



KRUGER PRODUCTS L.P.

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2013 AND DECEMBER 31, 2012

March 18, 2014

Independent Auditor's Report

To the Shareholders of Kruger Products L.P.

We have audited the accompanying consolidated financial statements of Kruger Products L.P. and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2013 and December 31, 2012 and the consolidated statements of comprehensive income (loss), changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Kruger Products L.P. and its subsidiaries as at December 31, 2013 and December 31, 2012 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Ontario

Kruger Products L.P.

Consolidated Statements of Financial Position

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

	December 31, 2013	December 31, 2012
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	87,674	121,489
Trade and other receivables (note 5)	94,789	94,308
Receivables from related parties (note 15)	1,429	668
Inventories (note 6)	151,505	116,873
Current portion of income tax recoverable (note 14)	630	-
Prepaid expenses	4,777	4,413
	<u>340,804</u>	<u>337,751</u>
Non-current assets		
Property, plant & equipment (note 7)	616,687	580,814
Other long-term assets (note 12)	10,268	6,236
Income tax recoverable (note 14)	14,132	3,443
Goodwill (note 8)	152,021	152,021
Intangible assets (note 8)	13,483	13,828
Deferred income taxes (note 14)	14,141	1,178
	<u>1,161,536</u>	<u>1,095,271</u>
Liabilities		
Current liabilities		
Trade and other payables (note 10)	188,470	186,309
Payables to related parties (note 15)	5,134	9,057
Distributions payable (notes 13 and 15)	9,455	-
Current portion of income tax payable (note 14)	-	571
Current portion of provisions (note 11)	999	3,719
Current portion of long-term debt (note 12)	8,276	3,802
	<u>212,334</u>	<u>203,458</u>
Non-current liabilities		
Long-term debt (note 12)	342,013	323,885
Other long-term liabilities	323	544
Provisions (note 11)	6,615	5,506
Pensions (note 9)	80,380	148,989
Post-retirement benefits (note 9)	48,746	48,302
	<u>690,411</u>	<u>730,684</u>
Liabilities to non-unitholders		
Current portion of Partnership units liability (note 13)	3,475	-
Long-term portion of Partnership units liability (note 13)	114,364	118,562
Total Partnership units liability	<u>117,839</u>	<u>118,562</u>
Total liabilities	<u>808,250</u>	<u>849,246</u>
Equity		
Partnership units (note 13)	282,672	257,516
Retained earnings (deficit)	50,945	(14,736)
Accumulated other comprehensive income	19,669	3,245
Total equity	<u>353,286</u>	<u>246,025</u>
Total equity and liabilities	<u>1,161,536</u>	<u>1,095,271</u>
Reorganization (note 1)		
Commitments and contingencies (note 16)		
Subsequent events (notes 9 and 13)		

Approved by the Board of Directors

/s/ David Spraley
Director

/s/ Huw Thomas
Director

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

Kruger Products L.P.

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2013 and December 31, 2012

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

	2013	2012
	\$	\$
Revenue (notes 15 and 23)	955,346	922,874
Expenses		
Cost of sales (notes 15 and 17)	675,730	646,089
Operating expenses (notes 15 and 17)	199,794	194,987
Impairment (recovery) of non-financial assets (note 7)	(1,789)	4,608
Restructuring costs (note 11)	1,372	9,391
Operating income	<u>80,239</u>	<u>67,799</u>
Interest expense (note 12)	<u>42,251</u>	<u>27,829</u>
Income before income taxes	37,988	39,970
Income taxes (note 14)	<u>(10,940)</u>	<u>(1,428)</u>
Net income for the year	<u>48,928</u>	<u>41,398</u>
Other comprehensive income (loss)		
Items that will not be reclassified to net income:		
Remeasurement of pensions	55,619	(39,342)
Remeasurement of post-retirement benefits	599	(102)
Items that may be subsequently reclassified to net income:		
Available-for-sale investment	69	-
Cumulative translation adjustment	<u>16,355</u>	<u>(3,969)</u>
Total other comprehensive income (loss) for the year	<u>72,642</u>	<u>(43,413)</u>
Comprehensive income (loss) for the year	<u><u>121,570</u></u>	<u><u>(2,015)</u></u>

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

Kruger Products L.P.

Consolidated Statements of Changes in Equity

For the years ended December 31, 2013 and December 31, 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	-	-	(2,209)	2,000	-	(209)
Distributions paid	-	-	-	(40,000)	-	(40,000)
Change in actuarial losses on pension	-	-	(52,512)	13,170	-	(39,342)
Change in actuarial losses on post retirement benefits	-	-	(4,795)	4,693	-	(102)
Cumulative translation adjustment	-	-	-	-	(3,969)	(3,969)
Net income for the year	-	-	35,997	5,401	-	41,398
Reorganization of Partnership (note 1)	43,014,300	247,188	(255,690)	-	8,502	-
Issuance of partnership units (note 13)	8,000,000	128,890	-	-	-	128,890
Partnership units liability (note 13)	-	(118,562)	-	-	-	(118,562)
As of December 31, 2012	51,014,300	257,516	-	(14,736)	3,245	246,025
As of January 1, 2013	51,014,300	257,516	-	(14,736)	3,245	246,025
Distributions payable (note 13)	-	-	-	(9,455)	-	(9,455)
Distributions paid (note 13)	-	-	-	(30,010)	-	(30,010)
Change in actuarial gains on pension	-	-	-	55,619	-	55,619
Change in actuarial gains on post retirement benefits	-	-	-	599	-	599
Change in available-for-sale investment	-	-	-	-	69	69
Cumulative translation adjustment	-	-	-	-	16,355	16,355
Net income for the year	-	-	-	48,928	-	48,928
Issuance of partnership units (note 13)	1,513,250	25,156	-	-	-	25,156
As of December 31, 2013	52,527,550	282,672	-	50,945	19,669	353,286

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

Kruger Products L.P.

Consolidated Statements of Cash Flows

For the years ended December 31, 2013 and December 31, 2012

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

	2013 \$	2012 \$
Cash flows from operating activities		
Net income for the year	48,928	41,398
Items not affecting cash		
Depreciation	33,561	28,331
Amortization	581	530
Loss (gain) on sale of fixed assets	(5)	1,060
Change in amortized cost of Partnership units liability (note 13)	(723)	-
Unrealized foreign exchange (gain) loss	2,992	(777)
Interest expense	42,251	27,829
Pension and post retirement benefits	9,959	9,393
Provisions (note 11)	800	9,613
Income taxes	(10,940)	(1,428)
Impairment (recovery) of non-financial assets (note 7)	(1,789)	4,608
Total items not affecting cash	76,687	79,159
Net change in non-cash working capital (note 24)	(34,271)	39,906
Contributions to pension and post-retirement benefit plans	(30,369)	(29,707)
Provisions paid	(2,841)	(7,245)
Income tax payments	(2,675)	(360)
Net cash from operating activities	55,459	123,151
Cash flows used in investing activities		
Purchase of property, plant & equipment	(20,265)	(17,652)
Purchases of through-air-dried (TAD) expansion	(39,631)	(161,155)
Interest paid on credit facilities related to TAD	-	(6,125)
Available-for-sale investment	(836)	-
Government grants received	1,078	-
Purchases of software	(236)	(51)
Proceeds on sale of property, plant and equipment	5	199
Net cash used in investing activities	(59,885)	(184,784)
Cash flows from (used in) financing activities		
Proceeds from credit facilities	10,813	145,957
Repayment of credit facilities	(7,999)	(65,000)
Payment of deferred financing fees	(641)	(26)
Transfer of assets to related parties	-	(209)
Interest paid on credit facilities	(27,676)	(17,720)
Settlement of interest rate swap	-	(413)
Distributions paid	(30,010)	(40,000)
Equity issuance costs	(1,206)	(11,110)
Proceeds from issuing partnership units	26,362	140,000
Net cash from (used in) financing activities	(30,357)	151,479
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	968	(154)
Increase (decrease) in cash and cash equivalents during the year	(33,815)	89,692
Cash and cash equivalents - Beginning of year	121,489	31,797
Cash and cash equivalents - End of year	87,674	121,489

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 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 whose partners are Kruger Inc., KPGP Inc. and KP Tissue Inc. 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 were 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 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 consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and with interpretations of the International Financial Reporting Committee which the Canadian Accounting Standards Board has approved for incorporation into Part 1 of the CPA Canada Handbook - Accounting. These consolidated financial statements were approved by the board of directors of KPGP Inc. on March 18, 2013.

3 Summary of significant accounting policies

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

(a) *Basis of measurement*

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

(b) Consolidation

Subsidiaries are all those entities over which the Partnership has the power over the investee, is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect these returns through its power over the investee. Subsidiaries are fully consolidated from the date on which control is transferred to the Partnership and de-consolidated from the date that control ceases. Intercompany transactions, balances and unrealized gains/losses on transactions between group companies are eliminated on consolidation.

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

(c) Segment reporting

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

(d) Foreign currency translation

(i) Functional and presentation currency

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

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

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the rate of exchange in effect at the dates of the transactions. Foreign exchange gains and losses arising from translating monetary foreign currency balances are included in operating expenses.

(e) Cash and cash equivalents

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

(f) *Trade receivables*

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

(g) *Inventories*

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

(h) *Borrowing costs*

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

(i) *Property, plant and equipment*

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

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

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

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

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

(j) *Goodwill*

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

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

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

(k) *Intangible assets*

(i) Trademarks

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

(ii) Software and licences

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

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

(l) *Impairment of non-financial assets*

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

(m) *Related party transactions*

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

(n) Leases

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

(o) Provisions

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

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

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

(p) Government grants and investment tax credits

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

(q) Revenue recognition

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

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

(r) Cost of sales and operating expenses

Cost of sales includes cost of finished goods sold and inventory write-downs. Freight, warehousing and handling, selling, and general and administrative expenses are included in operating expenses.

(s) Pensions and post-retirement benefits

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

- The costs of pensions under defined benefit plans and post-retirement benefits are actuarially determined using the projected unit credit method and management's best estimate of expected plan investment performance for

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

funded plans, salary escalation, retirement ages of employees and expected health-care costs. Actuarial valuations for defined benefit plans and post-retirement benefits are completed annually. The discount rate applied in arriving at the present value of the pension liability represents the yield on high quality corporate bonds denominated in the currency in which the benefits are to be paid and having terms to maturity approximating the terms of the related pension liability.

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

(t) *Income taxes*

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

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

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

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

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

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

(u) *Financial instruments*

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

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

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

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

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

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

which are classified as non-current.

- (iii) *Loans and receivables*: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables include cash and cash equivalents, receivables from related parties and trade and other receivables. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment. Loans and receivables are classified as current, except for the portion expected to be realized beyond 12 months of the dates of the consolidated statements of financial position, which are classified as non-current.
- (iv) *Financial liabilities at amortized cost*: Financial liabilities at amortized cost include trade and other payables, payables to related parties, long-term debt and the Partnership units liability. Payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade and other payables are measured at amortized cost using the effective interest method. Long-term debt is recognized initially at fair value, net of any transaction costs incurred and subsequently at amortized cost using the effective interest method. The Partnership units liability is recognized initially at fair value and subsequently at amortized cost. Amortized cost is estimated based on the expected tax distributions to be paid as required by the partnership agreement using a discount rate that reflects current market assessments of the time value of money and the rates specific to the obligation, and a terminal value as the obligation will continue indefinitely.

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

(v) *Fair value hierarchy*

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

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

(w) *Interest rate swap*

From time to time, the Partnership uses interest rate swap contracts to manage part of its exposure to movements in interest rates on its long-term debt. The interest rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based and are recorded as an adjustment to interest expense on the loan. The related amounts payable to or receivables from counterparties are included as an adjustment to accrued interest and are settled on a net basis. Interest to be paid or received under such a swap contract is recognized over the life of the contract as an adjustment to interest expense. Interest rate swap contracts are recorded at fair value at each reporting period with the change in fair value recognized in interest expense. The net position at the end of each reporting period is recorded in other long-term assets or other long-term liabilities in the consolidated statements of financial position. There are no interest rate swap contracts outstanding as of December 31, 2013 and December 31, 2012.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

(x) *Embedded derivatives*

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

(y) *Accounting standards implemented for the year ended December 31, 2013*

- (i) IFRS 7, Financial Instruments - Disclosures, has been amended to include additional disclosure requirements in the reporting of offsetting of financial instruments. The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement.

The amendments have been applied retrospectively. As the Partnership does not have any offsetting arrangements in place as of December 31, 2013 and December 31, 2012, the application of the amendments has had no material impact on the disclosures or on the amounts recognized in the consolidated financial statements.

- (ii) 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. Under previous IFRS, consolidation was required when an entity had the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaced SIC-12, Consolidation - Special Purpose Entities, and parts of IAS 27, Consolidated and Separate Financial Statements. The adoption of this amendment did not have a material impact on the consolidated financial statements.
- (iii) 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 address the nature of, and risks associated with, an entity's interests in other entities. The adoption of this standard did not have a material impact on the consolidated financial statements.
- (iv) 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. Under previous IFRS, guidance on measuring and disclosing fair value was dispersed among the specific standards requiring fair value measurements and did not always reflect a clear measurement basis or consistent disclosures. The adoption of this standard did not have a material impact on the consolidated financial statements.
- (v) IAS 1, Presentation of Financial Statements, has been amended to require entities to separate items presented in other comprehensive income (OCI) into two groups, based on whether or not items may be recycled in the future. Entities that choose to present OCI items before tax are required to show the amount of tax related to the two groups separately. The amendments have been applied retrospectively, and hence the presentation of items of OCI has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.
- (vi) IAS 19, Employee Benefits, has been amended to make significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to enhance the disclosure of

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

all employee benefits. A number of other amendments have been made to recognition, measurement and classification including redefining short-term and other long-term benefits, guidance on the treatment of taxes related to benefit plans, guidance on risk/cost sharing features and expanded disclosures. The Partnership has recorded the interest portion of the defined benefit costs and the post-retirement benefit costs as interest expense.

IAS 19 (Amended in 2011), Employee Benefits, amends certain accounting requirements for defined benefit plans and termination benefits. IAS 19 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 amendments did not have an impact on the opening consolidated statement of financial position as of January 1, 2012 and accordingly the opening consolidated statement of financial position has not been presented. 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>2012</u>
Net income before accounting change	46,552
Increase in:	
Cost of sales	(263)
Operating expenses	(89)
Interest expense	(4,802)
Decrease in net income	(5,154)
Net income after accounting change	<u>41,398</u>

	<u>2012</u>
Comprehensive loss before accounting change	(2,015)
Decrease in net income	(5,154)
Decrease in other comprehensive loss for remeasurements of pensions	5,154
Change to comprehensive loss	-
Comprehensive loss after accounting change	<u>(2,015)</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2014, except as noted below, with earlier application permitted. The Partnership continues to assess the impact of these standards and amendments and has not yet determined whether it will early adopt them.

- (i) IFRS 9, Financial Instruments, was issued in November 2009 and addresses the classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, Financial Instruments - Recognition and Measurement, for debt instruments with a new mixed measurement model having only two categories: amortized cost; and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely. Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

IFRS 9 was amended in November 2013 to (i) include guidance on hedge accounting, (ii) allow entities to early adopt the requirement to recognize changes in fair value attributable to changes in an entity's own credit risk from financial liabilities designated under the fair value option in other comprehensive income without having to adopt the remainder of IFRS 9, and (iii) remove the previous mandatory effective date of January 1, 2015, although the standard is available for early adoption.

- (ii) Amendments to IAS 32, Offsetting Financial Assets and Financial Liabilities, prescribe rules for the offsetting of financial assets and financial liabilities. It specifies that a financial asset and a financial liability should be offset and the net amount reported when, and only when an entity has a legally enforceable right to set off the amounts, and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. The amendments require clarification on four main areas: the meaning of 'currently has a legally enforceable right of set-off', the application of simultaneous realization and settlement, the offsetting of collateral amounts, and the unit of account for applying the offsetting requirements. The amendment is effective for annual periods beginning on or after January 1, 2014.
- (iii) IAS 39, Financial Instruments – Recognition and Measurement, has been amended to provide relief from discontinuing hedge accounting when novation of a hedging instrument to a central counterparty meets specified criteria.
- (iv) IAS 36, Impairment of Assets, has been amended to remove the requirement to disclose the recoverable amount when a cash generating unit (CGU) contains goodwill or indefinite lived intangible assets but there has been no impairment; to require disclosure of the recoverable amount of an asset or CGU when an impairment loss has been recognized or reversed; and to require detailed disclosure of how the fair value less costs of disposal has been measured when an impairment loss has been recognized or reversed.
- (v) 2012 annual improvements - improvements and amendments to the following existing standards, basis of conclusions and guidance, effective for years beginning on or after January 1, 2014:
- IFRS 2, Share-based payment, amends the definitions of 'vesting condition' and 'market condition' and adds definitions for 'performance condition' and 'service condition' (which were previously part of the definition of 'vesting condition').

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

- IFRS 3, Business Combinations (with consequential amendments to other standards), clarifies that contingent consideration that is classified as an asset or a liability shall be measured at fair value at each reporting date.

4 Critical accounting estimates and judgments

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

Environmental and asset retirement obligations

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

Pensions and post-retirement benefit obligations

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

On February 13, 2014, the Canadian Institute of Actuaries (CIA) released their final report on Canadian Pensioner Mortality. These tables have changed from the draft tables issued by the CIA in July 2013, which were the tables used for the estimate of the pension obligation as of December 31, 2013. Management has not yet assessed the impact of the revised mortality tables on the Partnership's pension obligation. Such impact could be significant.

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in note 9.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

Partnership units

On December 13, 2012, in connection with the issuance of Partnership units to KP Tissue Inc. (KPT), the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. KPLP has determined that it is appropriate to reclassify a portion of its equity as a liability as required under IFRS as the obligation meets the definition of a financial liability for accounting purposes. Accordingly, \$118.6 million of equity has been reclassified as a liability in respect of this obligation as of December 31, 2012. The reassessment performed as of December 31, 2013 resulted in a decrease in the liability to \$117.8 million. The change in carrying value of \$0.7 million has been included in operating expenses. This reflects KPLP's estimate of the net present value of the financial liability arising from the obligation to make the Tax Distribution using estimates of tax payable by KPT and a discount rate and terminal growth rate of 11.50% and 0% (December 31, 2012 – 10.60% and 0%), respectively. Projections of tax payable are based on additional assumptions including estimates of taxable income and tax rates. Taxable income can differ significantly from accounting income as a result of both timing and permanent tax differences based on enacted tax legislation and therefore changes in the partnership unit obligation are not necessarily indicative of a change in the expected future profitability of KPLP.

TAD expansion

The capitalized cost of TAD expansion includes soft costs, which include interest expense, engineering costs and legal fees. The Partnership retained a third party to assist with the allocation of the costs between buildings and equipment. The third party report resulted in the reallocation of costs between buildings and equipment of \$22.0 million. The reallocation resulted in additional depreciation of \$0.4 million recorded in the fourth quarter of 2013.

Income taxes

The Partnership computes its income taxes in each jurisdiction in which its subsidiaries operate. Estimation of income taxes includes evaluating the recoverability of the deferred tax assets and the income taxes recoverable based on an assessment of the ability to use the underlying tax deductions and credits against future taxable income. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period.

5 Trade and other receivables

	December 31, 2013	December 31, 2012
	\$	\$
Trade receivables	90,782	90,374
Other receivables	4,345	3,785
Employee loans	15	261
Less: Allowance for doubtful accounts	(353)	(112)
Trade and other receivables	<u>94,789</u>	<u>94,308</u>

6 Inventories

	December 31, 2013	December 31, 2012
	\$	\$
Finished products	74,476	52,452
Work-in-process	27,881	21,494
Raw materials and supplies	24,872	20,503
Spare parts	24,276	22,424
	<u>151,505</u>	<u>116,873</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

Total inventories recognized as cost of sales during the year ended December 31, 2013 were \$675.7 million (December 31, 2012 - \$646.1 million). The Partnership wrote-off inventories during the year ended December 31, 2013 totalling \$0.1 million (December 31, 2012 - \$0.8 million), primarily related to obsolete packaging. Inventory provisions as of December 31, 2013 were \$4.9 million (December 31, 2012 - \$4.7 million).

7 Property, plant and equipment

	Land \$	Buildings \$	Machinery and equipment \$	Assets under construction or development \$	Total \$
As of January 1, 2012					
Cost	40,366	112,400	581,091	113,276	847,133
Accumulated depreciation and impairments	-	(57,009)	(365,930)	-	(422,939)
Net book value as of January 1, 2012	40,366	55,391	215,161	113,276	424,194
Additions	-	-	-	189,875	189,875
Capitalized interest	-	-	-	7,642	7,642
Transfers	83	21,120	80,714	(101,917)	-
Government grants and investment tax credits	-	-	(3,244)	(1,990)	(5,234)
Disposals	-	(372)	(887)	-	(1,259)
Depreciation	-	(4,008)	(21,836)	-	(25,844)
Impairments	(1,789)	-	(2,819)	-	(4,608)
Exchange differences	(23)	29	(428)	(3,530)	(3,952)
As of December 31, 2012	38,637	72,160	266,661	203,356	580,814
As of December 31, 2012					
Cost	40,426	132,448	634,410	203,356	1,010,640
Accumulated depreciation and impairment	(1,789)	(60,288)	(367,749)	-	(429,826)
Net book value as of December 31, 2012	38,637	72,160	266,661	203,356	580,814
Additions	-	1	4	59,509	59,514
Capitalized interest	-	-	-	507	507
Government grants and investment tax credits	-	-	(12,382)	-	(12,382)
Transfers	63	30,742	226,560	(257,365)	-
Depreciation	-	(4,352)	(30,086)	-	(34,438)
Recovery	1,789	-	-	-	1,789
Exchange differences	75	3,250	11,358	6,200	20,883
As of December 31, 2013	40,564	101,801	462,115	12,207	616,687
As of December 31, 2013					
Cost	40,564	166,719	854,566	12,207	1,074,056
Accumulated depreciation and impairment	-	(64,918)	(392,451)	-	(457,369)
Net book value as of December 31, 2013	40,564	101,801	462,115	12,207	616,687

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

As a result of the decision to cease production of parent rolls for sale, certain production assets and the timber lands became redundant and, accordingly, were written down to their estimated fair value of \$1.2 million. An impairment charge of \$4.6 million was recorded during the year ended December 31, 2012. During the year ended December 31, 2013, an adjustment was recorded related to the estimated fair value of the timber lands resulting in the reversal of a portion of the write-down of \$1.8 million.

During the year ended December 31, 2012, the Partnership revised its estimates of the useful lives of all of its machinery and equipment from 3 to 25 years to 5 to 40 years. The change in estimate resulted in a decrease in annual depreciation expense of \$6.8 million.

8 Goodwill and intangible assets

	Trademarks	Software	Total
	\$	\$	\$
As of January 1, 2012			
Cost	11,825	3,203	15,028
Accumulated amortization	-	(721)	(721)
Net book value			
as of January 1, 2012	11,825	2,482	14,307
Additions	-	51	51
Amortization	-	(530)	(530)
Net book value			
as of December 31, 2012	<u>11,825</u>	<u>2,003</u>	<u>13,828</u>
As of January 1, 2013			
Cost	11,825	3,254	15,079
Accumulated amortization	-	(1,251)	(1,251)
Net book value			
as of January 1, 2013	11,825	2,003	13,828
Additions	-	236	236
Amortization	-	(581)	(581)
Net book value			
as of December 31, 2013	<u>11,825</u>	<u>1,658</u>	<u>13,483</u>
As of December 31, 2013			
Cost	11,825	3,490	15,315
Accumulated amortization	-	(1,832)	(1,832)
Net book value			
as of December 31, 2013	<u>11,825</u>	<u>1,658</u>	<u>13,483</u>

The carrying value of goodwill as of December 31, 2013 was \$152,021 (December 31, 2012 - \$152,021).

Impairment tests

The Partnership performed its annual impairment tests for goodwill and indefinite lived trademarks as of December 31, 2013 and December 31, 2012 and no impairments were recognized.

Goodwill is allocated to Canada (CGU).

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

The recoverable amount of the CGU is determined based on value in use. The estimates of value in use were based on the present value of the forecasted future cash flows expected to be derived from Canada CGU. Based on the sensitivity analysis, no reasonable change in assumptions would result in an impairment.

9 Pensions and post-retirement benefits

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

The Partnership has five registered defined benefit pension plans with a final average salary component, four of which are registered in the province of Quebec and one of which is registered in the province of Ontario. The pension obligation, net of plan assets for these five plans of \$58.9 million as of December 31, 2013 (December 31, 2012 - \$125.5 million) is included in pensions on the consolidated statements of financial position.

The Partnership has a Supplementary Retirement Plan (SRP) for designated employees. The accrued benefit liability, net of plan assets related to the SRP as of December 31, 2013 was \$14.0 million (December 31, 2012 - \$15.9 million) and is supported by irrevocable letters of credit in the amount of \$24.6 million (December 31, 2012 - \$26.8 million).

The Partnership also sponsors a Term Annuity Arrangement for the Western Manufacturing Division, which provides hourly employees with a bridging supplement commencing at age 61 and payable up to but not including age 65. The Term Annuity Arrangement is unfunded and the pension obligation of \$7.5 million as of December 31, 2013 (December 31, 2012 - \$7.6 million) is included in pensions on the consolidated statements of financial position.

The Partnership's hourly employees at the Western Manufacturing Division are members of an industry multi-employer pension plan to which the Partnership contributes monies. During the year ended December 31, 2013, the Partnership contributed and expensed \$2.4 million (December 31, 2012 - \$3.1 million) related to this defined benefit plan. Sufficient information regarding the Partnership's share of the defined benefit obligation is not available and accordingly the Partnership accounts for the multi-employer plan as a defined contribution plan.

On January 1, 2011, a new defined contribution plan was created by the Partnership, which covers substantially all of its salaried employees. During the year ended December 31, 2013, the Partnership recorded \$2.3 million (December 31, 2012 - \$2.3 million) related to this plan.

KTG sponsors a defined contribution plan that covers substantially all of its employees. During the year ended December 31, 2013, the Partnership recorded \$0.6 million (December 31, 2012 - \$0.5 million) related to this plan.

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

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

By their design, the defined benefit pension plans and the post-retirement benefits plan exposes the Partnership to the typical risks faced by such plans such as investment performance (pension plans only), changes to the discount rate used to value the obligations, longevity of plan members and future inflation. Pension and benefit risk is managed by regular monitoring of the plans, applicable regulations and other factors that could impact the expenses and cash flows of the Partnership. As of December 31, 2012, the aggregate solvency deficit of the defined benefit plans was \$176.6 million. The next required revaluation will be completed in the first half of fiscal 2014. The funding obligations are dependent on a number of factors, including the assumptions used in the most recent actuarial valuation. Actual contributions that are determined on the basis of future valuation reports may vary significantly from the predictions.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

The cumulative actuarial losses recognized in retained earnings (deficit) as of December 31, 2013 and December 31, 2012 were as follows:

	December 31, 2013	December 31, 2012
	\$	\$
Pensions	68,586	124,205
Post-retirement benefits	11,509	12,108
Total	<u>80,095</u>	<u>136,313</u>

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

	Pensions		Post-retirement benefit plans	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
	\$	\$	\$	\$
Change in defined benefit obligation:				
As of January 1	568,223	509,903	48,302	46,497
Gain on curtailment	(124)	-	-	-
Current service cost	8,158	7,481	1,395	1,560
Interest costs	23,969	25,351	2,061	2,385
Employee contributions	3,815	3,755	-	-
Benefits paid	(32,430)	(28,234)	(2,413)	(2,242)
Remeasurements:				
Gains from changes in experience	(4,981)	(9,758)	-	(4,160)
Losses/(Gains) from changes in economic assumptions	(23,646)	59,725	(2,099)	4,262
Losses from changes in demographic assumptions	18,150	-	1,500	-
As of December 31	<u>561,134</u>	<u>568,223</u>	<u>48,746</u>	<u>48,302</u>
Change in plan assets at fair value:				
As of January 1	419,234	386,813	-	-
Expected return on plan assets	17,567	19,162	-	-
Remeasurements:				
Gains on plan assets	45,142	10,625	-	-
Administrative costs	(530)	(352)	-	-
Employer contributions	27,956	27,465	2,413	2,242
Employee contributions	3,815	3,755	-	-
Benefits paid	(32,430)	(28,234)	(2,413)	(2,242)
As of December 31	<u>480,754</u>	<u>419,234</u>	<u>-</u>	<u>-</u>
Accrued benefit liability				
Funded status - deficit	<u>80,380</u>	<u>148,989</u>	<u>48,746</u>	<u>48,302</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

	December 31, 2013	December 31, 2012
	%	%
Fixed income	38.0	42.0
Public equities	33.0	29.0
Alternative assets	29.0	29.0
Total	<u>100.0</u>	<u>100.0</u>
Quoted on an active market	70.0	70.0
Unquoted	30.0	30.0
	<u>100.0</u>	<u>100.0</u>

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

	Pensions		Post-retirement benefit plans	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
	%	%	%	%
Assumptions				
Discount rate - accrued benefit obligation	4.60	4.25	4.60	4.25
Rate of compensation increases	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00	3.25 - 4.00

On February 13, 2014, the Canadian Institute of Actuaries (CIA) released their final report on Canadian Pensioner Mortality. These tables have changed from the draft tables issued by the CIA in July 2013, which were the tables used for the estimate of the pension obligation as of December 31, 2013.

IAS 19 requires the annual expense for the funded benefit 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 the amendment retrospectively (refer to note 3).

Post-retirement benefit plans:

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

	December 31, 2013		December 31, 2012	
	1% increase \$	1% decrease \$	1% increase \$	1% decrease \$
Increase (decrease) in:				
current service cost and interest cost for the year	352	(321)	519	(450)
post-retirement benefit obligations	4,112	(3,698)	3,808	(3,421)

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

	December 31, 2013	
	1% increase \$	1% decrease \$
Increase (decrease) in:		
current service cost and interest cost for the year	(508)	639
post-retirement benefit obligations	(5,549)	6,819

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

	December 31, 2013	
	One-year increase \$	One-year decrease \$
Increase (decrease) in:		
current service cost and interest cost for the year	52	(53)
post-retirement benefit obligations	985	(994)

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

Pensions:

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

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

	Discount rate		Rate of compensation		Life expectancy
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012	December 31, 2013
	\$	\$	\$	\$	\$
Increase in pension expense	3,055	2,592	417	480	196
Increase in pension obligation	82,100	86,731	8,890	12,142	11,024

Contributions to the defined benefit pension plans for the year ending December 31, 2014 are expected to be \$29.9 million.

The defined benefit pension plan and post-retirement benefit plan expense for the year ended December 31, 2013 included the following components:

	Defined pension plans		Post-retirement benefit plans	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
	\$	\$	\$	\$
Net plan expense				
Current service cost	8,158	7,481	1,395	1,560
Interest costs	23,969	25,351	2,061	2,385
Expected return on plan assets	(17,567)	(19,162)	-	-
Administrative costs	530	352	-	-
Gain on curtailment	(124)	-	-	-
	<u>14,966</u>	<u>14,022</u>	<u>3,456</u>	<u>3,945</u>

The following amounts are recognized in other comprehensive income (loss):

	Defined pension plans		Post-retirement benefit plans	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
	\$	\$	\$	\$
Gains from changes in experience	4,981	9,758	-	4,160
(Losses)/Gains from changes in economic assumptions	23,646	(59,725)	2,099	(4,262)
Losses from changes in demographic assumptions	(18,150)	-	(1,500)	-
Gains on plan assets	45,142	10,625	-	-
	<u>55,619</u>	<u>(39,342)</u>	<u>599</u>	<u>(102)</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

10 Trade and other payables

	December 31, 2013	December 31, 2012
	\$	\$
Trade payables	61,536	55,835
Accrued expenses	69,896	75,091
Merchandising accruals	57,038	55,339
Commodity swap contract	-	44
	<u>188,470</u>	<u>186,309</u>

11 Provisions

	Environmental and asset retirement obligations	Long-term incentives	Restructuring	Total
	\$	\$	\$	\$
	(a)	(b)	(c)	
Provisions as of January 1, 2012	3,223	1,983	-	5,206
Additional provisions	1,425	1,150	8,463	11,038
Paid during the year	-	(2,015)	(5,230)	(7,245)
Interest accretion	226	-	-	226
Provisions as of December 31, 2012	4,874	1,118	3,233	9,225
Current	-	486	3,233	3,719
Non-current	<u>4,874</u>	<u>632</u>	<u>-</u>	<u>5,506</u>
Provisions as of January 1, 2013	4,874	1,118	3,233	9,225
Additional provisions	213	800	-	1,013
Paid during the year	-	(607)	(2,234)	(2,841)
Interest accretion	217	-	-	217
Provisions as of December 31, 2013	5,304	1,311	999	7,614
Current	-	-	999	999
Non-current	<u>5,304</u>	<u>1,311</u>	<u>-</u>	<u>6,615</u>

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 \$0.2 million was recorded during the year ended December 31, 2013 (December 31, 2012 - \$1.4 million).

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

b) Long-term incentives

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

c) Restructuring

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 \$1.2 million (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.

In November 2013, the Partnership undertook an initiative to consolidate distribution activities from its Gatineau warehouse to its distribution operations in Laval. The Partnership incurred restructuring costs of \$1.4 million in the year ended December 31, 2013.

12 Long-term debt

	<u>Maturity</u>	<u>December 31, 2013</u>	<u>December 31, 2012</u>
		\$	\$
Revolving credit facilities ^(a)	2016	-	76
8% Senior unsecured notes ^(b)	2018	171,926	171,288
2.87% Nordea facility ^(c)	2019	40,904	39,879
Loan payable ^(d)	2017	3,225	3,923
Caisse facility ^(e)	2018	134,234	112,521
		<u>350,289</u>	<u>327,687</u>
Less: Current portion of long-term debt		<u>8,276</u>	<u>3,802</u>
		<u>342,013</u>	<u>323,885</u>

a) Revolving credit facilities

On May 16, 2013, the Partnership entered into the fourth amended and restated credit agreement (the Credit Agreement) related to its revolving credit facilities. The Credit Facility was reduced from CDN\$195.0 million 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 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 \$0.6 million have been deferred and classified as other long-term assets during the year ended December 31, 2013.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

As of December 31, 2013, the Partnership had \$92.6 million (net of letters of credit of \$32.4 million) available on this facility (December 31, 2012 - \$162.5 million). The weighted average interest rate for the year ended December 31, 2012 was 4.65%.

b) Senior unsecured notes

On August 9, 2011, the Partnership issued \$175 million in an aggregate principal amount of 8.0% senior unsecured notes due August 9, 2018 (the Notes) through a private placement. As of December 31, 2013, unamortized deferred financing fees were \$3.1 million (December 31, 2012 - \$3.7 million). The Partnership pays interest on the Notes in equal instalments on February 9 and August 9 of each year, commencing February 9, 2012. The Partnership may, at its option, redeem all or part of the Notes at any time prior to August 9, 2015 at an applicable redemption premium and on or after August 9, 2015 at fixed redemption prices plus, in each case, accrued and unpaid interest, if any, to the applicable redemption date. In addition, prior to August 9, 2014, the Partnership may, at its option, redeem up to 35% of the Notes with the net proceeds of certain equity offerings by the Partnership or cash contributions to its common equity capital at a redemption price equal to 108% of the principal of the Notes to be redeemed, plus accrued and unpaid interest, if any, to the applicable redemption date. If the Partnership undergoes a change in control, it will be required to offer to purchase the Notes.

The Notes include an early repayment option and an option to redeem a portion of the principal amount outstanding with proceeds from an equity offering. The Partnership has determined that the early repayment option is an embedded derivative that is not closely related to the Notes. Accordingly, the embedded derivative has been bifurcated from the Notes. The embedded derivative is recorded at its fair value with changes in fair value included in interest expense in the consolidated statements of comprehensive income (loss). During the year ended December 31, 2013, management revised its assumptions with respect to the valuation of the embedded derivative. An asset of \$3.0 million has been recognized as of December 31, 2013 (December 31, 2012 - \$1.7 million) to record the embedded derivative at its fair value.

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

c) Nordea facilities

On July 8, 2011, the Partnership entered into a credit agreement with Nordea Bank AB (the Nordea Facility), providing for a term loan in the principal amount of approximately U.S.\$46.2 million, to be used for the financing of a through-air-dried (TAD) tissue machine in its subsidiary, KTG. The Nordea Facility has a term of seven years and bears interest at a fixed interest rate of approximately 3% per annum, comprised of a Swedish state reported interest rate, risk premium and administrative margin. The loan is secured by the assets of the Partnership ranking pari passu with the Senior Lenders of the Credit Agreement. The loan is repayable in 14 equal consecutive semi-annual instalments of principal together with interest commencing on June 30, 2013. The Partnership fully utilized the Nordea Facility by making a final draw of U.S.\$4.5 million during the first quarter of 2013. As of December 31, 2013, U.S.\$46.2 million had been drawn on the facility (December 31, 2012 - U.S.\$41.7 million) resulting in a remaining borrowing capacity of nil (December 31, 2012 - U.S.\$4.5 million).

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

As of December 31, 2013 unamortized deferred financing fees were \$1.2 million (December 31, 2012 - \$1.6 million).

On May 16, 2013, the Partnership entered into the amended credit agreement (the "Credit Agreement") related to its Nordea Facility. No significant changes were made to the Nordea Facility.

d) Loan payable

The loan payable is related to an agreement with the Government of Quebec for financing related to its Crabtree converting line expansion. The loan payable is secured with the converting line assets and is non-interest bearing. The loan was valued on discounted future cash flows using a market rate of 6.0%. The Partnership has a moratorium on repayment of the principal for the initial 12 quarters, then the balance of the loan is repayable equally over 16 quarters. The Partnership has drawn \$3.5 million from this facility as of December 31, 2013 (December 31, 2012 - \$4.5 million).

e) Caisse facility

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

The Caisse Facility is for a seven-year term, maturing on August 16, 2018. The Caisse Facility bears interest at a base rate of 8% per annum, with an applicable margin rate set each period based on KTG's net debt to EBITDA ratio and KTG's excess cash flows, as defined in the agreement. The applicable margin consists of (i) 5% per annum at any time prior to the TAD Project service commencement date and KTG Excess cash flow has become positive, and (ii) thereafter, if the net debt to KTG EBITDA ratio is (A) higher or equal to 2.5, the greater of interest calculated at 5% per annum and an amount equal to 30% of KTG excess cash flow (B) lower than 2.5 but not lower than 2.0, the greater of interest calculated at 5% per annum and an amount equal to 25% of KTG excess cash flow or (C) lower than 2.0, the greater of interest calculated at 4% per annum and an amount equal to 15% of KTG excess cash flow. The weighted average interest rate on the Caisse Facility was 15.44% for the year-ended December 31, 2013 (December 31, 2012 – 15.08%).

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

As of December 31, 2013, TAD Canco Inc. had received proceeds of U.S.\$125.0 million from this facility (December 31, 2012 – U.S.\$117.4 million).

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

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

	<u>\$</u>
Less than 1 year	8,276
Between 1 and 5 years	348,358
More than 5 years	<u>7,018</u>
	<u>363,652</u>

Interest expense reflected on the consolidated statements of comprehensive income (loss) were as follows:

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Interest expense on long-term debt (excluding the Caisse facility)	17,163	20,658
Interest accredited on provisions and other liabilities	217	44
Pension and post-retirement benefits - net	8,463	8,574
Changes in fair value of interest rate swap	-	(297)
Embedded derivatives on debt	(1,300)	(1,728)
Caisse facility interest expense	<u>17,708</u>	<u>578</u>
Interest expense	<u>42,251</u>	<u>27,829</u>

13 Partnership units

	Partnership units equity	Partnership units liability
	<u>\$</u>	<u>\$</u>
As of January 1, 2012	-	-
Reorganization of Partnership	247,188	-
Issuance of Partnership units (note 1)	128,890	-
Reclassification of Partnership units liability	<u>(118,562)</u>	<u>118,562</u>
As of December 31, 2012	<u>257,516</u>	<u>118,562</u>
As of January 1, 2013	257,516	118,562
Issuance of Partnership units	25,156	-
Change in amortized cost of Partnership units liability	<u>-</u>	<u>(723)</u>
As of December 31, 2013	<u>282,672</u>	<u>117,839</u>

On September 21, 2012, the net assets of Former KPLP were transferred to the Partnership. As a result of the reorganization, the Partnership issued the following units: (i) 43,000,000 partnership units issued to Kruger Inc. (formerly held by Kruger Products 2010 L.P. (KP2010LP), which was amalgamated with Kruger Inc. in October 2013) in partial consideration for the transfer of all of the assets of the tissue business; (ii) 9,989 partnership units issued to Kruger Inc. at a price of \$1 per unit; (iii) 4,300 partnership units issued to KPGP Inc. (KPGP) at a price of \$1 per unit; (iv) 10 partnership units issued to Kruger Inc. at a price of \$1 per unit on May 8, 2012, which were subsequently transferred to KP2010LP; and (v) 1 partnership unit issued to KPGP at a price of \$1 per unit on May 8, 2012 (see note 1).

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

On December 13, 2012, 8,000,000 Partnership units were issued to KPT at a unit price of \$17.50, resulting in KPT having a 15.7% interest in the Partnership. Costs incurred of \$11.1 million in respect of the issuance were netted against the gross proceeds of \$140 million.

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Partnership agreement was amended to require the Partnership to declare a distribution in such an amount that would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. Since the Tax Distribution is a contractual obligation to deliver cash it meets the definition of a financial liability for accounting purposes. Accordingly, the net present value of \$118.6 million was reclassified from Partnership units to Partnership units liability in the consolidated financial statement of financial position as of December 13, 2012, being the portion of the carrying value of the Partnership units related to the Tax Distribution. The Partnership units liability is classified as a financial liability at amortized cost for accounting purposes. The value of the Partnership units liability was \$117.8 million as of December 31, 2013. The change in amortized cost of \$0.7 million has been included in operating expenses.

As contemplated in the prospectus filed by KPT, a distribution of \$40 million was declared and paid to Kruger on December 13, 2012 from the proceeds received from the issuance of the Partnership units to KPT.

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 July 15, 2013, the Partnership paid a quarterly distribution of \$9.4 million. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 241,241 additional partnership units at a price of \$16.76 for the gross proceeds of \$4.0 million.

On October 15, 2013, the Partnership paid a distribution of \$9.4 million. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 246,974 additional partnership units at a price of \$16.53 for the gross proceeds of \$4.0 million.

On November 13, 2013, the Partnership declared a distribution of \$9.5 million, which was paid on January 15, 2014. Pursuant to the DRIP, a portion of the distribution was reinvested by the partners and the Partnership issued 252,478 additional partnership units at a price of \$16.59 for the gross proceeds of \$4.2 million.

On February 28, 2014, the Partnership paid a Tax Distribution of \$3.5 million of which \$0.6 million was used to pay the tax instalment on behalf of KPT and \$2.9 million was paid to Kruger Inc. and KPGP.

Subsequent to December 31, 2013, the Partnership declared a distribution of \$9.5 million, payable on April 15, 2014.

14 Income taxes

The Partnership is not a tax paying entity for the years ended December 31, 2013 and December 31, 2012. The taxable income (loss) from the Partnership flows to the partners, Kruger Inc., KPGP and KPT. However, the Partnership's subsidiaries KP USA, KTG, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L are corporate entities and, therefore, subject to tax.

The consolidated income tax recovery for the Partnership of \$10.9 million for the year ended December 31, 2013 (December 31, 2012 – recovery of \$1.4 million) related to KP USA, KTG, TAD Canco Inc. and GTM.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

The major components of income taxes recognized in the consolidated statement of comprehensive income (loss) were as follows:

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Current income tax expense	1,507	1,344
Deferred income tax expense	(12,447)	(2,772)
	<u>(10,940)</u>	<u>(1,428)</u>

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

	December 31, 2013		December 31, 2012	
	<u>\$</u>	<u>%</u>	<u>\$</u>	<u>%</u>
Combined federal and provincial income tax rates after manufacturing and processing credits	9,914	26.1	10,352	25.9
Income taxed in partners' hands	(15,145)	(39.9)	(10,233)	(25.6)
Difference in statutory income tax rate of foreign operations	(2,078)	(5.5)	(133)	(0.3)
Investment tax credits	(3,611)	(9.5)	(953)	(2.4)
Permanent and other	(20)	-	(461)	(1.2)
	<u>(10,940)</u>	<u>(28.8)</u>	<u>(1,428)</u>	<u>(3.6)</u>

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

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Property, plant and equipment	13,319	4,504
Net operating losses	(23,229)	(4,425)
Other	(4,231)	(1,257)
	<u>(14,141)</u>	<u>(1,178)</u>

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

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Deferred tax (asset) liability to be recovered within 12 months	(387)	(402)
Deferred tax (asset) liability to be recovered after 12 months	(13,754)	(776)
	<u>(14,141)</u>	<u>(1,178)</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

The Partnership had the following net operating loss carry-forwards available as of December 31, 2013:

	U.S. Federal		U.S. State		Canada		
	\$	Expiry date	\$	Expiry date	\$	Expiry date	
2003	5	2023	-	2018	-		
2004	4,270	2024	1,069	2019	-		
2005	22	2025	-	2020	-		
2006	4,714	2026	4,712	2021	-		
2009	1,297	2029	-	2025	-		
2011	558	2031	96	2026	926		2031
2012	1,891	2032	1,677	2027	8,580		2032
2013	51,048	2033	27,845	2028	18,720		2033
	<u>63,805</u>		<u>35,399</u>		<u>28,226</u>		

The Partnership had the following U.S. State tax credits available for carry-forward as of December 31, 2013:

	U.S. State	
	\$	Expiry date
2011	318	2026
2012	3,411	2027
2013	11,228	2028
	<u>14,957</u>	

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

15 Related party transactions

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

In addition, there were related party transactions related to distributions and dividends in connection with the corporate reorganization.

Sales of goods and services to Kruger Inc. for the year ended December 31, 2013 were \$5.9 million (December 31, 2012 - \$4.3 million). Sales of goods to subsidiaries of Kruger Inc. for the year ended December 31, 2013 were \$0.6 million (December 31, 2012 - \$0.2 million). Goods are sold based on the price lists in force and terms that would be available to third parties. Services are delivered at the terms outlined in the agreements between the related parties.

Purchases of goods and services from Kruger Inc. for the year ended December 31, 2013 were \$49.4 million (December 31, 2012 - \$54.7 million). Purchases of goods and services from subsidiaries of Kruger Inc. for the year ended December 31, 2013 were \$9.5 million (December 31, 2012 - \$9.4 million). Goods are purchased from Kruger Inc. and related parties under normal commercial terms and conditions. These purchases of goods and services are included within cost of sales and operating expenses in the consolidated statements of comprehensive income (loss). During the year ended December 31, 2013, management fees of \$4.0 million (December 31, 2012 - \$9.2 million) were paid to Kruger Inc. for management services provided to the Partnership.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

Balances due to and from related parties are as follows:

	December 31, 2013	December 31, 2012
		\$
Receivables from Kruger Inc.	1,255	458
Receivables from subsidiaries of Kruger Inc.	174	210
	<u>1,429</u>	<u>668</u>
Payables to Kruger Inc.	3,472	9,053
Payables to subsidiaries of Kruger Inc.	1,662	4
	<u>5,134</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 non-interest bearing. There were no provisions related to the receivables from related parties as of December 31, 2013 and December 31, 2012. There were no loans outstanding with related parties as of December 31, 2013.

As of December 31, 2013, the Partnership had declared distributions to its related parties as follows:

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

During the year ended December 31, 2013, the Partnership paid distributions to its related parties as follows:

	December 31, 2013
	\$
Distribution paid to Kruger Inc.	24,949
Distribution paid to KPGP	3
Distribution paid to KPT	<u>5,058</u>
Total distributions paid	<u>30,010</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

16 Commitments and contingencies

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

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Less than 1 year	13,040	15,401
Between 1 and 5 years	46,017	54,194
More than 5 years	<u>57,444</u>	<u>75,479</u>
	<u>116,501</u>	<u>145,074</u>

Operating lease expense recognized in the consolidated statements of comprehensive income (loss) during the year ended December 31, 2013 was \$12.3 million (December 31, 2012 - \$10.4 million).

As of December 31, 2013, the Partnership had commitments under service contracts of \$1.8 million for 2014 and \$0.9 million for 2015.

As of December 31, 2013, the Partnership had no commitments (December 31, 2012 - \$30.0 million) related to the TAD project.

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

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

As of December 31, 2013, the Partnership had irrevocable letters of credit outstanding of \$32.4 million (December 31, 2012 - \$32.4 million), which included letters of credit for the pension plans disclosed in note 9.

17 Expenses by nature

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Materials and production costs	277,879	239,957
Wages and other employee benefit expenses	214,054	233,553
Maintenance materials and labour	86,954	85,159
Energy costs	62,701	60,284
Depreciation and amortization	34,142	28,861
Freight and distribution	111,095	103,445
Marketing, selling and administrative expenses	<u>88,699</u>	<u>89,817</u>
Total expenses by nature	<u>875,524</u>	<u>841,076</u>

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

Classified in the consolidated statements of comprehensive income (loss) were:

	December 31, 2013	December 31, 2012
	<u>\$</u>	<u>\$</u>
Cost of sales	675,730	646,089
Operating expenses	199,794	194,987
	<u>875,524</u>	<u>841,076</u>

18 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 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.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

				2012
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	745,548	156,632	20,694	922,874
Segment operating profit (loss)	113,716	3,008	(5,782)	110,942
Depreciation and amortization				28,861
Interest expense				27,829
Impairment of non-financial assets				4,608
Loss on disposal of property, plant and equipment				1,060
Restructuring costs				9,391
Unrealized foreign exchange gain				(777)
Income before income taxes				39,970
Income taxes				(1,428)
Net income for the year				<u>41,398</u>

Geographic segments

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

	Canada	US	Mexico	2012
	\$	\$	\$	Total
				\$
Revenue	662,952	231,532	28,390	922,874
Property, plant and equipment	294,022	286,792		580,814
Goodwill	152,021	-	-	152,021
Intangible assets	13,828	-	-	13,828

19 Compensation of key management

	2013	2012
	\$	\$
Compensation awarded to key management included		
Short-term employee benefits	5,749	4,687
Post-employment benefits	350	347
Other long-term benefits	469	1,501
	6,568	6,535

Key management includes the Partnership's senior executives.

20 Financial instruments

Classification of financial instruments

Financial instruments are classified into one of the following categories: fair value through profit and loss, held-to-maturity, available-for-sale, loans and receivables and financial liabilities. As of December 31, 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	87,674	87,674
Trade and other receivables	loans and receivables	amortized cost	94,789	94,789
Receivables from related parties	loans and receivables	amortized cost	1,429	1,429
Embedded derivative	fair value through profit or loss	fair value	3,028	3,028
Available-for-sale investment	fair value through other comprehensive income or loss	fair value	836	836
Trade and other payables	financial liabilities	amortized cost	(188,470)	(188,470)
Payables to related parties	financial liabilities	amortized cost	(5,134)	(5,134)
Distribution payable	financial liabilities	amortized cost	(9,455)	(9,455)
Long-term debt	financial liabilities	amortized cost	(350,289)	(377,295)
Partnership unit liability	financial liabilities	amortized cost	(117,839)	(117,839)

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 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, 2013:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Embedded derivative	-	3,028	-	3,028
Available-for-sale investment	836	-	-	836

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

	Classification	Measurement	Carrying amount	Fair Value
			\$	\$
Cash and cash equivalents	loans and receivables	amortized cost	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)

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, payables to related parties and distributions payable are short-term financial instruments whose fair value approximates the carrying amount, given they will mature in the near future. As of December 31, 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 December 31, 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 \$42.1 million and \$143.0 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 December 31, 2013, the fair value of the loans payable was \$3.2 million (December 31, 2012 - \$3.9 million).

The commodity swap did not trade and the price of an identifiable instrument could not 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.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

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

The fair value of the Available-for-sale investment is based on quoted market price in the active market. Unrealized gains were not significant as of December 31, 2013 and have been recorded in other comprehensive income until realized. The valuation methodology used is categorized as a Level 1 methodology.

Fair value of the Partnership units liability

The Partnership units liability is classified as a financial liability at amortized cost. Management has estimated the fair value of the Partnership units liability using discounted cash flow model. Significant assumptions include the income tax obligation, discount rate and an industry capitalization rate (see note 4).

Objectives and policies relating to financial risk management

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

Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Partnership's financial instruments exposed to credit risk include cash and cash equivalents, trade and other receivables, and derivative commodity contracts. The Partnership places its cash and cash equivalents, and commodity swap with financial institutions of high creditworthiness.

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

	December 31, 2013	December 31, 2012
	\$	\$
Trade receivables	90,782	90,374
Less: Allowance for doubtful accounts	(353)	(112)
Total trade receivables - net	<u>90,429</u>	<u>90,262</u>
Trade receivables - net		
0 to 60 days	90,132	89,250
61 to 90 days	299	790
Over 90 days	351	334
Less: Allowance for doubtful accounts	(353)	(112)
	<u>90,429</u>	<u>90,262</u>

Currency risk

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

The Partnership sells certain of its products in U.S. dollars at prevailing U.S. dollar prices. A majority of the currency exposure is naturally offset by U.S. dollar expenses and the U.S. dollar denominated debt. As a result, the Partnership is a net buyer or seller of U.S. dollars.

As of December 31, 2013, the Partnership has net liabilities denominated in U.S. dollars of \$50.0 million (December 31, 2012 - \$46.0 million). Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the hypothetical result on income before income taxes for the year ended December 31, 2013 would have been an increase/decrease of \$2.5 million (December 31, 2012 - \$2.3 million).

Liquidity risk

The purpose of liquidity risk management is to maintain sufficient cash and cash equivalents and to ensure the Partnership has sufficient authorized credit facilities to finance operations. The Partnership had unused lines of credit available of \$92.6 million as of December 31, 2013 (December 31, 2012 - \$162.5 million). The Partnership prepares projections to ensure it has sufficient funds to fulfill its obligations. Refinancing risks are minimized by ensuring the credit facility will not mature for two years. The ability to pay its obligations relies on the Partnership collecting its trade receivables in a timely manner and by maintaining sufficient cash and cash equivalents in excess of anticipated needs. The Partnership's trade and other payables of \$188.5 million (December 31, 2012 - \$186.3 million) are all due for payment within 12 months of the dates of the consolidated statements of financial position.

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

	December 31, 2013		
	Less than 1 year	1 to 5 years	Greater than 5 years
	\$	\$	\$
Partnership units liability	3,475	35,895	87,895
Long-term debt ^(a)	34,899	438,579	7,170
Trade and other payables	188,470		
Payables to related parties	5,134		

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

	December 31, 2012		
	Less than 1 year	1 to 5 years	Greater than 5 years
	\$	\$	\$
Partnership units liability	-	39,255	78,615
Long-term debt ^(a)	32,423	143,347	323,106
Trade and other payables	186,309		
Payables to related parties	9,057		

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

Interest rate risk

As of December 31, 2013, the Partnership had variable rate debts of nil (December 31, 2012 - \$0.1 million). These loans bear interest at the Canadian prime rate, U.S. base rate, banker's acceptance or LIBOR plus the applicable margins. The applicable margin on the loans ranges between 0.20% and 2.50%.

A 1% increase/decrease in the market rate of interest would result in a decrease/increase in income before income taxes of nil for the year ended December 31, 2013 (December 31, 2012 - nil).

The Partnership used an interest rate swap contract to manage part of its exposure to movements in interest rates on its revolving credit facilities until September 18, 2012 when the interest rate swap was settled.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2013 and December 31, 2012

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

21 Capital management

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

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

22 Environmental costs

The Partnership is subject to extensive regulation by various federal and provincial agencies concerning compliance with environmental control statutes and regulations. These regulations impose limitations on the discharge of materials into the environment and require the Partnership to operate in compliance with the conditions of permits and other governmental authorizations. Future environmental expenditures will depend on the emergence of new regulations and technological developments.

23 Economic dependence

The Partnership manufactures, distributes and sells a wide range of disposable tissue paper and related products primarily in Canada and the U.S. As of December 31, 2013, the Partnership had three major customers, which represented 41.4% (December 31, 2012 – 39.4%) of total revenues, and of these customers, one represented 19.0% (December 31, 2012 – 18.8%) of the total revenues and another represented 11.8% (December 31, 2012 – 10.9%). The Partnership's concentration of credit risk primarily arises from exposure to these three customers and amounted to approximately 31.8% of the trade receivables as of December 31, 2013 (December 31, 2012 – 41.5%). These customers are included in the consumer segment.

24 Non-cash working capital

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

	December 31, 2013	December 31, 2012
	\$	\$
Decrease (increase) in trade receivables	2,951	(3,346)
Decrease (increase) in receivables from related parties	(78)	62
Decrease (increase) in inventories	(32,039)	19,842
Decrease (increase) in prepaid expenses	(320)	970
Increase in other assets	(1,183)	-
Decrease (increase) in income taxes	39	(643)
Increase in trade and other payables	282	23,371
Decrease in payables to related parties	(3,923)	(350)
	<u>(34,271)</u>	<u>39,906</u>