Linen purchase obligations	2,206	2,206	–	–	–

Scheduled lease and forward utility contract payments for 2010 are $6.0 million. The operating lease obligations are secured by automotive equipment and are more fully described in note 9(b) of the Notes to the Consolidated Financial Statements. The source of funds for these commitments will be from operating cash flow and the undrawn portion of the revolving credit facility.

Financial Position

	December 31, 2010		December 31, 2009	
Long-term debt	$	10,763	$	4,043
Unitholders' equity		63,709		63,793
Total capitalization	$	74,472	$	67,836
Debt to total capitalization (%)		14.5		6.0

For the year ended December 31, 2010, the Fund had a payout ratio (see Terminology) of 49.5%, a debt to total capitalization of 14.5%, an unused revolving credit facility of $28,987 and has not incurred any events of default under the terms of its credit facility agreement.

As at December 31 2010, the Fund had net working capital of $9,138 compared to its working capital position of $7,896 at December 31, 2009.

Management believes that K-Bro has the capital resources and liquidity necessary to meet its commitments, support its operations and finance its growth strategies. In addition to K-Bro's ability to generate cash from operations and its revolving credit facility, K-Bro is also able to issue additional units to provide for capital spending and sustain its property, plant and equipment.

distributions for the period

Distributions comprise a return of capital portion (tax deferred) and a return on capital portion (taxable). The return of capital component reduces the cost basis of the units held. Effective January 1, 2011, K-Bro has paid dividends to its Shareholders. Dividends from K-Bro are taxed differently than distributions of the Fund in that dividends do not comprise a return of capital and thus are fully taxable. For a more detailed breakdown, please visit our website at www.k-brolinen.com. The following table is a summary of historical distributions paid:

		2010		2009	
Fiscal Period	**Payment Date**	**Amount per Unit**	**Total Amount**	**Amount per Unit**	**Total Amount**
Fund Units					
Q1, 2010		$ 0.27501	$ 1,907	$ 0.27501	$ 1,907
Q2, 2010		0.27501	1,907	0.27501	1,907
Q3, 2010		0.27501	1,907	0.27501	1,907
October	November 15	0.09167	636	0.09167	636
November	December 15	0.09167	636	0.09167	636
December	December 31	0.09167	636	0.09167	636
Q4, 2010		0.27501	1,907	0.27501	1,907
2010 YTD		$ 1.10	$ 7,626	$ 1.10	$ 7,626
Exchangeable Shares					
Q1, 2010		$ 0.27501	$ 20	$ 0.27501	$ 20
Q2, 2010		0.27501	20	0.27501	20
Q3, 2010		0.27501	20	0.27501	20
October	November 15	0.09167	7	0.09167	7
November	December 15	0.09167	7	0.09167	7
December	December 31	0.09167	7	0.09167	7
Q4 2010		0.27501	20	0.27501	20
2010 YTD		$ 1.10	$ 80	$ 1.10	$ 80
Total Distributions			**$ 7,706**		**$ 7,706**

For the year ended December 31, 2010, the Fund distributed $1.10 per unit compared with $2.22 per diluted unit of Distributable Cash (see Terminology). The actual payout ratio was 49.5%.

The Fund's policy was 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 were declared payable each month in equal amounts to the Fund Unitholders and exchangeable shareholders on the last business day of each month and were paid by the 15th of the following month. In the anticipation of the conversion to a corporation, the final distribution was paid on December 31, 2010.

distributable cash (see terminology)

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

($ Thousands, except per unit data and percentages)	2010 Q4	2010 Q3	2010 Q2	2010 Q1	2009 Q4	2009 Q3	2009 Q2	2009 Q1
Cash provided by (used in) operating activities	$ 3,557	$ 5,180	$ 4,538	$ 3,830	$ 3,549	$ 5,568	$ 3,539	$ (796)
Add (deduct):								
Net changes in non-cash working capital items[1]	$ 274	(432)	(417)	(63)	146	(1,505)	494	4,183
Maintenance capital expenditures[2]	128	(153)	(455)	(430)	(187)	(256)	(608)	(133)
Distributable cash	$ 3,959	$ 4,595	$ 3,666	$ 3,337	$ 3,508	$ 3,807	$ 3,425	$ 3,254
Distributable cash per weighted average diluted Units outstanding	$ 0.57	$ 0.66	$ 0.53	$ 0.48	$ 0.50	$ 0.54	$ 0.49	$ 0.46
Distributions declared[3]	1,927	1,927	1,927	1,927	1,927	1,927	1,927	1,927
Distributions declared per Unit	0.275	0.275	0.275	0.275	0.275	0.275	0.275	0.275
Payout ratio (%)	48.6	41.7	52.1	57.6	54.8	50.5	56.3	59.2
Weighted average Units outstanding during the period, basic	6,905	6,892	6,878	6,935	6,935	6,930	6,946	6,970
Weighted average Units outstanding during the period, diluted	6,992	6,971	6,951	6,992	6,989	6,994	7,010	6,999
Trailing-twelve months ("TTM")								
Distributable cash	15,557	15,106	14,318	14,077	13,994	13,476	13,036	12,558
Distributions	7,706	7,706	7,706	7,706	7,706	7,706	7,706	7,706
Payout ratio (%)	49.5	51.0	53.8	54.7	55.1	57.2	59.1	61.4
Cumulative since IPO								
Distributable cash	61,706	57,747	53,152	49,486	46,149	42,641	38,834	35,409
Distributions	38,983	37,057	35,131	33,204	31,278	29,351	27,424	25,498
Payout ratio (%)	63.2	64.2	66.1	67.1	67.8	68.8	70.6	72.0

1. *Net changes in non-cash working capital is excluded from the calculation as management believes 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.*
2. *Maintenance capital expenditure is discussed under Investing Activities. Also included are software costs included in Intangible Assets.*
3. *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 2010, the Fund had 6,932,562 Fund Units outstanding and 72,411 Special Trust Units outstanding (unchanged from September 30, 2010, June 30, 2010 and March 31, 2010 and 2009). The basic and the diluted weighted average number of units outstanding for 2010 were 6,905,369 and 6,992,400 respectively (6,946,495 and 6,999,719, respectively for 2009).

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 approved LTIP compensation of $1.4 million (2009 – $0.8 million) and approved the funding and transfer of $1.4 million (2009 – $0.8 million) of cash to the LTIP Trust in March 2010 in order to fund the purchase of Units by the LTIP Trust. In April 2010, the LTIP Trust purchased 87,423 Units of the Fund (2009 – 68,173). As at December 31, 2010, 115,780 Units held by the LTIP Trust have vested (December 31, 2009 – 72,739). The cost of the 114,074 unvested units held in trust by the LTIP at December 31, 2010 (December 31, 2009 – 69,692) was $1.6 million (December 31, 2009 - $0.8 million). The basic net earnings per unit calculation excludes the unvested units held by the LTIP Trust.

At March 14, 2011, there were 7,004,973 common shares issued and outstanding (see *Conversion to a Corporation – Summary of Results and Key Events*).

related party transactions

The Fund incurred expenses in the normal course of business for advisory consulting services provided by Mr. Matthew Hills, a Trustee (and now a director of the Corporation), primarily 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, 2010, the Fund incurred fees totaling $138 (2009 – $138).

off-balance sheet arrangements

The Corporation has no off-balance sheet arrangements in place at December 31, 2010.

critical accounting estimates

The Fund's summary of significant accounting policies are contained in Note 1 to the audited consolidated financial statements.

The Fund's financial statements include estimates and assumptions made by management in respect of operating results, financial conditions, contingencies, commitments, and related disclosures. Actual results may vary from these estimates. The following are, in the opinion of management, the Fund's most critical accounting estimates, being those that involve the most difficult, subjective and complex judgements, requiring estimates that are inherently uncertain and which may change in subsequent reporting periods.

K-Bro has continuously refined and documented its management and internal reporting systems to ensure that accurate, timely, internal and external information is gathered and disseminated. Management also regularly evaluates these estimates and assumptions which are based on past experience and other factors that are deemed reasonable under the circumstances.

K-Bro has hired individuals and consultants who have the skills required to make such estimates and ensures that individuals or departments with the most knowledge of the activity are responsible for the estimates. Furthermore, past estimates are reviewed and compared to actual results, and actual results are compared to budgets in order to make more informed decisions on future estimates.

K-Bro's leadership team's mandate includes ongoing development of procedures, standards and systems to allow K-Bro staff to make the best decisions possible and ensuring those decisions are in compliance with the Fund's policies.

Preparation of the Fund's consolidated financial statements requires management to make estimates and assumptions that affect:

- volume rebates;
- linen in service;
- intangible assets;
- goodwill;
- income taxes; and,
- allowance for doubtful accounts.

Volume Rebates

The Fund earns revenue from linen management and laundry services 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 reasonable that the criteria 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.

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.

Intangible Assets

The Fund accounts for intangible assets and goodwill in accordance with CICA Handbook Sections 1581, Business Combinations and 3064, Goodwill and Intangible Assets. In a business combination, K-Bro may acquire the assets and assume certain liabilities of an acquired entity. The allocation of the purchase price for these transactions involves judgment in determining the fair values assigned to the tangible and intangible assets acquired and the liabilities assumed on the acquisition. The determination of these fair values involves a variety of assumptions, including revenue growth rates, expected operating income, discount rates, and earnings multiples. If K-Bro's estimates or assumptions change prior to finalizing the purchase price allocation for a transaction, a revision to the purchase price allocation or the carrying value of the related assets and liabilities acquired may impact our net income in future periods.

At the date of the acquisition, K-Bro must estimate the value of acquired intangible assets that do not have a well defined market value, such as the value of customer lists and relationships and non-competition agreements.

Valuing these assets involves estimates of the future net benefit to K-Bro and the useful life of such benefits and is based upon various internal and external factors. A change in those estimates could cause a material change to the value of the intangible assets.

Although intangible assets are amortized over their useful life, if the estimated value of an intangible asset has declined below its amortized book value, a write-down would be recorded in the period in which the event causing the decline in value occurred, which would increase amortization expense and decrease the intangible assets balance. At this time, K-Bro does not believe any intangible assets have a book value in excess of their fair market value.

terminology

Figures expressed in percentages are calculated from amounts rounded in thousands of dollars.

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 as it is an indication of our capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their vintage, technological currency and management's estimate of their useful life. Accordingly, EBITDA comprises revenues less operating costs before: financing costs, capital asset and intangible asset amortization, disposal and impairment charges, and income taxes.

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. 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.

Year ended		**2010**		**2009**
Net earnings	$	7,785	$	7,802
Add:				
Income tax expense (recovery)		349		(125)
Interest expense and financial charges, net		643		311
Depreciation of property, pant and equipment		5,666		5,347
Amortization and intangible assets		2,540		2,157
Loss on disposal of property, plant and equipment		187		54
EBITDA	**$**	**17,170**	**$**	**15,546**

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 the Fund. For reconciliation with GAAP, please refer to the Distributable Cash section.

Due to the impact of the weighted average number of units outstanding and financial rounding throughout the interim periods the aggregate quarterly distributable cash per unit may not equal the annual total for the corresponding year. The aggregate total of the quarterly distributable cash per share, compared with the amounts for the full year are as follows:

	2010		2009	
	Quarterly	Annual	Quarterly	Annual
Distributable cash per unit, diluted	2.24	2.22	1.99	2.00

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 the Fund, 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.

Cash Dividends per Share

Subsequent to the Conversion, the Corporation's policy is to pay dividends to Shareholders 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 Directors of the Corporation. Dividends are declared payable each month to the Shareholders on the last business day of each month and are paid by the 15th of the following month. All dividends are discretionary. The Board of Directors periodically reviews cash dividends taking into account the Corporation's current and prospective performance.

changes in accounting policies & international financial reporting standards ("IFRS")

For interim and annual periods in 2011 and beyond, K-Bro will be required to prepare consolidated financial statements in accordance with IFRS. In order to ensure accurate and efficient reporting under IFRS, K-Bro has identified the differences between Canadian GAAP applicable in 2010 and IFRS that affect K-Bro and made the required changes to accounting processes and controls (including information technology systems).

The differences identified are detailed in the following sections, which include a reconciliation of the Fund's closing balance sheet under previous GAAP in 2009 with its provisional opening balance sheet under IFRSon January 1, 2010. This opening balance sheet may be adjusted before the issuance of K-Bro's audited 2011 IFRS consolidated financial statements if new pronouncements are issued by the IFRS oversight body, or different interpretations are adopted. Reconciliations for the year ended December 31, 2010 will be provided in the Corporation's first quarter 2011 financial statements.

The accounting changes resulting from the transition to IFRS do not impact the Corporation's compliance with any of its maintenance covenants on its debt obligations.

Optional exemptions from full retrospective application

IFRS 1 sets out a number of optional exemptions from full retrospective application of IFRS that may be elected by a company on transition. K-Bro expects to apply the following of these exemptions:

(a) Business combinations exemption

K-Bro has applied the business combinations exemption and accordingly has not restated business combinations that took place prior to the January 1, 2010 transition date.

In addition to these optional exemptions, K-Bro has also ensured that all estimates at January 1, 2010 are consistent with estimates made at the same date under previous GAAP, as required by IFRS 1.

Our clients talk to us not only about their present needs, but about where their business is going. They depend on the knowledge we've accumulated over our 55 year history.

Reconciliation of provisional opening balance sheet as at January 1, 2010

Explanatory notes are provided in the section following this reconciliation.

	Note	Canadian GAAP	Effect of IFRS	IFRS
Assets				
Current assets				
Accounts receivable		$ 9,451	$ –	$ 9,451
Linen in service	a	7,305	(56)	7,249
Prepaid expenses and deposits	a,b	1,213	(606)	607
Future income taxes	c	449	(449)	–
		18,418	**(1,111)**	**17,307**
Non-current assets				
Restricted escrow funds		–	–	–
Deferred tax asset	c	–	449	449
Property, plant and equipment	a	33,583	229	33,812
Intangible assets		14,595	–	14,595
Goodwill		16,220	–	16,220
Total assets		**$ 82,816**	**$ (433)**	**$ 82,383**
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities		$ 9,880	$ –	$ 9,880
Distributions payable to unitholders		642	–	642
		$ 10,522	**–**	**10,522**
Non-current liabilities				
Long-term debt		4,043	–	4,043
Finance lease liabilities		–	–	–
Unamortized lease incentives		611	–	611
Future income taxes	c	3,847	(134)	3,713
Total liabilities		**19,023**	**(134)**	**18,889**
Unitholders' Equity				
Exchangeable shares		724	–	724
Fund units		70,676	–	70,676
Fund units held in trust by LTIP		(834)	–	(834)
Contributed surplus		572	–	572
Deficit	b,c	(7,310)	(299)	(7,608)
Accumulated other comprehensive income		(35)	–	(35)
Total unitholders' equity		**63,793**	**(299)**	**63,494**
Total liabilities and unitholders' equity		**$ 82,816**	**$ (433)**	**$ 82,383**

(a) Spare parts and servicing equipment are usually carried as inventory and recognized in profit or loss as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when K-Bro expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they should be accounted for as PPE.

Spare parts in the past have generally been expensed as incurred or recognized as prepaid expenses in other current assets or in linen-in-service. K-Bro has determined that the new IFRS policy for spare parts going forward is that items under $5,000 will be expensed as incurred, since they are not significant enough to consider capitalizing and tracking as discrete capital assets, and items over $5,000 will be capitalized into a new category of PPE called Spare Parts. Most spare parts used by K-Bro are specific to an item of PPE, and therefore would meet the criteria to be recognized as PPE.

(b) Acquisition-related costs are accounted for as expenses in the periods in which the costs are incurred and the services are received. Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities.

Under GAAP acquisition costs were treated as part of the purchase price in an acquisition and at December 31, 2009 the acquisition costs for second Vancouver plant were capitalized on the balance sheet. This amount has been expensed under the new IFRS standard.

(c) GAAP deferred tax balances are split between current and non-current assets and liabilities on the same basis as the asset and liability they relate to; however, under IFRS all deferred tax balances are classified as non-current, based on the principle that any deferred tax will not be paid until at least the following year, and only the current tax balance will be paid in the current year.

financial instruments

K-Bro's financial instruments at December 31, 2010 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to Unitholders and long-term debt. The Corporation does not enter into financial instruments for trading or speculative purposes. Financial assets are either classified as available for sale, held to maturity, trading or loans and receivables. Financial liabilities are recorded at amortized cost. Initially, all financial assets and financial liabilities must be recorded on the balance sheet at fair value. Subsequent measurement is determined by the classification of each financial asset and liability. Unrealized gains and losses on financial assets that are held as available for sale are recorded in other comprehensive income until realized, at which time they are recorded in the consolidated statement of earnings. All derivatives, including embedded derivatives that must be separately accounted for, are recorded at fair value in the consolidated balance sheet. Transaction costs related to financial instruments are capitalized and then amortized over the expected life of the financial instrument using the effective interest method.

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 that gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in interest rates. In order to manage these risks, K-Bro may enter into interest rate swaps, forward contracts or option contracts.

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 as discussed above.

critical risks and uncertainties

The K-Bro management team is focused on long-term strategic planning and has identified the key risks, uncertainties and opportunities associated with K-Bro's business that can impact the financial results as follows:

Effects of Market Volatility and Uncertainty

See "Summary of Results and Key Events – Effects of Economic Volatility and Uncertainty", "Market Activities and Opportunities" and "Outlook". Risks and uncertainties in this area include those associated with contract renewals, customer volumes, price adjustments and customer cost cutting initiatives.

Labour Market Availability

Despite an increased unemployment rate in Alberta, K-Bro continues to be faced with a 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 mitigates labour shortages through utilization of the Temporary Foreign Worker program, competitive remuneration and benefits and expanded recruitment.

Continuance of the federally legislated Temporary Foreign Worker program in its current form is an important factor in this process but there can be no assurance of this continuance given the declining national unemployment rate.

Competitive Environment

K-Bro experiences competition in its markets from its public and private sector competitors, especially so when a contract is due to expire and K-Bro may be subjected to a competitive Request for Proposal process. 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 operating room linen market in Canada.

These risks are managed primarily by entering into long-term contacts where possible, providing a comprehensive program of services, 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. However, there can be no assurance that contract renewals will be achieved given the competitive environment faced by the Corporation.

Dependence on 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. K-Bro is the exclusive provider of laundry and linen services to most of its customers. The contracts typically do not provide customers with the ability to terminate without cause and termination rights are limited to uncured events of default. Notwithstanding this, a breach by any of K-Bro's customers of their contracts, renegotiation of the terms thereof, or failure to renew the contracts upon expiration could have an adverse effect on the business, financial condition and future prospects of K-Bro.

Commodity Prices

K-Bro's operations utilize natural gas, electricity and water that comprise approximately 9% 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 up to three 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.

If K-Bro engages in activities to manage its commodity price exposure, it may forego the benefits it would otherwise experience if commodity prices were to decrease. In addition, commodity derivative contracts activities could expose K-Bro to losses. To the extent that K-Bro engages in risk management activities related to commodity prices, it will be subject to credit risks associated with counterparties with which it contracts.

Textile Demand

The Corporation is a significant buyer of linens, the majority of which are constructed from cotton or cotton-blended textiles. Variations in global demand could result in an increase to cotton futures pricing and consequently the amount cost of the linens to K-Bro. During 2010 the cotton market experienced unprecedented prices as demand outstripped global production.

K-Bro has entered into fixed price linen supply contracts for a one-year term in efforts to limit our exposure to the increase in cotton pricing. Significant increases in the price of cotton and other materials could result in higher linen costs and, consequently, have an adverse effect on K-Bro's earnings if K-Bro is not successful in offsetting such increases through cost reduction efforts.

Credit Facility and Debt Service

K-Bro currently has a $40 million financial covenant-based credit facility with a single Canadian bank which expires in June 2012. During the next year the lender will review the credit facility and determine if it will extend for another period. In the event that the facility is not renewed or extended, indebtedness under the facility will become repayable. There is also a risk that the credit facility will not be renewed for the same amount or on the same terms. Any of these events could affect K-Bro's ability to fund ongoing operations and make future dividend payments.

The credit facility is subject to floating interest rates and, therefore, is subject to fluctuations in interest rates. Interest rate fluctuations are beyond the Corporation's control and there can be no assurance that interest rate fluctuations will not have a material adverse effect on the Corporation's earnings and in turn reduce cash available for future cash distributions to Unitholders.

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 and amend material contracts. These covenants restrict numerous aspects of the business of K-Bro.

K-Bro is required to comply with covenants under the credit facility. The failure to comply with the terms of the credit facility would, after the expiration of available cure periods, entitle the lender to accelerate all amounts outstanding under the credit facility, and upon such acceleration, the lender would be entitled to begin enforcement procedures against the assets of the Corporation.

K-Bro's ability to satisfy the restrictive covenants may be affected by events beyond its control. K-Bro routinely reviews the covenants based on actual and forecast results and has the ability to make changes to its development plans and/or dividend policy to comply with covenants under the credit facility. If K-Bro becomes unable to pay its debt service charges or otherwise commits an event of default such as bankruptcy, the lender may foreclose on such assets of K-Bro or sell the working interests. K-Bro has incurred no events of default under the terms of its credit facility agreement.

Income Tax Legislation

In the future, income tax laws or other laws may be changed or interpreted in a manner that adversely affects K-Bro or its Shareholders. Tax authorities having jurisdiction over K-Bro or its Shareholders may disagree with how K-Bro calculates its income for tax purposes to the detriment of K-Bro and its Shareholders.

Dependence on the Public Sector

A significant portion of K-Bro's revenue is derived from contracts with various hospital and health care institutions which are government owned and funded. Consequently, any reduction in demand for K-Bro's services by the public sector, whether due to funding constraints, changing capital spending plans or willingness to outsource, would likely have an adverse effect on K-Bro if that business is not replaced from within the private sector. The current trend in healthcare is to outsource certain services and redeploy internal capital and resources towards core healthcare initiatives, however individual institutions and regional authorities continually assess and review their outsourcing strategy, the outcome of which could have an adverse effect on K-Bro.

Capital Investment

K-Bro's operations require a significant amount of working capital due to a large manpower workforce in our processing plants. K-Bro's ability to obtain additional capital is a significant factor in achieving its strategy of expansion and consolidation in the commercial laundry industry. There can be no assurance that the current working capital of the Corporation will be sufficient to enable it to implement all of its objectives. There can be no assurance that if, and when, K-Bro seeks equity or debt financing, it will be able to obtain the required funding on favourable commercial terms, or at all. Any such future financing may also result in additional dilution to existing Shareholders.

Furthermore, laundry equipment can, with proper ongoing maintenance, remain useful for long periods of time. K-Bro's maintenance capital expenditures have historically been modest. Management currently expects that for the foreseeable future, the normalized level of capital expenditures required to maintain K-Bro's laundry processing operations will be approximately $0.85 million per year. Commencing in 2009 and continuing throughout 2010, K-Bro had a project to upgrade its management information systems which will increase this anticipated annual amount throughout 2011.

K-Bro also funds capital expenditures necessary for growth or that result in efficiencies that provide high returns in terms of anticipated increased revenues or lower costs. The amount of these strategic capital expenditures have fluctuated over the past several years as K-Bro has selectively pursued growth opportunities through the purchase of (i) new equipment to increase capacity; (ii) equipment with an anticipated high payback from a reduction in labour and utility costs; and (iii) the purchase or construction of new laundry facilities.

The timing and amount of capital expenditures by K-Bro will indirectly affect the amount of cash available for the payment of dividends to Shareholders. Dividends may be reduced, or even eliminated, at times when K-Bro deems it necessary to make significant capital or other expenditures.

Employee Relations and Collective Agreements

Certain of K-Bro's plants are subject to collective bargaining agreements with their hourly employees. Approximately 35% of K-Bro labour is unionized and their employment is governed by the terms of a collective agreement. Any work stoppage resulting from a strike or lockout could have a material adverse effect on K-Bro's business, financial condition and results of operations, including increased labour costs and service disruptions. In 2010, new collective bargaining agreements were ratified by the labour union in British Columbia. Collective bargaining between K-Bro and the UFCW workers' union in Ontario commenced in early 2011. There can be no assurance that any of these collective agreements will be successfully renegotiated upon their expiration. Furthermore, there may be a significant effect on the operations of K-Bro in the event that the negotiations are unsuccessful.

In addition, K-Bro's clients employ workers governed under collective agreements. Any work stoppage or labour disruption experienced by K-Bro's clients could affect the amount and timing of K-Bro services required.

Acquisitions and Integration of Acquired Businesses

In the past K-Bro has grown through expansion and acquisition. The Corporation's growth strategy contemplates more acquisitions; however, future acquisition opportunities may not be identified and obtainable on suitable terms. The ability to undertake future acquisitions is limited, in part, by the Corporation's ability to access financing. If integration of new businesses does not occur as expected, their performance is less than expected, or an unknown liability is acquired, K-Bro's revenues may be lower and operational costs higher than anticipated.

This long-term growth strategy depends, in part, on the Corporation's ability to 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 alleviate this risk.

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.

Volatility of Market Trading

The market price of the Corporation's common shares (formerly trust units) may be volatile and could be subject to fluctuations in response to quarterly variations in operating results, changes in financial estimates by securities analysts, or other events or factors. In addition, the financial markets have experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many companies.

Often, these fluctuations have been unrelated to the operating performance, or have resulted from the failure of the operating result of such companies to meet market expectations in a particular quarter. Broad market fluctuations, or any failure of the Corporation's operating results in a particular quarter to meet market expectations, may adversely affect the market price of the Corporation's common shares. This risk is mitigated through long-term contracts with many of the Corporation's customers thereby reducing the volatility in processing volumes.

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 ("CEO") and the Vice-President and Chief Financial Officer ("CFO"), are responsible for establishing and maintaining disclosure controls and procedures, as well as internal control over financial reporting.

Disclosure Controls and Procedures

The Corporation has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements of the Fund was properly recorded, processed, summarized and reported to the Board of Directors and the Audit Committee. The Corporation's CEO and CFO have evaluated the effectiveness of these disclosure controls and procedures for the year ending December 31, 2010, and have concluded that they are effective.

Internal Controls over Financial Reporting

The CEO and CFO acknowledge responsibility for the design of internal controls over financial reporting ("ICFR"), and confirm that there were no changes in these controls that occurred during the year ended December 31, 2010 which materially affected, or are reasonably likely to materially affect, the Fund's ICFR. Based upon their evaluation of these controls for the year ended December 31, 2010, the CEO and CFO have concluded that these controls were operating effectively.

As IFRS requires more judgment with respect to various accounting treatments, additional or modified processes and controls have been put in place. These changes to financial reporting controls will ensure that the Corporation is making the appropriate judgments and adhering to the IFRS accounting policies selected.

A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute, assurance that the objectives of the control system are met. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, including instance of fraud, if any, have been detected. These inherent limitations include, amongst other items: (i) that managements' assumptions and judgments could ultimately prove to be incorrect under varying conditions and circumstances; or, (ii) the impact of isolated errors.

Additionally, controls may be circumvented by the unauthorized acts of individuals, by collusion of two or more people, or by management override. The design of any system of controls is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential (future) conditions.

Additional information regarding K-Bro including the current Annual Information Form and other required securities filings are available on our website at www.k-brolinen.com and on the Canadian Securities Administrators' website at www.sedar.com; the System for Electronic Document Analysis and Retrieval ("SEDAR").

consolidated financial statements

auditors report

PRICEWATERHOUSECOOPERS

March 9, 2011

Independent Auditor's Report

To the Shareholders of K-Bro Linen Inc.
(former Unitholders of K-Bro Linen Income Fund)

PricewaterhouseCoopers LLP
Chartered Accountants
TD Tower
10088 102 Avenue NW, Suite 1501
Edmonton, Alberta
Canada T5J 3N5
Telephone +1 780 441 6700
Facsimile +1 780 441 6776

We have audited the accompanying consolidated financial statements of K-Bro Linen Income Fund which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of earnings and deficit, comprehensive income and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of K-Bro Linen Income Fund as at December 31, 2010 and 2009 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

consolidated balance sheets

(thousands of Canadian dollars)

As at December 31	**2010**	**2009**
ASSETS		
Current assets		
Accounts receivable	$ 13,352	$ 9,451
Linen in service	7,933	7,305
Prepaid expenses and deposits	1,277	1,213
Future income taxes (note 8)	–	449
	$ 22,562	**$ 18,418**
Restricted escrow funds (note 2)	250	–
Property, plant and equipment (note 3)	34,070	33,583
Intangible assets (note 4)	15,199	14,595
Goodwill (note 2)	20,048	16,220
	$ 92,129	**$ 82,816**
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 13,326	$ 9,880
Distribution payable to unitholders	–	642
Future income taxes (note 8)	98	–
	$ 13,424	**$ 10,522**
Long-term debt (note 5)	$ 10,763	$ 4.043
Unamortized lease inducements (note 7)	566	611
Future income taxes (note 8)	3,667	3,847
	$ 28,420	**$ 19,023**
UNITHOLDERS' EQUITY		
Exchangeable shares (note 10b)	$ 724	$ 724
Fund units (note 10b)	70,676	70,676
Fund units held in trust by LTIP (note 11)	(1,601)	(834)
Contributing surplus (note 10c)	1,141	572
Deficit	(7,231)	(7,310)
Accumulated other comprehensive loss (note 10d)	–	(35)
	$ 63,709	**$ 63,793**
Contingencies and commitments (note 9)	**$ 92,129**	**$ 82,816**

The accompanying notes are an integral part of these financial statements

Approved on behalf of the Fund

Ross S. Smith, Chair

Matthew B. Hills, Director

consolidated statements of earnings and deficit

(thousands of Canadian dollars, except unit and per unit amounts)

Years ended December 31

	2010	2009
Revenue	$ 104,051	$ 87,533
Expenses		
Wages and benefits	47,848	39,433
Linen	10,603	10,192
Utilities	8,361	6,273
Delivery	3,993	3,280
Occupancy costs	3,762	2,991
Materials and supplies	3,492	3,015
Repairs and maintenance	3,416	3,177
Corporate	5,406	3,626
	$ 86,881	**$ 71,987**
Earnings before the undernoted	$ 17,170	$ 15,547
Other expenses		
Depreciation of property, plant and equipment	$ (5,666)	$ (5,347)
Amortization of intangible assets	(2,540)	(2,157)
Financial charges (note 6)	(643)	(311)
Loss on disposal of property, plant and equipment	(187)	(54)
	$ (9,036)	**$ (7,869)**
Earnings before income taxes	8,134	7,677
Income tax (expenses) recovery (note 8)	(349)	125
Net earnings	$ 7,785	$ 7,802
Deficit – beginning of year, as previously stated	$ (7,310)	$ (7,310)
Adjustment due to accounting policy change	–	(96)
Deficit – beginning of year, as restated	(7,310)	(7,406)
Distributions to unitholders (note 12)	(7,706)	(7,706)
Deficit – end of year	$ (7,231)	$ (7,310)
Net earnings per unit:		
Basic	$ 1.13	$ 1.12
Diluted	$ 1.11	$ 1.11
Weighted average number of units outstanding (note 10e)		
Basic	6,905,369	6,946,495
Diluted	6,992,400	6,999,719

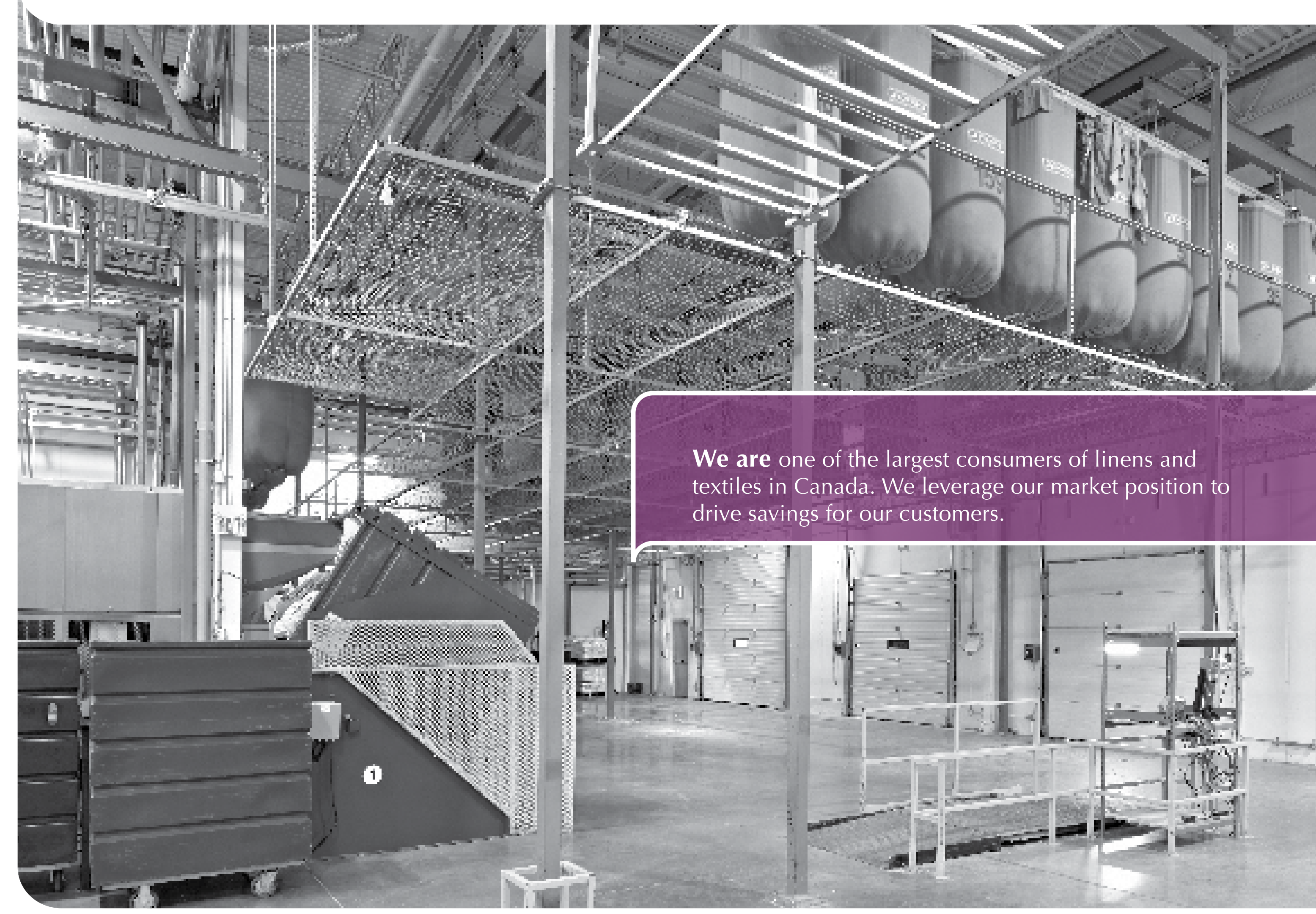
The accompanying notes are an integral part of these financial statements

consolidated statements of comprehensive income

(thousands of Canadian dollars)

As at December 31

	2010	2009
Net earnings	$ 7,785	$ 7,802
Other comprehensive income for the year		
Gain on derivative financial instruments designated as cash flow hedges, net of future income taxes of $19 (2009 – $30)	50	77
Comprehensive income	$ 7,835	$ 7,879



We are one of the largest consumers of linens and textiles in Canada. We leverage our market position to drive savings for our customers.

consolidated statements of cash flow

(thousands of Canadian dollars)

Years ended December 31	2010	2009
OPERATING ACTIVITIES		
Net earnings	$ 7,785	$ 7,802
Depreciation of property, plant and equipment	5,666	5,347
Amortization of intangible assets	2,540	2,157
Amortization of lease inducements (note 7)	(45)	(56)
Loss on disposal of property, plant and equipment	187	54
Settlement of interest rate swaps	(15)	–
Future income taxes	349	(125)
	16,467	15,179
change in non-cash balances relating to operations (note 13)	638	(3,319)
Cash provided by operating activities	17,105	11,860
FINANCIAL ACTIVITIES		
Proceeds from revolving credit facility	12,924	–
Repayments to revolving credit facility	(6,204)	(18)
Distributions paid to unitholders	(8,348)	(7,706)
Cash used in financing activities	(1,628)	(7,724)
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(2,330)	(3,479)
Proceeds from disposal of property, plant and equipment	21	22
Purchase of intangible assets	(244)	(679)
Acquisition of business (note 2)	(12,674)	–
Funds transferred to escrow	(250)	–
Cash used in investing activities	(15,477)	(4,136)
Change in cash during the year	–	–
Cash, beginning of year	–	–
Cash, end of year	$ –	$ –
Supplementary cash flow information		
Interest paid	$ 438	$ 317

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

notes to the consolidated financial statements

(thousands of Canadian dollars, except where indicated, years ended December 31, 2010 and 2009)

K-Bro Linen Income Fund (the “Fund”) was established as a limited purpose trust under the laws of Alberta pursuant to an 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 that include the processing, management and distribution of general linen and operating room linen. The Fund’s units traded on the Toronto Stock Exchange (“TSX”) under the symbol “KBL.un” until January 5, 2011 (note 18(a)).

1 Significant accounting policies

These consolidated financial statements are presented in Canadian dollars, except where otherwise indicated, and have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and reflect the following principles:

a) Principles of Consolidation

These consolidated financial statements include the Fund, all of its wholly owned subsidiary companies including K-Bro Linen Systems Inc. and the LTIP Trust, a variable interest entity (note 11). All intercompany balances and transactions have been eliminated upon consolidation.

b) Use of Estimates

Consolidated financial statements prepared in accordance with GAAP require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from these estimates. Uncertainty is inherent in estimating the useful life of property and equipment and corresponding depreciation rates, the useful life of intangible assets and corresponding amortization rates, allowances for doubtful accounts receivable, future income taxes, provision for legal contingencies, volume rebates and the fair value of goodwill and financial instruments. The impact on the consolidated financial statements of future changes in such estimates could be material.

c) 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.

d) Revenue Recognition

Revenue from linen management and laundry services is largely based on 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.

e) Property, Plant and Equipment

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

Asset	Rate
Building	5% Declining balance
Laundry equipment	15% Declining balance
Office equipment	20% Declining balance
Delivery equipment	20% Declining balance
Computer hardware	30% Declining balance
Leasehold improvements	Straight-line over lease

f) Intangible assets

Intangible assets are recorded at cost and include customer contracts in progress and related relationships, which are being amortized using the straight-line method over the remaining lives of the related contracts and relationships. Intangible assets which relate to computer software are amortized using the straight-line method over five years when put into service.

g) Impairment of Long-Lived Assets

The Fund tests for the impairment of long-lived assets held for use through a two-step process, with the first step determining when an impairment is recognized and the second step measuring the amount of the impairment. The Fund assesses impairment of its long-lived 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.

h) 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 of the Fund is distributed to the unitholders, no provision for current income taxes on earnings of the Fund is made in the financial statements. On June 11, 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 was effective for the 2007 taxation year but the application of the rules was 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 realized. The effect on future income tax assets or liabilities is recognized in income in the period that the tax rate 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.

i) Goodwill

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the identifiable assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination. Goodwill is not amortized and is tested for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. When the carrying amount of goodwill exceeds the implied fair value, an impairment loss is recognized in an amount equal to the excess.

j) 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.

k) Earnings Per Unit

Basic earnings per unit are computed by dividing net earnings by the weighted average number of fund units outstanding during each reporting period. Units issued during the year and units reacquired during the year are weighted for the portion of the year that they were outstanding. Diluted earnings per unit are computed using the treasury stock method, which assumes that any unrecognized unit based compensation is applied to purchase units at the average price during the year. The difference between the number of units obtainable under this computation, on a weighted average basis, is added to the number of units outstanding.

l) Employee Future Benefits

The Fund and its subsidiaries have a Registered Retirement Savings Plan. The Fund contributes to the plan based on the amount of employee contributions. The Fund accounts for contributions as an expense in the year that they are made. The Fund does not provide other post employment or post-retirement benefits.

m) Financial instruments

Financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification as described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition. Transaction costs are recognized immediately in income or are capitalized, depending upon the nature of the transaction and the associated product.

Available-for-sale

Financial assets classified as available-for-sale are carried at fair value with changes in fair value recorded in other comprehensive income. The fair value of a financial instrument on initial recognition is normally the transaction price. Subsequent to initial recognition, fair values for financial assets are determined by bid prices quoted in active markets. Securities that are classified as available-for-sale and do not have a readily available market value are recorded at cost. Available-for-sale securities are written down to fair value through income whenever it is necessary to reflect other than temporary impairment. Gains and losses realized on disposal of available-for-sale securities, which are calculated on an average cost basis, are recognized in other income.

Loans, receivables and other liabilities

Loans, receivables and other liabilities are accounted for at amortized cost using the effective interest rate method. The Fund has made the following classifications:

	Classification	Measurement
Financial assets		
Cash	Available for sale	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Financial liabilities		
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Distribution payable	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost

2 Business Acquisition

On January 29, 2010, the Fund completed the acquisition of the laundry business, linen, certain working capital and equipment of a processing plant located in Greater Vancouver, 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. The acquisition was funded through the Fund's revolving credit facility.

The purchase price allocated to the net assets acquired, based on their estimated fair values, is as follows:

Consideration		
Purchase price including acquisition costs	$	12,924
Less:		
Restricted escrow funds		(250)
Net cash consideration	$	12,674
Net assets acquired:		
Working capital	$	1,228
Linen in service		500
Property, plant and equipment		4,218
Intangible assets		2,900
Goodwill		3,828
	$	12,674

During the fourth quarter, the Fund self-assessed provincial sales taxes relating to the acquired assets which resulted in an increase to the purchase price of $312. This amount has been allocated to the property, plant and equipment.

Of the cash consideration payable, $250 was deposited with an agent to be held in escrow and released to the vendor upon the determination that certain representations and warranties are satisfied in the twelve-month period subsequent to the acquisition. On January 31, 2011 the full amount of the escrow account was released to the vendor and consequently the amount of goodwill will be adjusted by the same amount during fiscal 2011.

Intangible assets acquired are made up of customer contracts along with related relationships and customer lists.

3 Property, Plant and Equipment

December 31. 2010	Cost	Accumulated Depreciation	Net Book Value
Land	$ 70	$ –	$ 70
Building	555	75	48
Laundry equipment	42,842	17,543	25,299
Office equipment	537	250	287
Delivery equipment	1,025	302	723
Computer equipment	1,436	958	478
Leasehold improvements	11,240	4,507	6,733
	$ 57,705	$ 23,635	$ 34,070

December 31. 2009	Cost	Accumulated Depreciation	Net Book Value
Land	$ 70	$ –	$ 70
Building	550	51	499
Laundry equipment	37,504	13,655	23,849
Office equipment	692	242	450
Delivery equipment	421	219	202
Computer equipment	1,337	801	536
Leasehold improvements	11,131	3,154	7,977
	$ 51,705	$ 18,122	$ 33,583

4 Intangible Assets

December 31. 2010		Cost		Accumulated Depreciation		Net Book Value
Healthcare contracts	$	15,700	$	6,675	$	9,025
Operating room contracts		3,500		2,889		611
Hospitality contracts		7,597		2,778		4,819
Computer software		923		179		744
	$	27,720	$	12,521	$	15,199

December 31. 2009		Cost		Accumulated Depreciation		Net Book Value
Healthcare contracts	$	15,700	$	5,547	$	10,153
Operating room contracts		3,500		2,401		1,099
Hospitality contracts		4,697		2,033		2,664
Computer software		679		–		679
	$	24,576	$	9,981	$	14,595

5 Long-Term Debt

	2010	2009
Bankers' Acceptances, interest at 30 day BA rates plus 2.5% depending on certain financial ratios, due January 20, 2011, renewable monthly until June 30, 2012	$ 4,000	$ 4,000
Prime rate loan, secured with a general security agreement, interest at prime plus 1.0% depending on certain financial ratios, monthly repayment of interest only, maturing on June 30, 2012	6,763	43
	$ 10,763	$ 4,043

The Fund has a revolving credit facility of up to $40,000 of which $11,013 is drawn (including letters of credit totalling $250 per note 9a). The facility is a two-year committed facility maturing June 30, 2012. It is extendable annually for another year at the lender's option. Interest payments only are due during the term of the facility.

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. At December 31, 2010 for Bankers' Acceptances the margin ranged from 2.50% to 3.50% and for Canadian prime rate loans, the margin ranged from 1.00% to 2.00%.

A general security agreement over all assets, a mortgage against all leasehold interests and real property, insurance policies and an assignment of material agreements have been pledged as collateral. The Fund has incurred no events of default under the terms of its credit facility agreement.

6 Financial Charges

	2010	2009
Interest on long-term debt	$ 436	$ 317
Other charges, net	207	(6)
	$ 643	$ 311

7 Unamortized Lease Inducements

The Fund entered into a ten-year lease in 2007 that included certain lease inducements consisting of a tenant allowance and a rent-free period. Tenant allowances are recorded as a liability when credited or received and 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 is recorded as an increase or deferral in unamortized lease inducements.

The balance consists of:

	2010	2009
Lease inducements received	$ 699	$ 699
Accumulated amortization, net	(88)	(43)
	611	656
Less current portion, included in accrued liabilities	(45)	(45)
	$ 566	$ 611

8 Income Taxes

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

		2010		2009
Earning before income taxes	$	8,134	$	7,677
Non-deductible expenses		193		130
Income subject to tax		8,327		7,807
Income tax at statutory rate of 28.7% (2009 – 30.1%)		2,392		2,349
Impact of substantively enacted rates and other		104		(226)
Tax on income of the Fund allocated to unitholders		(2,147)		(2,248)
Income tax expense (recovery)	$	349	$	(125)

Future income tax assets (liabilities) are attributable to the following items:

		2010		2009
Linen in service	$	(617)	$	108
Accounts payable and accrued liabilities		519		341
Current future income tax asset (liability)		(98)		449
Property, plant and equipment		(1,276)		(1,094)
Intangible assets and Goodwill		(2,631)		(3,146)
Offering costs and Other		240		393
Long-term future income tax liability		(3,667)		(3,847)
Future income tax liability, net	$	(3,765)	$	(3,398)

The amount of goodwill deductible for tax purposes is $7,691 (2009 – $3,862).

9 Contingencies and Commitments

a) Contingencies – Letters of credit

The Fund has a standby letter of credit issued as part of normal business operations in the amount of $250 (2009 – $250) which remains outstanding for the duration the Fund provides services to the customer.

b) Commitments

(i) 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:

2011	$	6.022
2012		4,319
2013		2,088
2014		1,429
2015		974
Subsequent		1,788
	$	16,620

(ii) Linen purchase commitments

At December 31, 2010, the Fund was committed to linen expenditure obligations in the amount of $2,206 (2009 – $1,898).

10 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

	2010		2009	
	Units	**Unit Capital**	**Units**	**Unit Capital**
Fund units				
Balance, beginning of year	6,932,562	$ 70,676	6,932,562	$ 70,676
Issued/Cancelled	–	–	–	–
	6,932,562	$ 70,676	6,932,562	$ 70,676
Exchangeable shares				
Balance, beginning of year	72,411	$ 724	72,411	$ 724
Issued/Cancelled	–	–	–	–
	72,411	$ 724	72,411	$ 724
Total fund units and exchangeable shares issued	7,004,973		7,004,973	

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. Special Trust Units are attached to and issued in conjunction with Exchangeable Shares for the sole purpose of entitling holders thereof to voting rights at any meeting of holders of Fund Units and Special Trust Units.

c) Contributed surplus

	2010	2009
Balance, beginning of year	$ 572	$ 341
Net unit based compensation	1,196	650
Issuance of vested fund units to participants	(627)	(419)
Balance, end of year	$ 1,141	$ 572

d) Accumulated other comprehensive income

	2010	2009
Balance, beginning of year	$ (35)	$ (112)
Other comprehensive income during the year	50	77
Transfer of interest rate swap gains to earnings	(15)	–
Balance, end of year	$ –	$ (35)

e) Weighted average number of units outstanding

	2010	2009
Balance, beginning of year	7,004,973	7,004,973
Weighted average unvested units purchased for LTIP	(99,604)	(58,478)
Basic weighted average units for the year	6,905,369	6,946,478
Basic weighted average units for the year	6,905,369	6,946,495
Dilutive effect of LTIP units	87,031	53,224
Fully diluted weighted average units for the year	6,992,400	6,999,719

11 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 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 consolidated financial statements by the Trustees upon the participant signing a Participation Agreement and three-quarters vest on the second anniversary 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.

	2010		**2009**	
	Unvested	**Vested**	**Unvested**	**Vested**
Balance, beginning of year	69,692	72,739	35,297	38,961
Issued during year	62,945	24,478	51,129	17,044
Vested during year	(18,563)	18,563	(16,734)	16,734
Balance, end of year	114,074	115,780	69,692	72,739

The cost of the 114,074 unvested units held in trust by the LTIP at December 31, 2010 (2009 – 69,692) was $1,601 (2009 - $834).

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

12 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 day of the following month. The final distribution of $642 of the Fund prior to the Conversion (note 18(a)) was declared on December 22, 2010 and paid on December 31, 2010.

During the year ended December 31, 2010, the Fund declared total distributions to Unitholders and Exchangeable Shareholders of $7,706 (2009 – $7,706) or $1.10 per unit (2009 – $1.10).

13 Net Change in Non-Cash Working Capital

	2010	2009
Accounts receivable	$ (2,437)	$ (781)
Linen in service	(129)	451
Prepaid expenses and deposits	(64)	(589)
Accounts payable and accrued liabilities	3,268	(2,400)
	$ 638	$ (3,319)

14 Financial Instruments

a) Fair value

The Fund's financial instruments at December 31, 2010 consist of accounts receivable, accounts payable and accrued liabilities, distribution payable to unitholders and long-term debt. The carrying value of accounts receivable, accounts payable and accrued liabilities, and distribution payable to unitholders approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of the Fund's interest-bearing debt approximates the respective carrying amount due to the floating rate nature of the debt.

b) Financial risk management

The Fund's activities are exposed to a variety of financial risks: price risk, credit risk and liquidity 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.

c) Price risk

(i) 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 if considered prudent to mitigate this risk. At December 31, 2010, no foreign exchange forward option contracts were outstanding.

(ii) Interest rate risk

The Fund is subject to interest rate risk as its credit facility bears interest at rates that depend on certain financial ratios of the Fund and vary in accordance with market interest rates. Based on the outstanding balance on the Fund's revolving credit facility, a 1% increase in the Canadian prime rate would result in an additional $108 in annual interest expense. Management does not believe that the impact of interest rate fluctuations will be significant.

(iii) Other price risk

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

d) Credit risk

The Fund's financial assets that are exposed to credit risk consist of accounts receivable. The Fund, in the normal course of business, is exposed to credit risk from its customers. The allowance for doubtful accounts and past due receivables are reviewed by management at each balance sheet reporting date. Any amounts greater than 60 days are considered overdue.

The Fund updates its estimate of the allowance for doubtful accounts based on the evaluation of the recoverability of accounts receivable balances of each customer taking into account historic collection trends, the contractual relationship with the customer and the nature of the customer which in many cases is a publicly funded health care entity.

Management believes that the risks associated with concentrations of credit risk with respect to accounts receivable are limited due to the nature of the customers and the generally short payment terms.

The aging of the Fund's receivables and related allowance for doubtful accounts are:

December 31. 2010	**Gross**	**Allowance**	**Net**
Current	$ 10,272	$ –	$ 10,272
31–60 days	2,660	–	2,660
Greater than 60 days	462	42	420
	$ 13,394	$ 42	$ 13,352

December 31. 2009	**Gross**	**Allowance**	**Net**
Current	$ 6,224	$ –	$ 6,224
31–60 days	2,699	–	2,699
Greater than 60 days	570	42	528
	$ 9,493	$ 42	$ 9,451

e) Liquidity risk

The Fund's accounts payable and distribution payable are due within one year.

The Fund has long-term debt with a maturity date of June 30, 2012 (see note 5). The degree to which the Fund is leveraged may reduce its ability to obtain additional financing for working capital and to finance investments to maintain and grow the current levels of cash flows from operations. The Fund may be unable to extend the maturity date of the credit facility.

Management, to reduce liquidity risk, has historically renewed the terms of the credit facility in advance of its maturity dates and the Fund has maintained financial ratios that management believes are conservative compared to financial covenants applicable to the credit facility. A significant portion of the available facility remains undrawn.

Management measures liquidity risk through comparisons of current financial ratios with financial covenants contained in the credit facility.

f) Hedge accounting

Where derivatives are held for risk management purposes or when transactions meet the criteria, including documentation requirements, specified in the CICA Handbook Section 3865, hedge accounting is applied to the risks being hedged. When hedge accounting is not applied, the change in the fair value of the derivative is recognized in earnings.

There is no interest rate swap outstanding at December 31, 2010. Previously the Fund applied hedge accounting on the interest rate swap agreement outstanding at December 31, 2009.

K-Bro has made significant investments in high-quality plants, investments that have allowed the company to move forward in achieving its vision.

15 Capital Management

The Fund views its capital resources as the aggregate of its debt, unitholders' equity and amounts available under its credit facility. In general, the overall capital of the Fund is evaluated and determined in the context of its financial objectives and its strategic plan.

The Fund's objective in managing capital is to ensure sufficient liquidity to pursue its growth and expansion strategy, while taking a conservative approach towards financial leverage and management of financial risk. The Fund's capital is composed of unitholders' equity and long-term debt. The Fund's primary uses of capital are to finance its growth strategies and capital expenditure programs. The Fund currently funds these requirements from internally-generated cash flows and interest bearing debt.

The Fund pays a distribution which reduces its ability to internally finance growth and expansion however the availability of the Fund's revolving line of credit provides sufficient access to capital to allow the Fund to take advantage of acquisition opportunities. The Fund has historically generated cash flow in excess of distributions and has used such excess to fund capital expenditures, working capital, growth capital and other reserves. The merits of the distribution are evaluated by the Fund's Board of Trustees from time to time.

The primary non-GAAP measures used by the Fund to monitor its financial leverage are its ratios of Funded Debt to EBITDA and Fixed Charge Coverage. EBITDA is not a measure that has any standardized meaning prescribed by Canadian GAAP and is considered to be a non-GAAP measure. Therefore, this measure may not be comparable to similar measures presented by other companies. This measure has been described and presented in the manner in which the chief operating decision maker assesses performance.

The Fund manages their Funded Debt to EBITDA ratio calculated as follows:

	2010	2009
Long-term debt, including current portion	$ 10,763	$ 4,043
Issued and outstanding letter of credit	250	250
Funded debt	$ 11,013	$ 4,293
Net earnings for the year	7,785	7,802
Add:		
Income tax expense (recovery)	349	(125)
Interest expense and financial charges, net	643	311
Depreciation of property, plant and equipment	5,666	5,347
Amortization of intangible assets	2,540	2,157
EBITDA	$ 16,983	$ 15,492
Funded debt to EBITDA	0.65x	0.28x

The Fund manages a Fixed Charge Coverage ratio, calculated on a trailing twelve-month basis as follows:

	2010		2009	
EBITDA	$	16,983	$	15,492
Interest expense and financial charges, net		643		311
Distributions to unitholders		7,706		7,706
	$	8,349	$	8,017
Fixed charge coverage		2.03x		1.93x

16 Segmented Information

The Fund provides laundry and linen services to the healthcare and hospitality sectors through operating divisions in Vancouver, Victoria, Calgary, Edmonton, Toronto and Quebec City. The services offered and the economic characteristics associated with these divisions are similar, therefore they have been aggregated into one reportable segment which operates exclusively in Canada. The results of the Greater Vancouver operation acquired (note 2) are reported commencing February 1, 2010

	2010			2009		
Healthcare	$	71,455	68.7%	$	66,846	76.4%
Hospitality		32,596	31.3%		20,687	23.6%
	$	104,051	100.0%	$	87,533	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 was renewed and currently expires on January 31, 2013. In Calgary, the major customer is contractually committed to February 28, 2018 and in Vancouver the major customer is contractually committed to November 12, 2015. For the year ended December 31, 2010, the Fund has recorded revenue of $52,887 (2009 – $52,400) from these three major customers, representing 51% (2009 – 60%) of total revenue.

17 Key Management Compensation

Key management includes the trustees and officers of the Fund. Compensation awarded to key management included:

		2010		2009
Salaries and retainer fees	$	1,507	$	1,492
Short-term bonus incentives		543		462
Post-employment benefits		43		41
Unit-based payments		1,220		760
	$	3,313	$	2,755

The Fund incurred expenses in the normal course of business for advisory consulting services provided by a Trustee primarily relating to acquisitions. The amounts charged are included as salaries and retainer fees and are recorded at their exchange amounts. For the year ended December 31, 2010, the Fund incurred such fees totalling $138 (2009 – $138).

18 Subsequent Events

a) Conversion from income trust to corporation

On December 6, 2010, unitholders of the Fund voted in favour of converting the Fund into a corporation, K-Bro Linen Inc. (the "Corporation"), pursuant to a plan of arrangement (the "Conversion"). The Conversion was completed January 1, 2011. As a result of the Conversion, unitholders of the Fund received one common share of the Corporation for each one unit of the Fund. Effective January 1, 2011 the Corporation holds all of the assets and liabilities, previously held, directly or indirectly, by the Fund. Accordingly, these consolidated financial statements reflect the Fund as a limited purpose trust as at and for the year ended December 31, 2010.

On January 6, 2011, the Corporation commenced trading on the TSX under the symbol "KBL".

The Conversion will be accounted for as a continuity of interests of the Fund since there has been no change of control and given that the Corporation will continue to operate the business of the Fund.

b) Dividends

K-Bro's Board of Directors declared an eligible dividend of $0.09167 per common share of the Corporation payable on each of February 15, March 15, and April 15, 2011 to shareholders of record on January 31, February 28, and March 31, 2011, respectively.

19 Comparative Amounts

Certain comparative amounts have been reclassified to conform to the current year's financial statement presentation.

CORPORATE INFORMATION

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Corporate Director

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Managing Director
LLM Capital Partners LLC

Steven Matyas, BSc
President
Staples Canada Inc.

Michael Percy, PhD
Dean, School of Business
University of Alberta

Linda McCurdy, MBA
President & Chief Executive Officer
K-Bro Linen Systems Inc.

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President & Chief Executive Officer

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Vice-President & Chief Financial Officer

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General Manager

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Operations Manager

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Calgary, Alberta

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PricewaterhouseCoopers LLP
Edmonton, Alberta

LEGAL COUNSEL

Goodmans LLP, Edmonton
McLennan Ross LLP, Edmonton

PRINCIPAL BANK

TD Bank, Edmonton

STOCK EXCHANGE LISTING

TSX: KBL

NOTICE OF ANNUAL MEETING

The annual meeting of Shareholders will be held at the Sheraton Centre Hotel, Carleton Room, 123 Queen Street West, Toronto, Ontario, Canada on June 16, 2011 at 1:00pm EST

K-Bro Linen Inc.