



KRUGER PRODUCTS L.P.

UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**FOR THE 26-WEEK PERIOD ENDED JUNE 30, 2013 AND
25-WEEK PERIOD ENDED JUNE 24, 2012**

Kruger Products L.P.

Unaudited Condensed Consolidated Statements of Financial Position

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

	June 30, 2013	December 31, 2012
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	78,364	121,489
Trade and other receivables	94,584	94,308
Receivables from related parties (note 10)	1,910	668
Inventories	138,400	116,873
Income tax recoverable	932	2,872
Prepaid expenses	8,468	4,413
	<u>322,658</u>	<u>340,623</u>
Non-current assets		
Property, plant & equipment (note 4)	604,329	580,814
Other long-term assets	8,280	6,236
Goodwill	152,021	152,021
Intangible assets	13,643	13,828
Income tax recoverable	11,575	-
Deferred income taxes	10,687	1,178
	<u>1,123,193</u>	<u>1,094,700</u>
Liabilities		
Current liabilities		
Trade and other payables	166,596	186,309
Payables to related parties (note 10)	2,935	9,057
Distribution payable (note 8)	9,367	-
Current portion of provisions (note 6)	1,991	3,719
Current portion of long-term debt (note 7)	7,960	3,802
	<u>188,849</u>	<u>202,887</u>
Non-current liabilities		
Long-term debt (note 7)	333,484	323,885
Other long-term liabilities	427	544
Provisions (note 6)	6,595	5,506
Pensions (note 5)	109,407	148,989
Post-retirement benefits (note 5)	47,391	48,302
Liabilities to non-unitholders	686,153	730,113
Partnership units	118,562	118,562
	<u>804,715</u>	<u>848,675</u>
Equity		
Partnership units (note 8)	274,899	257,516
Retained earnings (deficit)	26,960	(14,736)
Accumulated other comprehensive income	16,619	3,245
	<u>318,478</u>	<u>246,025</u>
Total equity and liabilities	<u>1,123,193</u>	<u>1,094,700</u>
Reorganization (note 1)		

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

Kruger Products L.P.
Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)
For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

	13-week period ended June 30, 2013 \$	13-week period ended June 24, 2012 \$	26-week period ended June 30, 2013 \$	25-week period ended June 24, 2012 \$
Revenue (note 10)	246,769	231,336	468,554	447,582
Expenses				
Cost of sales (note 10)	173,308	161,315	330,469	312,901
Operating expenses (note 10)	52,351	47,533	100,222	90,583
Impairment (recovery) of non-financial assets (note 4)	(1,789)	-	(1,789)	5,900
Restructuring costs (note 6)	-	(500)	-	8,600
Operating income	22,899	22,988	39,652	29,598
Interest expense	11,007	7,087	20,897	13,175
Income before income taxes	11,892	15,901	18,755	16,423
Income taxes (note 9)	(3,485)	269	(8,338)	432
Net income for the period	15,377	15,632	27,093	15,991
Other comprehensive income (loss)				
Items that will not be reclassified to net income:				
Remeasurements of pensions	21,203	(19,818)	33,698	(31,066)
Remeasurements of post-retirement benefits	1,504	27	1,504	(1,610)
Items that may be subsequently reclassified to net income:				
Cumulative translation adjustment	8,835	4,154	13,374	1,373
Total other comprehensive income (loss) for the period	31,542	(15,637)	48,576	(31,303)
Comprehensive income (loss) for the period	46,919	(5)	75,669	(15,312)

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

Kruger Products L.P.

Unaudited Condensed Consolidated Statements of Changes in Equity

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

	Partnership units		Equity	Retained earnings (deficit)	Accumulated other comprehensive income (loss)	Total equity
	#	\$	\$	\$	\$	\$
As of January 1, 2012	-	-	279,209	-	(1,288)	277,921
Transfer of assets from related parties	-	-	(706)	-	-	(706)
Change in actuarial losses on pension	-	-	(31,066)	-	-	(31,066)
Change in actuarial losses on post retirement benefits	-	-	(1,610)	-	-	(1,610)
Cumulative translation adjustment	-	-	-	-	1,373	1,373
Net income for the period	-	-	15,991	-	-	15,991
As of June 24, 2012	-	-	261,818	-	85	261,903
As of January 1, 2013	51,014,300	257,516	-	(14,736)	3,245	246,025
Distributions payable (note 8)	-	-	-	(9,367)	-	(9,367)
Distributions paid (note 8)	-	-	-	(11,232)	-	(11,232)
Change in actuarial gains on pension	-	-	-	33,698	-	33,698
Change in actuarial gains on post retirement benefits	-	-	-	1,504	-	1,504
Cumulative translation adjustment	-	-	-	-	13,374	13,374
Net income for the period	-	-	-	27,093	-	27,093
Issuance of partnership units (note 8)	1,025,035	17,383	-	-	-	17,383
As of June 30, 2013	52,039,335	274,899	-	26,960	16,619	318,478

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

Kruger Products L.P.

Unaudited Condensed Consolidated Statements of Cash Flows

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

	26-week period ended June 30, 2013 \$	25-week period ended June 24, 2012 \$
Cash flows from (used in) operating activities		
Net income for the period	27,093	15,991
Items not affecting cash		
Depreciation	16,189	11,623
Amortization	276	309
Loss (gain) on sale of fixed assets	(4)	70
Unrealized foreign exchange loss	2,493	461
Interest expense	20,897	13,175
Pension and post retirement benefits	5,164	4,876
Provisions	485	9,148
Income taxes	(8,338)	432
Impairment (recovery) of non-financial assets	(1,789)	5,900
Total items not affecting cash	35,373	45,994
Net change in non-cash working capital (note 13)	(44,216)	(5,939)
Contributions to pension and post-retirement benefit plans	(14,717)	(16,318)
Provisions paid	(1,802)	(1,623)
Income tax payments	(1,737)	(578)
Net cash from (used in) operating activities	(6)	37,527
Cash flows used in investing activities		
Purchase of property, plant & equipment	(7,590)	(10,934)
Purchases of through-air-dried (TAD) expansion	(28,773)	(70,397)
Purchases of software	(90)	-
Proceeds on sale of property, plant and equipment	4	-
Net cash used in investing activities	(36,449)	(81,331)
Cash flows from (used in) financing activities		
Proceeds from credit facilities	4,571	65,643
Repayment of credit facilities	(3,730)	(27,863)
Payment of deferred financing fees	(453)	-
Transfer of assets to related parties	-	(706)
Interest paid on credit facilities	(13,971)	(9,435)
Distribution paid	(11,232)	-
Proceeds from issuing partnership units, net	17,383	-
Net cash from (used in) financing activities	(7,432)	27,639
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	762	82
Decrease in cash and cash equivalents during the period	(43,125)	(16,083)
Cash and cash equivalents - Beginning of period	121,489	31,797
Cash and cash equivalents - End of period	78,364	15,714

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

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Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

1 General information

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

Reorganization

On September 21, 2012, the net assets of the tissue business, including those assets, liabilities and results of operations of Former KPLP that are attributable to the tissue business and all of the assets, liabilities and results of operations of West Tree Farms Limited, White Swan Tissue Company, Aztec Investments Inc., Kruger Products (USA) Inc. (KP USA), Grupo Tissue de Mexico S de RL de CV (GTM), K.T.G. (USA) Inc. (KTG), TAD Canco Inc. and TAD Luxembourg S.A.R.L (collectively the Tissue Business) were transferred to the Partnership. The Partnership issued 43,014,300 units to the former owners of the Tissue Business (Former KPLP) in exchange for all of the assets and liabilities of the Tissue Business.

As the Partnership continued the operations of the Tissue Business of Former KPLP, the reorganization has been accounted for in accordance with the continuity of interests method of accounting whereby the assets and liabilities of the Partnership were recorded at the carrying values of the assets and liabilities of the Tissue Business immediately prior to the reorganization. The comparative balances and results of operations included in these consolidated financial statements for period prior to the reorganization are derived from the combined financial statements of the Tissue Business. The combined financial statements of the Tissue Business were prepared on a combined carve-out basis from the books and records of Former KPLP and certain of its subsidiaries to represent the assets, liabilities and operating activities of the Tissue Business as if it had existed as a separate legal entity.

2 Basis of presentation

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of interim financial statements including International Accounting Standard 34, Interim Financial Reporting. These condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements of the Partnership for the year ended December 31, 2012. These condensed consolidated financial statements were approved by the board of directors of KPGP Inc. (KPGP) on August 12, 2013.

3 Summary of significant accounting policies

The significant accounting policies that have been used in the preparation of these condensed consolidated financial statements are described in the annual consolidated financial statements of the Partnership for the year ended December 31, 2012 and have been applied to all periods presented except the following accounting policies, which were adopted effective January 1, 2013:

- (i) IFRS 10, Consolidated Financial Statements, requires an entity to consolidate an investee when it has power over the investee, is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. IFRS 10 replaced SIC-12, Consolidation - Special Purpose Entities, and parts of IAS 27, Consolidated and Separate Financial Statements. The adoption of this standard had no significant impact on these condensed consolidated financial statements.
- (ii) IFRS 12, Disclosure of Interests in Other Entities, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosures that

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

address the nature of, and risks associated with, an entity's interests in other entities. The adoption of this standard had no significant impact on these condensed consolidated financial statements.

- (iii) IFRS 13, Fair Value Measurement, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The adoption of this standard did not require any adjustments to the valuation techniques used by the Partnership to measure fair value and did not result in any measurement adjustments as of January 1, 2013.
- (iv) IAS 19 (Amended in 2011), Employee Benefits, amends certain accounting requirements for defined benefit plans and termination benefits.

IAS 19 (Amended in 2011) requires the net defined benefit liability (asset) to be recognized on the balance sheet without any deferral of actuarial gains and losses and past service costs as previously allowed. Past service costs are recognized in net income when incurred. Expected returns on plan assets are no longer included in post-employment benefits' expense. Instead, post-employment benefits' expense includes the net interest on the net defined benefit liability (asset) calculated using a discount rate based on market yields on high quality bonds. Remeasurements consisting of actuarial gains and losses, the actual return on plan assets (excluding the net interest component) and any change in the asset ceiling are recognized in other comprehensive income. The Partnership continues to immediately recognize in retained earnings (accumulated deficit) all pension adjustments recognized in other comprehensive income (loss). The Partnership also continues to recognize interest expense (income) on net post-employment benefits liabilities (assets) in expense (income) in the condensed consolidated statements of comprehensive income (loss).

The Partnership adopted these amendments retrospectively. The post-employment benefits' finance expense and employee benefit expense for the comparable period have been adjusted to reflect the accounting changes for defined benefit plans. The adjustments for each financial statement line item affected are presented in the tables below.

Adjustments to the condensed consolidated statement of comprehensive income (loss):

	<u>13-week period ended June 24, 2012</u>	<u>25-week period ended June 24, 2012</u>
Net income before accounting change	16,780	18,440
Increase in:		
Cost of sales	108	305
Operating expenses	36	102
Interest expense	<u>1,004</u>	<u>2,042</u>
Decrease in net income	<u>1,148</u>	<u>2,449</u>
Net income after accounting change	<u><u>15,632</u></u>	<u><u>15,991</u></u>

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Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

	13-week period ended June 24, 2012	25-week period ended June 24, 2012
Comprehensive loss before accounting change	5	15,312
Decrease in net income	1,148	2,449
Decrease in other comprehensive loss for remeasurements of pensions	(1,148)	(2,449)
Change to comprehensive loss	-	-
Comprehensive loss after accounting change	<u>5</u>	<u>15,312</u>

4 Property, plant and equipment

	Land	Buildings	Machinery and equipment	Assets under construction or development	Total
	\$	\$	\$	\$	\$
As of January 1, 2013					
Cost	40,426	132,448	634,410	203,356	1,010,640
Accumulated depreciation and impairments	(1,789)	(60,288)	(367,749)	-	(429,826)
Net book value as of January 1, 2013	<u>38,637</u>	<u>72,160</u>	<u>266,661</u>	<u>203,356</u>	<u>580,814</u>
Additions	-	-	-	30,908	30,908
Capitalized interest	-	-	-	507	507
Government grants and investment tax credits	-	-	(9,736)	-	(9,736)
Transfers	-	49,959	178,275	(228,234)	-
Depreciation	-	(2,350)	(15,087)	-	(17,437)
Recovery	1,789	-	-	-	1,789
Exchange differences	61	2,441	8,628	6,354	17,484
As of June 30, 2013	<u>40,487</u>	<u>122,210</u>	<u>428,741</u>	<u>12,891</u>	<u>604,329</u>
As of June 30, 2013					
Cost	40,487	185,057	805,937	12,891	1,044,372
Accumulated depreciation and impairment	-	(62,847)	(377,196)	-	(440,043)
Net book value as of June 30, 2013	<u>40,487</u>	<u>122,210</u>	<u>428,741</u>	<u>12,891</u>	<u>604,329</u>

During the 25-week period ended June 24, 2012, as a result of the decision to cease production of parent rolls for sale in the New Westminster plant, certain production assets and the timber lands became redundant and, accordingly, a charge of \$5.9 million was recorded to write down the assets to their estimated fair value. During the 26-week period ended June 30, 2013, an adjustment was recorded related to the estimated fair value of the timber lands resulting in the reversal of the impairment charge of \$1.8 million.

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Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

5 Pensions and post-retirement benefits

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

	Pensions		Other benefit plans	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
	%	%	%	%
Assumptions				
Discount rate	4.50	4.25	4.50	4.25
Rate of compensation increases	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00

IAS 19 requires the annual expense for the funded benefit plan to include net interest expense, calculated by applying the discount rate to the net defined benefit liability. This replaces the finance charge and expected return on plan assets. The Partnership adopted this amendment retrospectively (refer to note 3).

The net benefit pension plan expense included the following components:

	Pensions		Other benefit plans	
	13-week period ended June 30, 2013	13-week period ended June 24, 2012	13-week period ended June 30, 2013	13-week period ended June 24, 2012
	\$	\$	\$	\$
Net benefit plan expense				
Current service cost	2,108	2,186	348	407
Interest costs	5,947	6,361	516	619
Expected return on plan assets	(4,365)	(5,229)	-	-
	<u>3,690</u>	<u>3,318</u>	<u>864</u>	<u>1,026</u>

	Pensions		Other benefit plans	
	26-week period ended June 30, 2013	25-week period ended June 24, 2012	26-week period ended June 30, 2013	25-week period ended June 24, 2012
	\$	\$	\$	\$
Net benefit plan expense				
Current service cost	4,591	4,140	697	736
Interest costs	12,002	12,722	1,031	1,173
Expected return on plan assets	(8,771)	(10,072)	-	-
Gain on curtailment	(124)	-	-	-
	<u>7,698</u>	<u>6,790</u>	<u>1,728</u>	<u>1,909</u>

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

A restructuring of the Partnership's activities at the New Westminster plant during the 25-week period ended June 24, 2012 resulted in the permanent lay-off of 95 active members, resulting in a curtailment gain of \$0.1 million during the 26-week period ended June 30, 2013.

6 Provisions

	Environmental and asset retirement obligations	Long-term incentives	Restructuring	Total
	\$	\$	\$	\$
	(a)	(b)	(c)	
Provisions as of December 31, 2012	4,874	1,118	3,233	9,225
Current	-	486	3,233	3,719
Non-current	4,874	632	-	5,506
Provisions as of December 31, 2012	4,874	1,118	3,233	9,225
Additional provisions	558	485	-	1,043
Paid during the period	-	(41)	(1,761)	(1,802)
Interest accretion	120	-	-	120
Provisions as of June 30, 2013	5,552	1,562	1,472	8,586
Current	-	519	1,472	1,991
Non-current	5,552	1,043	-	6,595

a) Environmental and asset retirement obligations

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

Management has retained third parties to assist with updating the estimate of the environmental remediation and asset retirement obligations. Based on the updated information obtained from a third party, an additional provision of \$0.6 million was recorded during the 26-week period ended June 30, 2013. Management expects further updates to the third party reports. The provision at the reporting date represents the Partnership's best estimate of the present value of the environmental and asset retirement obligation.

b) Long-term incentives

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

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For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

c) Restructuring

On March 7, 2012, the Partnership announced its intention to cease production of parent rolls for sale at its New Westminster plant. This portion of the plant was closed on August 31, 2012 and it was expected that the Partnership would incur costs of approximately \$6.6 million to close the related facilities. As a result of closing a portion of the plant, certain production assets and timber lands with a carrying value of \$5.9 million were written down to their estimated fair value of nil (note 4). In addition, there were other restructuring costs of approximately \$2.0 million at other locations.

The restructuring charges at the New Westminster plant and other locations resulted in an increase in provisions of approximately \$8.6 million during fiscal 2012. The provisions are based on management's best estimate of the severance and other costs to be incurred and are subject to change based on finalization of the severance packages and the employee's acceptance.

7 Long-term debt

	<u>Maturity</u>	<u>June 30, 2013</u> \$	<u>December 31, 2012</u> \$
Revolving credit facilities ^(b)	2016	-	76
8% Senior unsecured notes	2019	171,630	171,288
2.87% Nordea facility ^(a)	2020	43,682	39,879
Loan payable	2017	3,836	3,923
Caisse facility	2018	122,296	112,521
		<u>341,444</u>	<u>327,687</u>
Less: Current portion of long-term debt		<u>7,960</u>	<u>3,802</u>
		<u>333,484</u>	<u>323,885</u>

The terms and conditions of the debt facilities are disclosed in the annual consolidated financial statements of KPLP for the year ended December 31, 2012.

a) Nordea credit facilities

An additional draw of U.S.\$4.5 million was made during the 26-week period ended June 30, 2013.

b) Revolving credit facilities

On May 16, 2013, the Partnership entered into the fourth amended and restated credit agreement (the "Credit Agreement") related to its revolving credit facilities. The Credit Facility was reduced to CDN\$125.0 million. The borrowings under the Credit Facility will bear interest at a base rate of Prime Rate, U.S. Base Rate and Libor, plus a margin varying between 0.20% and 2.50% depending on the Partnership's rate of funded debt to EBITDA and the type of advance. The amended Credit Agreement is for a three year period and will mature July 22, 2016. The Credit Agreement provides for certain restrictive undertakings and covenants to be complied with by the Partnership. The transaction costs of \$0.5 million have been deferred and classified as other long-term assets during the 26-week period ended June 30, 2013.

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

8 Partnership units

On January 10, 2013, the Partnership issued 750,000 additional partnership units at a price of \$17.50 per unit to KP Tissue Inc. (KPT) in connection with the partial exercise of the over-allotment option. Costs incurred of \$0.9 million in respect of the issuance were netted against the gross proceeds of \$13.1 million.

On April 15, 2013, the Partnership paid a distribution of \$11.2 million. Pursuant to the Distribution Reinvestment Plan ("DRIP"), a portion of the distribution was reinvested by the partners and the Partnership issued 275,035 additional partnership units at a price of \$18.58 for the gross proceeds of \$5.1 million.

On May 14, 2013, the Partnership declared a quarterly distribution of \$9.4 million, payable on July 15, 2013.

Subsequent to June 30, 2013, the Partnership declared a distribution of \$9.4 million.

9 Income taxes

The Partnership is not a tax paying entity for the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012. The income (loss) from the Partnership flows to the partners, KP2010LP, KPGP, and KPT. However, the Partnership's subsidiaries KP USA, KTG, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L. are corporate entities and, therefore, are subject to tax.

Income tax expense (recovery) was recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. The estimated weighted average annual income tax rate for the 26-week period ended June 30, 2013 was (44.4)% (25-week period ended June 24, 2012 - 2.6%). The tax recovery recorded in the 26-week period ended June 30, 2013 includes a benefit of \$3.3 million of an investment tax credit.

The components of income taxes are as follows:

	13-week period ended June 30, 2013	13-week period ended June 24, 2012	26-week period ended June 30, 2013	25-week period ended June 24, 2012
	\$	\$	\$	\$
Current tax expense	372	304	829	467
Deferred tax credit	(3,857)	(35)	(9,167)	(35)
	<u>(3,485)</u>	<u>269</u>	<u>(8,338)</u>	<u>432</u>

10 Related party transactions

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

Sales of goods and services to Kruger Inc. for the 26-week period ended June 30, 2013 were \$2.7 million (25-week period ended June 24, 2012 - \$1.8 million). Sales of goods to subsidiaries of Kruger Inc. for the 26-week period ended June 30, 2013 were \$0.5 million (25-week period ended June 24, 2012 - nil). Goods are sold based on the price lists in force and terms that would be available to third parties. Services are delivered at the terms outlined in the agreements between the related parties.

Purchases of goods and services from Kruger Inc. for the 26-week period ended June 30, 2013 were \$32.5 million (25-week period ended June 24, 2012 - \$28.2 million). Purchases of goods and services from subsidiaries of Kruger Inc.

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

for the 26-week period ended June 30, 2013 were \$4.3 million (25-week period ended June 24, 2012 - \$7.7 million). Goods are purchased from Kruger Inc. and related parties under normal commercial terms and conditions. These purchases of goods and services are included within cost of products sold in the condensed consolidated statements of comprehensive income (loss). During the 26-week period ended June 30, 2013, management fees of \$2.0 million (25-week period ended June 24, 2012 - \$4.7 million) were paid to Kruger Inc. for management services provided to the Partnership.

Balances due to and from related parties are as follows:

	June 30, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Receivables from Kruger Inc.	1,701	458
Receivables from subsidiaries of Kruger Inc.	<u>209</u>	<u>210</u>
	<u>1,910</u>	<u>668</u>
Payables to Kruger Inc.	2,932	9,053
Payables to subsidiaries of Kruger Inc.	<u>3</u>	<u>4</u>
	<u>2,935</u>	<u>9,057</u>

The receivables from and payables to related parties are due two months after the date of sale or purchase. The receivables and payables are unsecured in nature and bear no interest. No provisions are held against receivables from related parties. There are no loans outstanding with related parties as of June 30, 2013.

The Partnership declared distributions to its related parties:

	June 30, 2013
	<u>\$</u>
Distribution payable to KP2010LP	7,787
Distribution payable to KPGP	1
Distribution payable to KPT	<u>1,579</u>
Total distribution payable	<u>9,367</u>

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

11 Segment information

Reportable segments

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

a) Consumer

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

b) AFH

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

c) Other

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

Segment operating profit is reviewed by the Chief Executive Officer, who has been identified as the chief operating decision maker based on earnings before interest, income taxes, depreciation, amortization, impairment of non-financial assets, restructuring costs, gains or losses on sales of fixed assets and unrealized foreign exchange gains or losses. The Partnership's assets, operations and employees are located primarily in Canada and the United States. The same long-term assets of the Partnership are used for the Consumer, AFH and Other segments. Accordingly, assets cannot be allocated to these segments.

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

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

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

	13-week period ended June 24, 2012			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	182,832	41,132	7,372	231,336
Segment operating profit (loss)	29,968	3,167	(3,759)	29,376
Depreciation and amortization				5,792
Interest expense				7,087
Loss on disposal of property, plant and equipment				70
Restructuring cost recovery				(500)
Unrealized foreign exchange loss				1,026
Income before income taxes				15,901
Income taxes				269
Net income for the period				15,632

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

	25-week period ended June 24, 2012			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	359,207	74,479	13,896	447,582
Segment operating profit (loss)	58,025	5,079	(6,543)	56,561
Depreciation and amortization				11,932
Interest expense				13,175
Impairment of non-financial assets				5,900
Restructuring costs				8,600
Loss on disposal of property, plant and equipment				70
Unrealized foreign exchange loss				461
Income before income taxes				16,423
Income taxes				432
Net income for the period				15,991

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

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

Geographic segments

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

	13-week period ended June 30, 2013	13-week period ended June 24, 2012	26-week period ended June 30, 2013	25-week period ended June 24, 2012
Revenue	\$	\$	\$	\$
Canada	183,087	165,454	340,649	320,368
US	56,331	58,715	113,465	113,210
Mexico	7,351	7,167	14,440	14,004
	<u>246,769</u>	<u>231,336</u>	<u>468,554</u>	<u>447,582</u>
	June 30, 2013			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	293,217	311,112	-	604,329
Goodwill	152,021	-	-	152,021
Intangible assets	13,643	-	-	13,643
	December 31, 2012			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	294,022	286,792	-	580,814
Goodwill	152,021	-	-	152,021
Intangible assets	13,828	-	-	13,828

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

12 Financial instruments

Classification of financial instruments

Financial instruments are classified into one of the following categories: fair value through profit and loss, loans and receivables and financial liabilities. As of June 30, 2013, the classification of the financial instruments, as well as their carrying amounts and fair values, were as follows:

	Classification	Measurement	Carrying amount	Fair Value
			\$	\$
Cash and cash equivalents	loans and receivables	amortized cost	78,364	78,364
Trade and other receivables	loans and receivables	amortized cost	94,584	94,584
Receivables from related parties	loans and receivables	amortized cost	1,910	1,910
Embedded derivative	fair value through profit or loss	fair value	1,911	1,911
Trade and other payables	financial liabilities	amortized cost	(166,596)	(166,596)
Payables to related parties	financial liabilities	amortized cost	(2,935)	(2,935)
Distribution payable	financial liabilities	amortized cost	(9,367)	(9,367)
Long-term debt	financial liabilities	amortized cost	(341,444)	(363,109)
Partnership unit liability	financial liabilities	amortized cost	(118,562)	(118,562)

The following table details the fair value hierarchy of financial instruments carried at fair value by level as of June 30, 2013:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Embedded derivative	-	1,911	-	1,911

As of December 31, 2012, the classification of the financial instruments, as well as their carrying amounts and fair values, were as follows:

	Classification	Measurement	Carrying amount	Fair Value
			\$	\$
Cash and cash equivalents	loans and receivables	amortized cost	121,489	121,489
Trade and other receivables	loans and receivables	amortized cost	94,308	94,308
Receivables from related parties	loans and receivables	amortized cost	668	668
Embedded derivative	fair value through profit or loss	fair value	1,728	1,728
Commodity swap	fair value through profit or loss	fair value	(44)	(44)
Trade and other payables	financial liabilities	amortized cost	(186,265)	(186,265)
Payables to related parties	financial liabilities	amortized cost	(9,057)	(9,057)
Long-term debt	financial liabilities	amortized cost	(327,687)	(356,008)
Partnership unit liability	financial liabilities	amortized cost	(118,562)	(118,562)

Kruger Products L.P.

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For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

The following table details the fair value hierarchy of financial instruments carried at fair value by level as of December 31, 2012:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Commodity swap	-	(44)	-	(44)
Embedded derivative	-	1,728	-	1,728

Fair value

Cash and cash equivalents, trade and other receivables, receivables from related parties, trade and other payables and payables to related parties and distribution payable are short-term financial instruments whose fair value approximates the carrying amount, given they will mature in the near future. The various components of long-term debt are measured separately for fair value purposes. As of June 30, 2013, the fair value of the revolving credit facilities was nil (December 31, 2012 - \$0.1 million), which was based on the current principal amount outstanding as the interest rate floats. As of June 30, 2013, the fair value of the senior notes was \$189.0 million (December 31, 2012 - \$189.0 million) based on the trading value of the debt on the over-the-counter market. The fair values of the Nordea Facility and the Caisse Facility were \$45.2 million and \$125.1 million (December 31, 2012 - \$41.5 million and \$121.5 million), respectively, which approximates the current principal amount outstanding as the interest rate approximates current market interest rates. As of June 30, 2013, the fair value of the loans payable was \$3.8 million (December 31, 2012 - \$3.9 million).

The commodity swap does not trade and the price of an identifiable instrument cannot be observed. The fair value of the commodity swap was estimated using a model with the main inputs being the future prices of pulp and the discount rate.

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

Fair value of the Partnership units liability

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

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Notes to Unaudited Condensed Consolidated Financial Statements

For the 26-week period ended June 30, 2013 and 25-week period ended June 24, 2012

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

13 Consolidated statements of cash flows

Non-cash working capital

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

	June 30, 2013	June 24, 2012
	<u>\$</u>	<u>\$</u>
Decrease (increase) in trade receivables	1,751	(13,004)
Decrease (increase) in receivables from related parties	(1,242)	750
Decrease (increase) in inventories	(18,784)	16,244
Increase in prepaid expenses	(4,014)	(3,147)
Increase in other assets	(1,300)	(1,759)
Decrease in income tax recoverable	74	-
Decrease in trade and other payables	(15,657)	(1,304)
Decrease in payables to related parties	(5,044)	(3,719)
	<u>(44,216)</u>	<u>(5,939)</u>

As of June 30, 2013, purchases of property, plant and equipment of \$6.2 million (June 24, 2012 - \$22.6 million) were not paid.