



2017 Annual Report





KP Tissue Inc.



KP Tissue Inc. (KPT) was created to acquire, and its business is limited to holding, a limited partnership interest in Kruger Products L.P. (KPLP). KPT held a minority interest in KPLP of 16.0% as at December 31, 2017 and of 15.9% as at May 10, 2018⁽¹⁾.

KPLP is Canada's leading manufacturer of quality tissue products for household, industrial and commercial use. KPLP serves the Canadian consumer market with such well-known brands as Cashmere®, Purex®, SpongeTowels®, Scotties® and White Swan®. In the U.S., KPLP manufactures the White Cloud® brand, as well as many private label products. The Away-From-Home division manufactures and distributes high-quality, cost-effective product solutions to a wide range of commercial and public entities. KPLP has approximately 2,500 employees and operates eight FSC® COC-certified (FSC® C-104904) production facilities in North America.

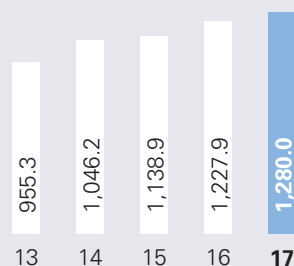
⁽¹⁾ KPT (the Corporation) holds a limited partnership interest in KPLP. KPT is a reporting issuer in all provinces and territories of Canada, and is required under Canadian Securities laws to report certain financial and business information of KPLP.

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Forward looking information: For any information on statements in this Annual Report that are of a forward-looking nature, please consult the section on "Cautionary forward looking statement." on page 1 in the Management's discussion and analysis of results of operations and financial position.

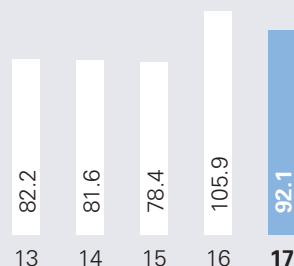
Revenue

(in millions of Canadian dollars)



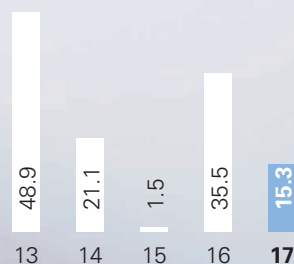
Operating Income

(in millions of Canadian dollars)



Net Income

(in millions of Canadian dollars)



Five-year Financial Performance⁽¹⁾

(In millions of Canadian dollars)

For the years ended December 31	2017	2016	2015	2014	2013
Revenue	1,280.0	1,227.9	1,138.9	1,046.2	955.3
Operating income	92.1	105.9	78.4	81.6	82.2
Net income	15.3	35.5	1.5	21.1	48.9

Other Financial Data

Adjusted EBITDA ⁽²⁾	144.2	152.5	126.4	121.6	116.2
Adjusted EBITDA margin ⁽²⁾	11.3%	12.4%	11.1%	11.6%	12.2%
Capital expenditures	69.3	82.0	57.4	42.3	59.0
Working capital ⁽³⁾	(79.5)	115.7	123.9	122.4	128.5
Long-term debt	225.4	415.4	425.9	358.6	342.0

2017 Highlights

- Revenue of \$1.3 billion, up 4.2% over 2016.
- Revenue increased in all geographic regions: Canada (+3.8%), U.S. (+5.4%) and Mexico (+1.6%).
- Adjusted EBITDA⁽²⁾ decreased by 5.4% to \$144.2 million, due primarily to higher pulp prices.
- TAD products Adjusted EBITDA⁽²⁾ achieved 2017 target.
- Number one in overall tissue market share in Canada.
- Continued focus on capital expenditure projects related to capacity growth and cost reduction.
- Initiated a value creation program to partially offset extraordinary short-term market cost conditions.

⁽¹⁾ All financial information presented herein are related to KPLP unless otherwise noted and have been prepared in accordance with IFRS. For the year ended December 31, 2017, KPT reported an equity loss of \$3.4 million, a net loss of \$5.4 million and basic loss per share of (\$0.59). For more information refer to the KPT Audited Financial Statements for the period ended December 31, 2017.

⁽²⁾ Adjusted EBITDA and Adjusted EBITDA margin are non-GAAP financial measures. These measures do not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similarly titled measures presented by other companies. Refer to the MD&A for the definition and reconciliation of Adjusted EBITDA.

⁽³⁾ Working capital for 2017 includes current portion of long-term debt of \$190.9 million, including *Caisse de dépôt et placement du Québec* facility of \$181.8 million maturing in August 2018.





Letter To Our Shareholders

Despite the challenges posed by the continuous rise in raw material prices, we are pleased with our Fiscal 2017 results and operational performance. We achieved record revenue for a fifth consecutive year since our initial public offering. The Company continued to be the leader in overall tissue market share in Canada, and pursued the expansion of its White Cloud® brand in the U.S. At the same time, we maintained a high level of capital expenditures with several key projects, such as our Crabtree PM8 machine, which was commissioned in the fourth quarter with better than expected operational results for the initial ramp-up period. Furthermore, the commercialization of our TAD products was a success and exceeded our target in Fiscal 2017.

Financial Highlights

For the year, revenue reached \$1.28 billion, an increase of 4.2% over the previous year. The increase was driven by higher sales volume in both the Consumer and Away-from-Home segments across all regions.

Adjusted EBITDA was \$144.2 million in Fiscal 2017, compared to \$152.5 million in Fiscal 2016. The decrease reflects the significant run-up in pulp prices and the unprecedented increase in freight costs, partially offset by higher sales volume and lower SG&A. The contribution by TAD products significantly improved in Fiscal 2017 with an Adjusted EBITDA of over \$60 million compared to \$49 million a year ago. Finally, net income totalled \$15.3 million compared to \$35.5 million last year.

Canadian Tissue Market Leader

While we continued to be the leader in overall tissue market share in Canada, we also remained the uncontested market leader in the bathroom tissue category, which accounts for close to 60% of the overall tissue market. In the facial tissue category, we held a 12% lead over our closest competitor, and in the paper towel category we held a strong number two position. For the past decade we have maintained this market leadership by virtue of powerful brand identification, a strong product offering, and the fundamental quality of our tissue. All of our employees from design and production to sales, marketing and customer service, have helped create a distinct culture at Kruger Products. It is a culture that constantly seeks to improve the quality of our products and enhance the experience of our consumers and customers.

Expanding Reach of Well-Known White Cloud® Brand in the U.S.

In Fiscal 2017, we pursued the expansion of our White Cloud® product line in the U.S. with encouraging results. During the year, our brand was sold in the U.S. at Walmart as well as in select retailers. We believe that the White Cloud® brand, which benefits from its long history in the U.S. and its strong brand name recognition, will continue to garner improved market share in the years to come.

Reaping the Results of High Return Capital Expenditures

In the past three years, our capital program has increased significantly and totalled \$69.3 million in Fiscal 2017. Our focus for the program was related to capacity growth and cost reduction with quick paybacks. One of our key projects in Fiscal 2017 was the \$55 million paper machine investment in Crabtree, Quebec to reduce our overall paper costs. This paper machine became operational in the fourth quarter of 2017 and is expected to make a positive contribution in Fiscal 2018. As for 2018, our capital expenditures will decrease to a more normal range of \$50 to \$60 million. These investments have allowed us to decrease our manufacturing costs during the year and we expect further positive impact from these capital projects on our costs going forward.

TAD Products Exceeded Annual Contribution Goal

We can now claim that TAD products form an integral part of our business and product offering, as Adjusted EBITDA related to TAD products exceeded our previously stated expectation of \$60 million for the year. We are in final stages of planning for a second TAD machine, as demand for high quality tissue in the North American market remains strong.

Improved Results from Away-from-Home

Fiscal 2017 proved to be stronger in our Away-from-Home segment as revenues increased 2.7% to \$233.3 million and Adjusted EBITDA was up 19.5% to \$6.2 million, despite the impact of higher input costs. With the recent start-up of our Crabtree paper machine and other production line projects, we expect that this segment will become more cost competitive, thus allowing us to improve our performance over the coming years.

Outlook

We are committed to our long-term strategy of building our brands in Canada and growing our business in the United States. On a short-term basis, we face the challenges of continued escalation of pulp and freight costs. We are implementing a value-creation program to partially mitigate the impact of these extraordinary short-term market conditions. For the remainder of 2018, we look forward to reaping the rewards from our capital investment program, including our new Crabtree paper machine. As well, we expect, expanded distribution of the White Cloud® brand, and continued success in our Consumer business in North America.

A Salute to Mario Gosselin

On a personal note, I must say that I stepped into large shoes two months ago when I succeeded Mario Gosselin as CEO of our Company. Mario was an exemplary leader. As CEO since 2012, Mario oversaw a number of major initiatives and capital projects resulting in significant growth in sales and profitability. We sincerely thank Mario for his exceptional contributions, and wish him well. My goal is to leverage the great work that Mario and the team have done as I lead Kruger Products into the next phase of growth.

A Word of Thanks

The credit for Kruger Products' operational achievements and sustained success in the marketplace belongs to our employees. I want to thank each and every one for their dedication to the Company. My gratitude as well to the members of our Board for their advice and guidance, and to our shareholders for their ongoing support.



Dino Bianco

Chief Executive Officer

KP Tissue Inc., and Kruger Products L.P.

Recognition Highlights

Corporate Knights 2017
FUTURE40
 Responsible Corporate Leaders in Canada

Kruger Products Recognized as a Corporate Knights Future 40 Responsible Leader



Recognized as One of Greater Toronto's Top Employers for the 5th Consecutive Year



United Grocers Inc. Best Supplier Award



Ranked #1 Canadian Packaged Goods Supplier, Industry Survey for 5th Consecutive Year



16 Marketing Awards Won in 2017





KP TISSUE INC. AND KRUGER PRODUCTS L.P.

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

FOR THE FOURTH QUARTER AND FISCAL YEAR ENDED DECEMBER 31, 2017

DATED MARCH 7, 2018

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The following Management's Discussion and Analysis (MD&A) dated March 7, 2018 for KP Tissue Inc. (KPT) and Kruger Products L.P. (KPLP) is intended to assist the readers in understanding the business environment, strategies, performance and risk factors relating to KPT and KPLP. It should be read in conjunction with the financial statements of KPT for the years ended December 31, 2017 and December 31, 2016, respectively, and the consolidated financial statements of KPLP for the years ended December 31, 2017 (Fiscal 2017) and December 31, 2016 (Fiscal 2016), respectively.

About KP Tissue Inc.

KPT was created to acquire, and its business is limited to holding, a limited partnership interest in KPLP, which is accounted for as an investment in an associate using the equity method of accounting. KPT currently holds a 15.9% interest in KPLP (16.0% as of December 31, 2017). The following MD&A provides discussion and analysis related to KPT to the extent necessary to understand the equity method of accounting. However, the majority of the discussion and analysis relates to KPLP and to KPT's investment in KPLP.

CAUTIONARY FORWARD LOOKING STATEMENT

Certain statements in this MD&A about KPT's and KPLP's current and future plans, expectations and intentions, results, levels of activity, performance, goals or achievements or any other future events or developments constitute forward-looking statements. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements. The forward-looking information is based on certain key expectations and assumptions made by KPT or KPLP. Although KPT and KPLP believe that the expectations and assumptions on which such forward-looking information is based are reasonable, undue reliance should not be placed on the forward-looking information since no assurance can be given that such expectations and assumptions will prove to be correct.

Many factors could cause KPLP's actual results, level of activity, performance or achievements or future events or developments (which could in turn affect the economic benefits derived from KPT's economic interest in KPLP) to differ materially from those expressed or implied by the forward-looking statements, including, without limitation, the following factors, which are discussed in greater detail in the "Risk Factors – Risks Related to KPLP's Business" section of the KPT Annual Information Form dated March 9, 2018 available on SEDAR at www.sedar.com (the Annual Information Form): Kruger Inc.'s influence over KPLP; KPLP's reliance on Kruger Inc.; consequences of an event of insolvency relating to Kruger Inc.; risks associated with the Memphis TAD Machine; operational risks; Gatineau Plant land lease; significant increases in input costs; reduction in supply of fibre; increased pricing pressure and intense competition; KPLP's inability to innovate effectively; adverse economic conditions; dependence on key retail trade customers; damage to the reputation of KPLP or KPLP's brands; KPLP's sales being less than anticipated; KPLP's failure to implement its business and operating strategies; KPLP's obligation to make regular capital expenditures; KPLP's entering into unsuccessful acquisitions; KPLP's dependence on key personnel; KPLP's inability to retain its existing customers or obtain new customers; KPLP's loss of key suppliers; KPLP's failure to adequately protect its intellectual property rights; KPLP's reliance on third party intellectual property licenses; adverse litigation and other claims affecting KPLP; material expenditures due to comprehensive environmental regulation affecting KPLP's cash flow; KPLP's pension obligations are significant and can be materially higher than predicted if KPLP Management's underlying assumptions are incorrect; labour disputes adversely affecting KPLP's cost structure and KPLP's ability to run its plants; exchange rate and U.S. competitors; KPLP's inability to service all of its indebtedness; exposure to potential consumer product liability; covenant compliance; interest rate and refinancing risk; information technology; cyber-security; insurance; internal controls; and trade related risk.

These factors are not intended to represent a complete list of the factors that could affect KPT and/or KPLP; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein.

To the extent any forward-looking information in this MD&A constitutes future-oriented financial information or financial outlooks within the meaning of securities laws, such information is being provided to demonstrate the potential benefits and readers are cautioned that this information may not be appropriate for any other purpose. Future-oriented

financial information and financial outlooks, including expected cost-savings related to the restructuring activities and refinancing, are, without limitation, based on the assumptions and subject to the risks set out above.

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

OVERVIEW

Business Overview

KPLP is Canada's leading tissue products supplier by overall market share. It produces, distributes, markets and sells a wide range of products, including bathroom tissue, facial tissue, paper towels and napkins, for both the Consumer and the Away-From-Home (AFH) market (in each case, as defined below). In addition to leading the Canadian consumer-branded tissue products market, KPLP is also a leader in the Canadian AFH market and is increasing its business in the U.S. in the consumer private label tissue market and through the expansion of the White Cloud brand to additional U.S. retailers. The Consumer segment consists of well recognized brands such as *Cashmere*, *Purex*, *Scotties*, and *SpongeTowels* in Canada and *White Cloud* in the U.S.

KPLP is headquartered in Mississauga, Ontario and has approximately 2,500 employees across North America. KPLP's Canadian manufacturing facilities, consisting of four tissue plants in Québec, two plants in Ontario, and one plant in British Columbia, have a combined annual tissue production capacity of approximately 268,000 metric tonnes.

KPLP's U.S. manufacturing facility held through K.T.G. (USA) Inc. (KTG) and located in Memphis, Tennessee consists of two paper machines with an aggregate annual capacity of 57,000 metric tonnes, and one adjacent Through-Air-Dried (TAD) tissue machine (Memphis TAD Machine) with an aggregate annual capacity of 55,000 metric tonnes.

Pursuant to its Articles, KPT's business is limited to (i) the investment in, holding of and disposition of limited partnership interests, units, shares or other securities of KPLP and its general partner, KPGP Inc. (KPGP) (or any successor entity of either KPLP or KPGP), (ii) the acquisition of, holding, operation and disposition of any assets, liabilities, operations or business of such entities, and (iii) all activities related, incidental or ancillary to any of the foregoing. As of the date of the MD&A and following the participation by the partners in the Dividend Reinvestment Plan (DRIP) on January 15, 2018, KPT held 15.9% of the KPLP Partnership Units (KPLP Units).

Basis of Presentation

The consolidated financial statements of KPLP presented for Fiscal 2017 and Fiscal 2016 have been prepared in accordance with IFRS (International Financial Reporting Standards). The financial statements of KPT for the years ended December 31, 2017 and December 31, 2016, have also been prepared in accordance with IFRS.

Accounting Periods

This MD&A, the consolidated financial statements of KPLP and accompanying notes thereto include financial information for the 3-month periods ended December 31, 2017 (Q4 2017) and December 31, 2016 (Q4 2016), respectively, and Fiscal 2017 and Fiscal 2016. The 3-month period ended December 31, 2017 consists of 98 days, and the 3-month period ended December 31, 2016 consists of 97 days.

Financial Measures and Key Indicators

This MD&A refers to "Adjusted EBITDA", a measure which does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similarly titled measures presented by other companies.

"Adjusted EBITDA" is calculated by KPLP as net income (loss) before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (gain on sale) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) foreign exchange loss (gain), (viii) costs related to restructuring activities, (ix) changes

in amortized cost of Partnership units liability, (x) change in fair value of derivatives, and (xi) one-time costs due to pension revaluations related to past service. We use “Adjusted EBITDA” to evaluate the performance of our business as it reflects its ongoing profitability. This MD&A contains a reconciliation of Adjusted EBITDA to net income, the most comparable IFRS measure, on page 5.

Outlook

KPLP is committed to building great consumer brands and developing winning products for its retail and commercial customers. KPLP’s strategy is to maintain its leadership position in the Canadian market. Though the Canadian tissue market is expected to remain competitive, KPLP believes that its brands and products are well positioned for continued growth. KPLP will aim to sustain its consumer and AFH leadership position in the Canadian tissue industry by driving marketing and sales excellence, extending product lines, continuing to leverage product development and manufacturing technology to drive product superiority and cost savings, and emphasizing manufacturing quality and efficiency.

In the U.S., KPLP expects to continue to grow by leveraging its TAD product capabilities and focusing on the high-end private label business in the U.S. market. KPLP’s U.S. strategy also includes the expansion of the White Cloud brand to additional U.S. retailers.

Following a successful TAD1 project in Memphis, KPLP is studying the potential for the installation of a second TAD paper machine (TAD2) along with related converting equipment and infrastructure, and has investigated various sites in North America, performed engineering assessments and has initiated preliminary financing discussions for a TAD2 project. A decision to proceed with the project is subject to a number of factors, including identification of an acceptable site and availability of financing on satisfactory terms. The project as presently conceived would require approximately two years for construction and installation once a decision to proceed is made, followed by a ramp-up period for production and sales.

Factors Affecting the Results of Operations

Revenue

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

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

Cost of Sales

Cost of sales includes fixed and variable costs to manufacture our products, freight, and warehousing and handling costs. Input costs associated with the manufacturing of tissue paper are primarily variable. Fibre, labour, and energy costs are the largest components, representing 50% to 70% of total cost of sales, depending on the type of fibre and paper making technology being used. Pulp is a world-wide easily accessible commodity. Though underlying pulp costs can fluctuate based on worldwide shifts in supply/demand, there has historically been an ability to pass along fluctuations to end customers and consumers. However, the ability to pass through the full amount of pulp cost increases has more

recently been affected by the competitive market situation at the time of the fluctuation. Periodically, KPLP has entered into fibre commodity swap contracts to reduce exposure to fluctuations in this key input cost, and may continue to do so going forward. These historically have not exceeded 15% of total fibre purchases. KPLP is exposed to fluctuations in the U.S. dollar against the Canadian dollar on production inputs, U.S. dollar denominated debt and other operating costs denominated in U.S. dollars. To manage this foreign exchange risk, KPLP has entered into foreign exchange swaps and foreign exchange forwards and may continue to do so going forward. Fixed costs at the plants include plant maintenance, overhead, insurance, property taxes, information technology, as well as depreciation and amortization (substantially all depreciation and amortization is included in cost of sales)

Freight, warehousing and handling costs vary based on sales volume, the geographical mix of the product shipped, and the cost of fuel used by freight carriers. Freight costs can also be subject to fluctuations based on North American shifts in supply and demand. Freight rates and availability of transportation assets are currently being impacted by high demand and lack of supply.

Selling, General and Administrative Expenses

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

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

Interest Expense

Interest expense is derived from the financing activities of KPLP. KPLP is a borrower under certain credit facilities, each of which is described under "Liquidity and Capital Resources" below. KPLP also records amortization related to deferred financing fees and interest costs related to pensions and post-retirement benefits in interest expense.

Other Income (Expense)

Other income (expense) includes foreign exchange gains and losses related to U.S. dollar denominated debt, the change in amortized cost of Partnership units liability, the change in fair value of derivatives and other items deemed to be non-operational in nature.

Income Taxes

KPLP is not a tax paying entity. The income (loss) from KPLP flowed to the partners, Kruger Inc., KPGP and KPT for Fiscal 2017 and Fiscal 2016. The income taxes recorded in the consolidated financial statements of KPLP relate to the income taxes for its incorporated subsidiaries in the U.S., Canada, Luxembourg and Mexico.

BUSINESS HIGHLIGHTS

Paper Machine Project

On July 25, 2016, KPLP announced a paper machine investment of \$55 million at its Crabtree, Québec plant (PM8). The project will increase the plant's overall production by approximately 20,000 metric tonnes annually. To finance the acquisition, relocation and installation of the paper machine, KPLP entered into a credit facility for a maximum amount of \$39.5 million from Investissement Québec. The paper machine was commissioned and in production by the third quarter ended September 24, 2017, and is ramping-up to produce tissue products primarily for the AFH and Consumer markets.

RESULTS OF OPERATIONS

Results of Operations of KPLP

(C\$ millions, unless otherwise noted)	\$ Change				
	Fiscal 2017	Fiscal 2016	Fiscal 2015	Fiscal 2017 vs. Fiscal 2016	Fiscal 2016 vs. Fiscal 2015
Statement of Operations Data:					
Revenue	1,280.0	1,227.9	1,138.9	52.1	89.0
Cost of sales	(1,098.1)	(1,031.6)	(970.8)	(66.5)	(60.8)
Selling, general and administrative expenses	(90.1)	(92.7)	(88.0)	2.6	(4.7)
Gain on sale of non-financial assets	0.1	2.9	1.1	(2.8)	1.8
Restructuring costs, net	0.2	(0.6)	(2.8)	0.8	2.2
Operating income	92.1	105.9	78.4	(13.8)	27.5
Interest expense	(42.0)	(44.0)	(58.2)	2.0	14.2
Other expense	(22.0)	(22.8)	(11.3)	0.8	(11.5)
Income before income taxes	28.1	39.1	8.9	(11.0)	30.2
Income taxes:					
Combined income tax rate after manufacturing and processing credits	(7.3)	(10.2)	(2.3)	2.9	(7.9)
Income tax in partners' hands	4.9	7.5	0.7	(2.6)	6.8
Other	(10.4)	(0.9)	(5.8)	(9.5)	4.9
Income taxes	(12.8)	(3.6)	(7.4)	(9.2)	3.8
Net income	15.3	35.5	1.5	(20.2)	34.0

(C\$ millions, unless otherwise noted)	Fiscal 2017	Fiscal 2016	Fiscal 2015	\$ Change	
				Fiscal 2017 vs. Fiscal 2016	Fiscal 2016 vs. Fiscal 2015
Reconciliation of Adjusted EBITDA to Net income:					
Net income	15.3	35.5	1.5	(20.2)	34.0
Interest expense	42.0	44.0	58.2	(2.0)	(14.2)
Income taxes	12.8	3.6	7.4	9.2	(3.8)
Depreciation and amortization	52.4	48.5	42.6	3.9	5.9
Foreign exchange (gain) loss	(1.4)	(0.3)	6.9	(1.1)	(7.2)
Change in amortized cost of Partnership units liability	23.0	23.4	4.0	(0.4)	19.4
Change in fair value of derivatives	0.4	-	-	0.4	-
Loss on sale of fixed assets	-	0.1	0.7	(0.1)	(0.6)
Pension revaluation - past service cost	-	-	3.4	-	(3.4)
Gain on sale of non-financial assets	(0.1)	(2.9)	(1.1)	2.8	(1.8)
Restructuring costs, net	(0.2)	0.6	2.8	(0.8)	(2.2)
Adjusted EBITDA	144.2	152.5	126.4	(8.3)	26.1

Results of Operations Fiscal 2017 compared to Fiscal 2016

Revenue

Revenue was \$1,280.0 million in Fiscal 2017 compared to \$1,227.9 million in Fiscal 2016, an increase of \$52.1 million or 4.2%. The increase in revenue was primarily due to increased sales volume. From a geographic perspective, revenue in Canada increased \$28.1 million, or 3.8%, while revenue in the U.S increased \$23.2 million, or 5.4%, and revenue in Mexico increased \$0.8 million or 1.6%.

Cost of Sales

Cost of sales was \$1,098.1 million in Fiscal 2017 compared to \$1,031.6 million in Fiscal 2016, an increase of \$66.5 million or 6.4%. Manufacturing costs increased primarily due to increased sales volume and also significantly higher commodity costs, particularly pulp and sorted office waste. These cost increases were partially offset by the benefits from cost reduction initiatives and capital projects. Freight and warehousing costs increased compared to Fiscal 2016 primarily due to higher carrier rates, increased sales volume and related inventory transfers. As a percentage of revenue, cost of sales were 85.8% in Fiscal 2017 compared to 84.0% in Fiscal 2016.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$90.1 million in Fiscal 2017 compared to \$92.7 million in Fiscal 2016, a decrease of \$2.6 million or 2.8%. The decrease was primarily due to lower bonus compensation and cost reduction initiatives. As a percentage of revenue, SG&A expenses were 7.0% in Fiscal 2017 compared to 7.5% in Fiscal 2016.

Adjusted EBITDA

Adjusted EBITDA was \$144.2 million in Fiscal 2017 compared to \$152.5 million in Fiscal 2016, a decrease of \$8.3 million or 5.4%. The decrease was primarily due to higher fibre costs, and increased freight and warehousing costs. These were partially offset by increased sales volume, lower SG&A expenses, and the benefits from cost reduction initiatives and capital projects.

Gain on Sale of Non-Financial Assets

During Fiscal 2016, KPLP sold certain timber lands included in the New Westminster 2012 Business Rationalization Project for cash proceeds of \$5.4 million. The sale resulted in a gain on non-financial assets of \$2.9 million, which was recorded in Fiscal 2016.

Interest Expense

Interest expense was \$42.0 million in Fiscal 2017 compared to \$44.0 million in Fiscal 2016, a decrease of \$2.0 million. The decrease was primarily due to lower U.S. interest expense.

Other Expense

Other expense was \$22.0 million in Fiscal 2017 compared to \$22.8 million in Fiscal 2016. Other expense in Fiscal 2017 was primarily related to the change in amortized cost of Partnership units liability of \$23.0 million (Fiscal 2016 – \$23.4 million), and the change in fair value of derivatives of \$0.4 million (Fiscal 2016 – nil). This was partially offset by a foreign exchange gain of \$1.4 million (Fiscal 2016 – \$0.3 million).

Income Taxes

An income tax expense of \$12.8 million was recorded in Fiscal 2017 compared to \$3.6 million in Fiscal 2016, a change of \$9.2 million. KPLP is not directly taxable on its Canadian business. The income tax expense resulted primarily from operating income related to the U.S. entities. Income tax expense in partner's hands was \$4.9 million in Fiscal 2017 compared to \$7.5 million in Fiscal 2016. The impact of U.S. tax reform on the consolidated financial statements for the year ended December 31, 2017 was an increase in deferred tax expense of \$6.2 million on the consolidated statement of comprehensive income (loss) and a corresponding drawdown of the deferred income tax asset of \$6.2 million on the consolidated statement of financial position. The impact on the consolidated financial statements was a result of a decrease in the U.S. federal tax rate from 35% to 21%, effective for taxation years beginning after December 31, 2017. Management has used the best information available to assess the implications of the U.S. tax reform for periods beginning January 1, 2018. However, as more guidance becomes available in respect of the implications of the U.S. tax reform, further adjustments may be required to the consolidated financial statements.

Net Income

Net income was \$15.3 million in Fiscal 2017 compared to \$35.5 million in Fiscal 2016, a decrease of \$20.2 million. The decrease was primarily due to an increase in tax expense of \$9.2 million, lower Adjusted EBITDA of \$8.3 million, higher depreciation expense of \$3.9 million, a decrease in the gain on sale of non-financial assets of \$2.8 million and the change in fair value of derivatives of \$0.4 million,. These items were partially offset by a decrease in interest expense of \$2.0 million, a change in the foreign exchange gain of \$1.1 million, a decrease in restructuring costs of \$0.8 million and a decrease in the change in amortized cost of Partnership units liability of \$0.4 million.

Results of Operations of KPT

(C\$ millions, unless otherwise noted)	Fiscal 2017	Fiscal 2016
Statement of Operations Data:		
Share of income	2.5	5.8
Depreciation of fair value increments	(5.9)	(5.9)
Equity loss	(3.4)	(0.1)
Dilution gain	0.2	0.2
Income (loss) before income taxes	(3.2)	0.1
Income taxes:		
Current tax expense	(0.3)	(1.4)
Deferred tax expense	(1.9)	(0.4)
Income taxes	(2.2)	(1.8)
Net loss	(5.4)	(1.7)
Basic loss per share (dollars)	(0.59)	(0.19)

The financial information presented above is based on KPT's interest in KPLP for Fiscal 2017 and Fiscal 2016. The share of income relates to KPT's share of income of KPLP. Refer to Results of Operations of KPLP above for an explanation of the results. The depreciation of fair value increments relates to adjustments to the carrying amount of certain assets of KPLP on its acquisition by KPT. Refer to note 5 in KPT's financial statements for additional information.

The current income tax expense is based on KPT's share of the taxable income of KPLP for the same periods. The deferred tax expense is a result of changes in the temporary differences of KPLP's assets and liabilities since acquisition and the difference between the accounting and tax basis for KPT's investment in KPLP. Refer to note 6 in KPT's financial statements for additional information.

Pursuant to the Tax Distribution as defined in the Partnership Agreement, on February 28, 2017, KPLP declared a Tax Distribution of \$8.6 million, of which \$1.4 million was used to settle the advances to KPT and pay the final tax instalment on behalf of KPT. The remaining \$7.2 million was used to settle Kruger Inc.'s and KPGP's respective advances, with the balance paid to Kruger Inc. and KPGP. KPT received an advance from KPLP of \$1.0 million during Fiscal 2017 to pay the Fiscal 2017 monthly tax instalments. The advances are non-interest bearing and non-recourse and were partially offset against the Tax Distributions of \$1.9 million paid by the Partnership on February 28, 2018. The excess advances over the Tax Distributions in the amount of \$4.5 million are repayable by the partners to the Partnership by March 31, 2019.

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

SEGMENT INFORMATION

Segment Operating Income

Segment operating income is the earnings (loss) for each such segment before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (gain on sale) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) foreign exchange loss (gain), (viii) costs related to restructuring activities, (ix) changes in amortized cost of Partnership units liability, (x) change in fair value of derivatives, and (xi) one-time costs due to pension revaluations related to past service. “Consumer Segment Adjusted EBITDA”, “AFH Segment Adjusted EBITDA”, and “Other Segment Adjusted EBITDA” means in each case the Segment operating income for the referring respective segment of KPLP.

Segment Results

(C\$ millions, unless otherwise noted)	Fiscal 2017	Fiscal 2016	Fiscal 2015	Fiscal 2017 vs Fiscal 2016		Fiscal 2016 vs Fiscal 2015	
				\$ Change	% Change	\$ Change	% Change
Segment Revenue							
Consumer	1,040.4	986.8	898.0	53.6	5.4%	88.8	9.9%
AFH	233.3	227.1	220.3	6.2	2.7%	6.8	3.1%
Other	6.3	14.0	20.6	(7.7)	-55.0%	(6.6)	-32.0%
Total segment revenue	1,280.0	1,227.9	1,138.9	52.1	4.2%	89.0	7.8%
Segment Adjusted EBITDA							
Consumer	138.2	146.4	122.5	(8.2)		23.9	
AFH	6.2	5.2	5.4	1.0		(0.2)	
Other	(0.2)	0.9	(1.5)	(1.1)		2.4	
Total Segment Adjusted EBITDA	144.2	152.5	126.4	(8.3)		26.1	

Consumer Segment

Fiscal 2017 compared to Fiscal 2016

Consumer segment revenue was \$1040.4 million in Fiscal 2017 compared to \$986.8 million in Fiscal 2016, an increase of \$53.6 million or 5.4%, due primarily to increased sales volume in the U.S. and Canada.

Consumer Segment Adjusted EBITDA was \$138.2 million in Fiscal 2017 compared to \$146.4 million in Fiscal 2016, a decrease of \$8.2 million. The decrease was primarily due to higher commodity costs, particularly pulp and sorted office waste, and higher freight costs, partially offset by increased sales volume and lower SG&A expenses.

AFH Segment

Fiscal 2017 compared to Fiscal 2016

AFH segment revenue was \$233.3 million in Fiscal 2017 compared to \$227.1 million in Fiscal 2016, an increase of \$6.2 million or 2.7%, due primarily to increased sales volume. AFH segment revenue increased in Canada, and decreased in the U.S.

AFH Segment Adjusted EBITDA was \$6.2 million in Fiscal 2017 compared to \$5.2 million in Fiscal 2016, an increase of \$1.0 million. This increase was due primarily to increased sales volume, improved manufacturing efficiency, and the benefit from capital projects, partially offset by higher fibre costs.

Other Segment

Fiscal 2017 compared to Fiscal 2016

Other segment revenue was \$6.3 million in Fiscal 2017 compared to \$14.0 million in Fiscal 2016, a decrease of \$7.7 million due to lower parent roll sales.

Other Segment Adjusted EBITDA was a loss of \$0.2 million in Fiscal 2017 compared to EBITDA income of \$0.9 million in Fiscal 2016, a decrease of \$1.1 million primarily due to lower parent roll sales, and start-up costs related to the PM8 project in Crabtree.

LIQUIDITY AND CAPITAL RESOURCES

Overview

KPLP's principal uses of funds are for operating costs, working capital, capital expenditures and pension contributions (together, the Funding Requirements). To date, KPLP has met the Funding Requirements by using cash generated from operating activities and from borrowings under its various debt facilities. The registered defined benefit pension plans (RDBPP) sponsored by KPLP are currently in a solvency deficiency position, requiring KPLP to make funding contributions over the next ten years. KPLP Management believes that cash generated from operations, together with amounts available under the various debt facilities will be sufficient to meet its future funding requirements. However, KPLP's ability to fund future requirements and its ability to make scheduled payments of interest and principal on its debt facilities and to satisfy any of its other present or future debt obligations will depend on its future operating performance, which will be affected by general economic, financial and other factors including factors beyond its control. KPLP Management reviews investment opportunities in the normal course of its business and may, if suitable opportunities arise, make selected investments to implement KPLP's business strategy. Historically, the funding for any such investments has come from cash flow from operations and/or additional debt.

As of December 31, 2017, the Caisse Facility, which matures on August 16, 2018, has been classified as short-term debt, resulting in a working capital deficit. Management fully expects to refinance all or part of the indebtedness prior to the maturity date and is currently exploring various refinancing alternatives.

There can be no assurance that refinancing can be obtained. Refer to the "Risk Factors" section of the 2017 Annual Information Form dated March 9, 2018 available on SEDAR at www.sedar.com.

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

Typically, approximately \$25 million of the annual capital expenditures are related to maintenance projects and the remaining expenditures are focused on growth projects aimed at reducing costs or increasing production capacity. Regular growth projects focused on performance improvement generally have a 3 to 4 year payback. Capital expenditures were \$69.8 million in Fiscal 2017. Approximately half of the capital expenditures in Fiscal 2017 relate to PM8.

As of December 31, 2017, KPLP was in compliance with all of its financial covenants under all of its outstanding credit facilities. As of December 31, 2017, KPLP had drawn \$191.1 million from the \$300.0 million committed amount under the Senior Credit Facility, and had \$25.9 million of letters of credit outstanding, resulting in \$83.0 million available from the credit line, subject to covenant limitations. As of December 31, 2017, KPLP had total liquidity of \$53.3 million (December 31, 2016 - \$103.5 million) representing cash and cash equivalents and availability under the credit line within the covenant limitations.

The tissue industry is generally characterized by high sales volume and rapid turnover of inventories and accounts receivable. In general, accounts receivable and inventories are readily convertible into cash. Investment in working capital may be affected by fluctuations in the prices of pulp and other supply costs, vendor terms and timing of collection of accounts receivable.

Cash Flows

(C\$ millions, unless otherwise stated)	Fiscal 2017	Fiscal 2016	Fiscal 2015	\$ Change	
				Fiscal 2017 vs. Fiscal 2016	Fiscal 2016 vs. Fiscal 2015
Net cash flows from operating activities	99.2	142.1	84.0	(42.9)	58.1
Net cash flows used in investing activities	(63.9)	(73.0)	(56.6)	9.1	(16.4)
Net cash flows used in financing activities	(61.9)	(66.0)	(56.8)	4.1	(9.2)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	(1.1)	(1.1)	3.1	-	(4.2)
Increase (decrease) in cash and cash equivalents	(27.7)	2.0	(26.3)	(29.7)	28.3
Beginning cash and cash equivalents, net	27.5	25.5	51.8	2.0	(26.3)
Ending cash and cash equivalents, net	(0.2)	27.5	25.5	(27.7)	2.0
Bank indebtedness	9.0	9.0	-	-	9.0
Ending cash and cash equivalents	8.8	36.5	25.5	(27.7)	11.0

Net Cash Flows from Operating Activities

Net cash from operating activities was \$99.2 million in Fiscal 2017 compared to \$142.1 million in Fiscal 2016. Cash from operating activities in Fiscal 2017 was primarily driven by Adjusted EBITDA of \$144.2 million, partially offset by cash outflow required for working capital of \$35.2 million in Fiscal 2017 compared to cash inflow of \$1.4 million in Fiscal 2016, funding of pension and post-retirement benefit plans and income tax payments.

Net Cash Flows used in Investing Activities

Net cash used in investing activities was \$63.9 million in Fiscal 2017 compared to \$73.0 million in Fiscal 2016. Cash used in investing activities related primarily to capital expenditures (including purchases of software and capitalized interest) of \$69.8 million in Fiscal 2017 compared to \$82.2 million in Fiscal 2016. In addition, government assistance of \$4.6 million was received in Fiscal 2017 compared to \$2.4 million in Fiscal 2016.

Net Cash Flows used in Financing Activities

Net cash used in financing activities was \$61.9 million in Fiscal 2017 compared to cash used of \$66.0 million in Fiscal 2016. Net cash used in financing activities in Fiscal 2017 was primarily due to interest paid of \$33.1 million, distributions and advances paid of \$31.5 million (net of DRIP proceeds) and repayment of long-term debt of \$26.0 million. This was partially offset by proceeds from long-term debt of \$28.8 million.

Contractual Obligations

(C\$ millions, unless otherwise stated)	Fiscal 2018	Fiscal 2019	Fiscal 2020	Fiscal 2021	Thereafter
Contractual obligations:					
Senior Credit Facility, principal repayments	-	-	182.0	-	-
Nordea Credit Facility, principal repayments	8.3	8.3	-	-	-
TAD Credit Facility, principal repayments ^(a)	183.9	-	-	-	-
Ontario Loan, principal repayments	-	-	-	-	3.0
Quebec PM Loan, principal repayments	0.9	4.9	4.9	4.9	22.2
Interest expense	22.4	7.5	7.2	7.1	1.6
Operating leases	14.6	13.6	11.2	8.5	40.7
Service contracts	6.0	4.9	3.6	0.6	-
Total contractual obligations	236.1	39.2	208.9	21.1	67.5

(a) KPLP expects to refinance the facility at maturity.

KPLP's cash pension contribution for defined benefit pension arrangements in Fiscal 2017 was \$12.1 million, while its post-retirement benefits contribution was \$3.0 million. In addition, as of December 31, 2017, KPLP had \$25.5 million

of letters of credit related to pensions outstanding. Pension and post-retirement contributions for fiscal 2018 are expected to be \$16.2 million.

KPLP 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. The installation is expected to be complete during the year ended December 31, 2018.

As of December 31, 2017, KPLP had foreign exchange swaps outstanding of \$31.5 million (December 31, 2016 – nil) and foreign exchange forwards of \$19.0 million (December 31, 2016 – nil), with settlement dates ranging from January 3, 2018 to January 31, 2018.

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. KPLP determined that it was appropriate to reclassify a portion of its equity to Partnership units liability, since the Tax Distribution represents a contractual obligation to deliver cash and, as such, meets the definition of a financial liability for accounting purposes under IFRS. As of December 31, 2017, \$160.3 million was recorded as a liability in respect of this obligation (December 31, 2016 - \$145.9 million). The amount is in respect of a previously disclosed obligation owed to the partners of KPLP. It does not change the rights of or obligations owed to the partners of KPLP, and does not result in any change to the financial statements of KPT.

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

Pursuant to the Administration Agreement, KPLP, as administrator (the Administrator) has full power and authority to administer, subject to the general supervision and any specific instructions of the KPT Board, all of the ongoing operations and affairs of KPT in order for KPT to carry on its activities as a public company. The Administrator shall directly bear and pay for all KPT's normal operating expenses incurred in connection with the ordinary course operation of a company that is a reporting issuer. The Administrator may also advance funds to KPT in an amount equal to pay for any expenses of KPT that are outside of such ordinary course expenses, by way of non-recourse, interest-free loans, repayable upon payment by the Administrator of distributions to KPT. As KPT's agent, the Administrator will also bear and pay all outlays and expenses to third parties incurred by the Administrator in the administration of the affairs of KPT and the performance by the Administrator of its duties under the Administration Agreement.

Indebtedness

Senior Credit Agreement

General

KPLP is a party to a fifth amended and restated credit agreement dated as of September 28, 2015 entered into by KPLP, as borrower, the lenders party thereto and National Bank of Canada, as administrative agent as amended by a consent letter dated as of March 8, 2016 and by a first Supplemental Credit Agreement dated as of August 9, 2016 (the Senior Credit Agreement) pursuant to which a senior secured revolving credit facility in a maximum amount of \$300 million with a \$150 million accordion feature (the Senior Credit Facility) is made available to KPLP. The maturity date of the Senior Credit Facility is September 25, 2020. The Senior Credit Facility is to be used by KPLP to finance general

corporate purposes and the ongoing working capital requirements of the Restricted Credit Parties (as defined below) redeeming the Senior Unsecured Notes and to finance the cash portion of any permitted acquisition or investment by any such Restricted Credit Party (as defined below).

Under the Senior Credit Agreement, “Restricted Credit Parties” means KPLP, KPGP, Kruger Products Real Estate Holdings Inc., Grupo Tissue De Mexico S de RL de CV, Kruger Products (USA) Inc., Kruger Products AFH G.P. Inc. and Kruger Products AFH L.P. and their respective subsidiaries involved in the tissue business but excluding the Unrestricted Credit Parties (which include TAD Canco Inc., TAD Luxembourg S.A.R.L and KTG) and the Non-Material Credit Parties (as such terms are defined in the Senior Credit Agreement).

Interest Rates and Fees

Borrowings under the Senior Credit Facility bear interest at a base rate of Prime Rate, U.S. Base Rate, LIBOR, Bankers’ Acceptance Stamping Fees or LC Fees (as defined in the Senior Credit Agreement), plus a margin varying between 0.20% and 2.375% depending on the Restricted Credit Parties’ ratio of funded debt to EBITDA (as defined in the Senior Credit Agreement) and the type of advance. Stand-By Fees are also payable on the available portion of the Senior Credit Facility at a rate varying between 0.24% and 0.475% depending on the Restricted Credit Parties’ ratio of funded debt to EBITDA (as defined in the Senior Credit Agreement).

Prepayments and Repayments

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

Covenants

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

The Senior Credit Agreement requires the Restricted Credit Parties to comply with certain financial covenants, including, but not limited to, the maintenance of (i) a ratio of funded debt to EBITDA not greater than 3.50 to 1.00, and (ii) an interest coverage ratio of at least 3.00 to 1.00. The financial covenants are calculated on an Adjusted Consolidated Basis (as defined in the Senior Credit Agreement) such that the Unrestricted Credit Parties are accounted for as investments but not consolidated. As such, indebtedness under the Caisse Facility and KTG’s EBITDA are not included in such calculations.

The Senior Credit Agreement contains customary negative covenants of KPLP, including, but not limited to, (i) restrictions on the ability of KPLP and the Restricted Credit Parties to, subject to certain exceptions, grant liens, incur indebtedness, merge or consolidate, amend, restate or otherwise modify the Limited Partnership Agreement, make investments and loans, grant guarantees, make acquisitions, declare, set apart and pay distributions (which does not apply to the Tax Distribution (as defined below) to KPT), reduce capital, sell or otherwise dispose of assets, incur capital expenditures or materially change their business, and (ii) restrictions on the indebtedness of TAD Canco Inc., TAD Luxembourg S.A.R.L and KTG and the amendment of the TAD financing documents.

Events of Default

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

Security and Guarantees

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

Nordea Credit Agreement

General

KPLP is a party to a third amended and restated credit agreement dated as of September 28, 2015 entered into by KPLP, as borrower, the lender party thereto and Nordea Bank A.B. (publ), as administrative agent (the Nordea Credit Agreement) pursuant to which a senior secured non-revolving loan facility in a maximum amount of U.S. \$46.2 million (the Nordea Credit Facility) was made available to KPLP. The Nordea Credit Facility was used to pay up to 85% of the equity investment of KPLP in the Memphis TAD Machine and the fees of the Swedish Export Credits Guarantee Board (EKN) in connection with its guarantee of the Nordea Credit Facility. The Nordea Credit Facility matures on December 30, 2019.

Interest Rates and Fees

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

Prepayments and Repayments

The Nordea Credit Facility is repayable in 14 equal consecutive semi-annual installments of principal together with interest commencing on June 28, 2013. Prepayments are allowed subject to a make-whole payment on account of interest losses.

Covenants

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

Events of Default

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

Security and Guarantees

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

TAD Credit Agreement

General

TAD Canco is a party to a credit agreement dated as of August 16, 2011 entered into between TAD Canco, as borrower, TAD Luxembourg and KTG, as guarantors, and Caisse de dépôt et placement du Québec (Caisse), as lender (as amended as of September 21, 2012, the TAD Credit Agreement) pursuant to which a non revolving term loan facility for a maximum amount of U.S.\$211.1 million was made available to TAD Canco (the Caisse Facility). Under the terms of the Caisse Facility, KPLP could only make draws until February 15, 2014. As of that date, KPLP had drawn U.S.\$125.0 million. The Caisse Facility was used by TAD Canco to invest in TAD Luxembourg, which in turn lends such proceeds to KTG on substantially the same terms and conditions as the Caisse Facility to finance the Memphis TAD Machine. Recourse under the Caisse Facility is limited to TAD Canco, TAD Luxembourg and KTG. The Caisse Facility matures on August 16, 2018.

As of December 31, 2017, the Caisse Facility, which matures on August 16, 2018, has been classified as short-term debt, resulting in a working capital deficit. Management fully expects to refinance all or part of the indebtedness prior to the maturity date and is currently exploring various refinancing alternatives.

There can be no assurance that refinancing can be obtained. Refer to the “Risk Factors” section of the 2017 Annual Information Form dated March 9, 2018 available on SEDAR at www.sedar.com.

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

Interest Rates and Fees

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

Prepayments and Repayments

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

Change of Ownership

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

Covenants

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

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

Events of Default

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

Security and Guarantees

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

Ontario Loan Agreement

General

KPLP is a party to a conditional loan agreement dated as of July 1, 2015 entered into by KPLP, as borrower, and the Government of Ontario as lender (the Ontario Loan Agreement) pursuant to which a secured non-revolving loan in a maximum amount of \$10.0 million (the Ontario Loan) is made available to KPLP. The Ontario Loan is being used to partially finance the expansion project at the Trenton facility. The Ontario Loan Agreement matures ten years after the first loan disbursement, which occurred on February 24, 2016.

Interest Rates and Fees

Borrowings under the Ontario Loan bear interest, up to a maximum rate of 4.4% per annum for a period of ten years from the date of the first loan disbursement. A portion of the loan interest is forgivable, subject to prescribed conditions.

Prepayments and Repayments

The Ontario Loan has a moratorium on repayment of the principal for the initial five years following the date of the first loan disbursement, after which the principal is to be repaid in five equal annual payments. A portion of the loan principal is forgivable, subject to prescribed conditions, up to a maximum forgivable portion of \$5.0 million.

Covenants

The Ontario Loan Agreement contains covenants including, but not limited to, delivery of financial and other information to the Government of Ontario, the preservation of existence, maintenance of insurance, compliance with laws, payment of taxes, completion of project and limitations on project procurement. The Ontario Loan Agreement also contains restrictions on the disposition of assets and changing the nature of the business and an undertaking to comply with the negative covenants in the Senior Credit Agreement.

Events of Default

The Ontario Loan Agreement contains customary events of default such as non-performance, non-payment, misrepresentation, breach of covenants and abandonment of the project and also provides for a cross-default to the Senior Credit Agreement.

Security and Guarantees

The Ontario Loan is secured by the assets acquired for the expansion project at the Trenton facility.

Quebec PM Loan Agreement

General

KPLP is a party to a loan agreement dated as of August 9, 2016 entered into by KPLP, as borrower, and Investissement Québec as lender (the Quebec PM Loan Agreement) pursuant to which a secured non-revolving loan in a maximum amount of \$39.5 million (the Quebec PM Loan) is made available to KPLP. The Quebec PM Loan is being used to partially finance the acquisition and relocation of a paper machine to be installed at the Crabtree facility (PM Project). The Quebec PM Loan Agreement matures ten years after the first loan disbursement, which occurred on September 6, 2016.

Interest Rates and Fees

Borrowings under the Quebec PM Loan bear interest at a fixed interest rate of 2.5% per annum for a period of seven years from the date of the first loan disbursement. The interest rate thereafter increases to a fixed rate of 3.5% per annum until the eighth anniversary of the first loan disbursement, a fixed rate of 4.5% per annum until the ninth anniversary of the first loan disbursement, and a fixed rate of 5.5% per annum thereafter. Monthly interest payments commence the month following the first loan disbursement.

Prepayments and Repayments

The Quebec PM Loan has a moratorium on repayment of the principal for the initial 24 months following the date of the first loan disbursement, after which the principal is to be repaid in 96 monthly consecutive payments. The monthly repayments are reduced, in the reverse order of maturity, by repayments to Investissement Québec corresponding to KPLP's receipt of Government of Quebec electricity tariff rebates.

Covenants

The Quebec PM Loan Agreement contains covenants including, but not limited to, delivery of financial and other information to Investissement Québec, the preservation of existence, maintenance of insurance and maintenance of operations. The Quebec PM Loan Agreement also contains restrictions on the disposition of assets, incurrence of indebtedness and granting of liens, change of control and changes in the PM Project.

Events of Default

The Quebec PM Loan Agreement contains customary events of default such as non-performance, non-payment, misrepresentation and breach of covenants.

Security and Guarantees

The Quebec PM Loan is secured by the acquired paper machine and the portion of the property on which the paper machine will be installed. The security is second ranking immediately after the security granted in favour of the Senior Credit Facility.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

Currency Risk

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

As of December 31, 2017, KPLP had net liabilities denominated in U.S. dollars of \$23.2 million (December 31, 2016 – \$33.0 million). Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the result on net income before tax in Fiscal 2017 would have been an increase (decrease) of approximately \$1.2 million (Fiscal 2016 – \$1.7 million).

KPLP uses derivative financial instruments to manage foreign currency risk. Foreign exchange swaps and foreign exchange forwards are used to manage U.S. dollar borrowings. As of December 31, 2017, KPLP had foreign exchange swaps outstanding of \$31.5 million (December 31, 2016 – nil) and foreign exchange forwards outstanding of \$19.0 million (December 31, 2016 – nil), with settlement dates ranging from January 3, 2018 to January 31, 2018. Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the result on net income before tax in Fiscal 2017 would have been a (decrease) increase of approximately \$2.4 million (Fiscal 2016 – nil).

Interest Rate Risk

KPLP's interest rate risk arises from its variable rate debt related to the revolving credit facility. As of December 31, 2017, KPLP had variable rate debts of \$181.1 million (December 31, 2016 – \$196.7 million). This facility bears interest at a base rate of Canadian prime rate, U.S. base rate, banker's acceptance rates or LIBOR plus the applicable margins. The applicable margin on the loans ranges between 0.20% and 2.375%.

A 100 basis point increase (decrease) in the market rate of interest would result in a decrease (increase) in net income before tax of \$1.8 million (Fiscal 2016 - \$2.0 million).

From time to time, KPLP uses interest rate swaps to manage part of its exposure to movements in interest rates on its credit facilities. KPLP had no interest rate swaps or interest rate derivatives outstanding as of December 31, 2017.

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. KPLP's financial instruments exposed to credit risk as of December 31, 2017 included cash and cash equivalents, trade and other receivables, receivables from related parties and advances to partners. KPLP places its cash and cash equivalents with financial institutions of high creditworthiness.

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

Liquidity Risk

The purpose of liquidity risk management is to maintain sufficient cash and cash equivalents and to ensure KPLP has sufficient authorized credit facilities to maintain liquidity and meet its future obligations as they come due. As of December 31, 2017, KPLP had drawn \$191.1 million from the \$300.0 million committed amount under the Senior Credit Facility entered into on September 28, 2015, maturing in September 2020. KPLP had \$25.9 million of letters of credit outstanding, resulting in \$83.0 million available from the credit line, subject to covenant limitations. As of December 31, 2017, KPLP had total liquidity of \$53.3 million (December 31, 2016 - \$103.5 million) representing cash and cash equivalents and availability under the credit line within the covenant limitations. KPLP prepares projections to ensure it has sufficient funds to fulfill its obligations. The ability to pay its obligations relies on KPLP collecting its trade receivables in a timely manner and by maintaining sufficient cash and cash equivalents in excess of anticipated needs. KPLP's trade and other payables of \$190.7 million as of December 31, 2017 (December 31, 2016 - \$201.5 million) are all due for payment within twelve months of the dates of the consolidated statements of financial position.

As of December 31, 2017, the Caisse Facility, which matures on August 16, 2018, has been classified as short-term debt, resulting in a working capital deficit. Management fully expects to refinance all or part of the indebtedness prior to the maturity date and is currently exploring various refinancing alternatives.

There can be no assurance that refinancing can be obtained. Refer to the "Risk Factors" section of the 2017 Annual Information Form dated March 9, 2018 available on SEDAR at www.sedar.com.

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

Commodity Price Risk

Commodity price risk is the risk that future cash flows associated with purchasing required raw materials will fluctuate due to changes in commodity prices, which can be affected by foreign exchange and other trade related risks. KPLP is subject to commodity price fluctuations since KPLP's main raw material is fibre, which changes price due to market conditions, and therefore can result in periodic earnings volatility in the short term. Historically, the industry has generally been able to mitigate its exposure to commodity price risk over the medium term by passing increases in its supply costs onto its customers through incremental price increases, depending on the supply and demand balance. The ability to eventually pass through the full amount of pulp cost increases can be impacted by the competitive market situation. From time to time, KPLP enters into futures contracts to manage its commodity risk. No such contracts were outstanding as of December 31, 2017.

TRANSACTIONS WITH RELATED PARTIES

Kruger provides certain management and support services to KPLP, including corporate management and administrative support; accounting and tax support; corporate financing support; corporate treasury support; benefits and human resources support; corporate legal and secretarial, corporate insurance; corporate procurement support; and corporate engineering support. Such services are provided pursuant to a Management Services Agreement. KPLP pays Kruger an annual management fee of \$4.3 million (2016 - \$4.2 million).

KPLP also leases warehouses located in Laval, Québec and Vancouver, British Columbia from an entity of which an affiliate of Kruger is a 50% owner.

KPLP purchases certain supplies and services from Kruger and its affiliates, including fibre and small quantities of pulp and packaging. These transactions generally take place on arm's-length terms. KPLP also has the ability to procure these goods and services from third party suppliers.

Sales of goods to Kruger during Fiscal 2017 were \$1.1 million (Fiscal 2016 - \$0.9 million). Goods are sold based on the price lists in force and terms that would be available to third parties.

Purchases of goods and services from Kruger during Fiscal 2017 were \$36.2 million (Fiscal 2016 - \$33.1 million). Purchases of goods and services from subsidiaries of Kruger during Fiscal 2017 were \$10.5 million (Fiscal 2016 - \$8.3

million). Goods are purchased from Kruger and related parties under normal commercial terms and conditions. These purchases of goods and services are included within cost of sales and SG&A expenses. During Fiscal 2017, management fees of \$4.3 million (Fiscal 2016 - \$4.2 million) were paid to Kruger Inc. for management services provided to KPLP.

OFF BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

KPLP has entered into operating lease commitments related to land, buildings, IT services, vehicles and other machines and equipment. Contractual obligations including these operating leases are described in the “Contractual Obligations” subsection under the “Liquidity and Capital Resources” section of this MD&A.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements is in accordance with IFRS, which requires KPLP Management to make estimates and assumptions that affect the reported amounts and disclosures made in the KPLP and KPT financial statements and accompanying notes. KPLP Management continually evaluates the estimates and assumptions it uses. These estimates and assumptions are based on KPLP Management’s historical experience, best knowledge of current events and conditions and activities that KPLP and KPT may undertake in the future. Actual results could differ materially from these estimates. The estimates and assumptions described in this section depend upon subjective or complex judgment that may be uncertain and changes in these estimates and assumptions could materially impact the financial statements.

Pension and Post-Retirement Benefit Obligations

The cost and accrued benefit plan obligations of KPLP’s pension plans, consisting of the RDBPP, supplementary retirement arrangements and the Annuity Arrangement and other benefit plans are accrued based on actuarial valuations that are dependent on assumptions determined by KPLP Management. These assumptions include the discount rate, the expected growth rate of health care costs, the rate of compensation increase, and retirement ages and mortality rates. These assumptions are reviewed quarterly by KPLP Management and KPLP’s actuaries. The discount rate (based on market rates), and the expected growth rate in health care costs represent the most significant assumptions.

Partnership Units

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. KPLP determined that it was appropriate to reclassify a portion of its equity to Partnership units liability, since the Tax Distribution represents a contractual obligation to deliver cash and, as such, meets the definition of a financial liability for accounting purposes under IFRS. The liability is based on management’s best estimate of expected future Tax Distributions. Projections of tax payable are based on additional assumptions including estimates of taxable income and tax rates. Taxable income can differ significantly from accounting income as a result of both timing and permanent tax differences based on enacted tax legislation and therefore changes in the Partnership units obligation are not necessarily indicative of a change in the expected future profitability of KPLP. An increase/decrease in the discount rate by 0.5% would result in a decrease/increase in the Partnership units liability of approximately \$8.1 million and \$9.0 million, respectively. The discount rate reflects the risks associated with the business, which operates primarily in Canada.

As of December 31, 2017, \$160.3 million was recorded as a liability in respect of this obligation (December 31, 2016 - \$145.9 million). The Partnership units liability was adjusted during Fiscal 2017 to reflect the current year advances made to the partners required to allow KPT to make tax installment payments. The change in amortized cost of Partnership units liability of \$23.0 million recorded during Fiscal 2017 has been included in Other expense, and also includes an increase of \$21.1 million for the reassessment performed as of December 31, 2017. The reassessment reflects KPLP’s estimate of the net present value of the financial liability arising from the obligation to make the Tax Distribution using estimates of tax payable by KPT and a discount rate and terminal growth rate of 11.75% and 2.0% (December 31, 2016 – 11.50% and 2.0%), respectively. The change in the discount rate resulted in a decrease in liability of \$4.4 million.

Equity Method of Accounting

The equity method of accounting is being applied by KPT as it relates to its investment in KPLP. The conclusion to account for an investment using the equity method, particularly when the percentage of ownership is below 20%, is based on an assessment of several facts and circumstances and ultimately requires significant judgment in reaching a conclusion. Management has reviewed the agreements and made an assessment of the rights of KPT. Based on KPT having three of nine seats on the board of directors of KPGP, management has concluded that KPT has the ability to exercise significant influence over KPLP.

Impairment Tests

KPLP performs an annual impairment test for goodwill and indefinite lived trademarks. KPT is required to perform an impairment test on its investment in KPLP if there is objective evidence that the investment may be impaired. Under IFRS, KPT and KPLP did not perform an impairment test at December 31, 2017, as there were no events or changes in circumstances to indicate that the assets may be impaired.

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 based on an assessment of the ability to use the underlying tax deductions and credits against future taxable income. The assessment requires an estimate of future taxable income compared to the net operating loss carry forwards and U.S. State tax credits. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period. During the year ended December 31, 2017, KPLP reassessed its ability to utilize the U.S. state tax credits. As a result of the reassessment, a reversal of \$2.8 million of the U.S. state tax credits was recorded in the consolidated statement of comprehensive income (loss). The impact of U.S. tax reform on the consolidated financial statements for the year ended December 31, 2017 was an increase in deferred tax expense of \$6.2 million on the consolidated statement of comprehensive income (loss) and a corresponding drawdown of the deferred income tax asset of \$6.2 million on the consolidated statement of financial position. The impact on the consolidated financial statements was a result of a decrease in the U.S. federal tax rate from 35% to 21%, effective for taxation years beginning after December 31, 2017. Management has used the best information available to assess the implications of the U.S. tax reform for periods beginning January 1, 2018. However, as more guidance becomes available in respect of the implications of the U.S. tax reform, further adjustments may be required to the consolidated financial statements.

KPT has not recognized at the date of acquisition the deferred tax assets and liabilities related to the differences between the accounting and tax basis of KPLP's assets and liabilities. Accordingly, KPT is tracking temporary differences that are subject to the initial recognition exemption and recognizes newly created temporary differences as they arise. The determination of the temporary differences that are subject to the initial recognition exemption requires significant judgment. KPT has not recognized the deferred tax asset related to its Investment in KPLP.

ACCOUNTING CHANGES AND FUTURE ACCOUNTING STANDARDS

Accounting Standards Implemented for the Year Ended December 31, 2017

IAS 7, Statement of Cash Flows. In January 2016, the IASB issued an amendment to require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Other than the aforementioned additional disclosures, the application of the amendments to IAS 7 did not result in any changes to the presentation of the consolidated statement of cash flows.

IAS 12, Income Taxes – Deferred Tax. In February 2016, the IASB issued an amendment to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendment clarifies the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. Certain other aspects of accounting for deferred tax assets are also clarified. The adoption of this standard had no impact on the consolidated financial statements.

In December 2016, the IASB issued an amendment clarifying the scope of IFRS 12, Disclosure of Interests in Other Entities. The amendment clarified that the disclosures requirement of IFRS 12 are applicable to interest in entities classified as held for sale, except for summarized financial information. The adoption of this standard had no impact on the consolidated financial statements.

Future Accounting Standards

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2018, with earlier application permitted where indicated. KPLP and KPT Management continue to assess the impact of these standards and amendments and have not yet determined whether it will early adopt them, except as noted below.

IFRS 15, Revenue from Contracts with Customers, was issued by the IASB in May 2014. The standard specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with some informative, relevant disclosures. The standard supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions being leases, financial instruments and insurance contracts. In September 2015, the IASB issued an amendment to defer the mandatory effective date to interim periods beginning on or after January 1, 2018, with early adoption permitted. In April 2016, the IASB issued an amendment to clarify the guidance on identifying performance obligations, licences of intellectual property and principal versus agent, and to provide additional practical expedients on transition. The amendment is effective for annual periods beginning on or after January 1, 2018.

Management has performed an assessment of IFRS 15 adoption and does not expect a significant impact on the consolidated financial statements. It is expected that the application of IFRS 15 will result in a change in the revenue recognition related to dispensers and related revenue. Management will adopt IFRS 15 using the modified retrospective approach. A transitional adjustment of \$6.3 million to reduce the balance related to the dispensers currently recorded in Other long term assets will be recognized in retained earnings (deficit) on the date of initial application, January 1, 2018.

IFRS 9, Financial Instruments. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 would be annual periods beginning on or after January 1, 2018, with early adoption permitted. Management has performed a preliminary assessment of IFRS 9 adoption and does not expect a significant impact on the consolidated financial statements.

IFRS 16, Leases. In January 2016, the IASB issued IFRS 16, Leases which replaces the current guidance in IAS 17, Leases. IFRS 16 requires lessees to recognize a right-of-use asset and a lease liability reflecting future lease payments for virtually all lease contracts. IFRS 16 must be applied to an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2019, with early adoption permitted. Management can elect to adopt IFRS 16 using either the full retrospective approach or the modified retrospective approach.

Management has performed a preliminary assessment of IFRS 16 adoption and expects a significant impact on the consolidated financial statements. The right-of-use asset and lease liability are expected to be material to the consolidated statement of financial position. There is expected to be a change in presentation on the consolidated statement of comprehensive income (loss) and a significant impact on Adjusted EBITDA. IFRS 16 replaces operating lease expense (recorded in Cost of sales and Selling, general and administrative expenses) with a depreciation charge for right-of-use assets and interest expense on lease liabilities. The amount related to the depreciation charge and interest expense will differ from the previous operating lease expense. Both the depreciation charge and interest expense are excluded from the calculation of Adjusted EBITDA, while the operating lease expense was previously included in the calculation. Changes to systems and processes are expected to be required, in order to collect the new data requirements.

Management is evaluating the potential implications on data systems, internal controls over financial reporting, information technology, business processes, and financing and compensation arrangements. Management is also evaluating the transition approach it will apply and whether it will use the optional exemptions or practical expedients under the standard. Additional details, including the transition approach, practical expedients elected and estimated quantitative impact on the consolidated financial statements are expected to be disclosed before the adoption of IFRS 16.

IFRIC 23, Uncertainty over income tax treatments. In June 2017, the IFRS Interpretation Committee issued an interpretation which clarifies how the recognition and measurement requirements of IAS 12 Income taxes, are applied where there is uncertainty over income tax treatments. The interpretation is effective for annual periods beginning on or after January 1, 2019. Management has performed a preliminary assessment of IFRIC 23 adoption and does not expect a significant impact on the consolidated financial statements.

SELECTED ANNUAL FINANCIAL INFORMATION

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

(C\$ millions, unless otherwise stated)	December 31, 2017	December 31, 2016
KPT Financial Information		
Total assets	101.2	119.4
Total liabilities	4.2	4.3
KPLP Financial Information		
Total assets	1,299.8	1,337.0
Total liabilities	976.2	954.3

SELECTED QUARTERLY FINANCIAL INFORMATION

The following table summarizes quarterly financial results for KPLP for the last eight quarters:

(C\$ millions, unless otherwise stated)	2017				2016			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Number of days in the period	98	91	91	85	97	91	91	87
Revenue	340.0	336.3	314.4	289.3	339.6	312.8	295.8	279.7
Net income (loss) for the period	(18.0)	16.5	9.9	6.9	(4.5)	21.6	12.0	6.4
Reconciliation of Net income (loss) to Adjusted EBITDA								
Net income (loss)	(18.0)	16.5	9.9	6.9	(4.5)	21.6	12.0	6.4
Interest expense	10.4	10.5	10.8	10.3	10.7	11.2	10.9	11.2
Income taxes	7.8	0.1	2.2	2.7	2.0	0.1	0.9	0.6
Depreciation and amortization	13.3	14.6	12.5	12.0	13.8	12.3	12.0	10.4
Foreign exchange (gain) loss	0.9	(1.2)	(0.5)	(0.6)	0.9	0.8	(0.3)	(1.7)
Change in amortized cost of Partnership units liability	18.9	(0.9)	2.5	2.5	22.2	-	-	1.2
Change in fair value of derivatives	0.4	-	-	-	-	-	-	-
Loss on sale of fixed assets	-	-	-	-	0.1	-	-	-
Gain on sale of non-financial assets	-	-	(0.1)	-	(2.5)	(0.4)	-	-
Restructuring costs, net	-	(0.2)	-	-	0.2	-	0.4	-
Adjusted EBITDA	33.7	39.4	37.3	33.8	42.9	45.6	35.9	28.1

Results of Operations Q4 2017 compared to Q4 2016

Revenue

Revenue was \$340.0 million in Q4 2017 compared to \$339.6 million in Q4 2016, an increase of \$0.4 million or 0.1%, due primarily to a Consumer selling price increase implemented in Canada in Q4 2017, partially offset by lower consumer sales volume in Canada and the unfavourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.27 in Q4 2017 compared to 1.33 in Q4 2016). From a geographic perspective, revenue in Mexico increased \$2.1 million or 14.4%, and revenue in the U.S. increased \$1.9 million, or 1.7%, while revenue in Canada decreased \$3.6 million, or 1.7%.

Cost of Sales

Cost of sales was \$296.0 million in Q4 2017 compared to \$284.2 million in Q4 2016, an increase of \$11.8 million or 4.2%. Manufacturing costs increased primarily due to significantly higher pulp costs. These cost increases were partially offset by the favourable impact of foreign exchange fluctuations on USD denominated costs (USD average 1.27 in Q4 2017 compared to 1.33 in Q4 2016), the benefits from cost reduction initiatives and capital projects. Freight costs increased primarily due to higher carrier rates. As a percentage of revenue, cost of sales were 87.1% in Q4 2017 compared to 83.7% in Q4 2016.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$23.7 million in Q4 2017 compared to \$26.4 million in Q4 2016, a decrease of \$2.7 million or 10.2%. The decrease was primarily due to lower bonus compensation and cost reduction initiatives. As a percentage of revenue, SG&A expenses were 7.0% in Q4 2017 compared to 7.8% in Q4 2016.

Adjusted EBITDA

Adjusted EBITDA was \$33.7 million in Q4 2017 compared to \$42.9 million in Q4 2016, a decrease of \$9.2 million or 21.4%. The decrease was primarily due to higher pulp costs and increased freight costs. These were partially offset by lower SG&A expenses, cost reduction initiatives and capital projects.

Gain on Sale of Non-Financial Assets

A gain of \$2.5 million was recorded in Q4 2016 related to the New Westminster 2012 Business Rationalization Project. See above in Fiscal 2017 section for additional details regarding this initiative.

Interest Expense

Interest expense was \$10.4 million in Q4 2017 compared to \$10.7 million in Q4 2016, a decrease of \$0.3 million. The decrease was primarily due to lower U.S. interest expense and the favourable impact of foreign exchange.

Other Expense

Other expense was \$20.2 million in Q4 2017 compared to \$23.1 million in Q4 2016. Other expense in Q4 2017 was primarily related to the change in the amortized cost of the Partnership units liability in Q4 2017 of \$18.9 million (Q4 2016 - \$22.2 million), a foreign exchange loss of \$0.9 million (Q4 2016 - \$0.9 million) and the change in fair value of derivatives of \$0.4 million (Q4 2016 - nil).

Income Taxes

An income tax expense of \$7.8 million was recorded in Q4 2017 compared to \$2.0 million in Q4 2016. KPLP is not directly taxable on its Canadian business. The income tax expense resulted primarily from operating income related to the U.S. entities. Income tax recovery in partner's hands was \$2.0 million in Q4 2017 compared to \$2.1 million in Q4 2016. The impact of U.S. tax reform on the consolidated financial statements for the year ended December 31, 2017 was an increase in deferred tax expense of \$6.2 million on the consolidated statement of comprehensive income (loss) and a corresponding drawdown of the deferred income tax asset of \$6.2 million on the consolidated statement of financial position. The impact on the consolidated financial statements was a result of a decrease in the U.S. federal tax rate from 35% to 21%, effective for taxation years beginning after December 31, 2017. Management has used the best information available to assess the implications of the U.S. tax reform for periods beginning January 1, 2018. However, as more guidance becomes available in respect of the implications of the U.S. tax reform, further adjustments may be required to the consolidated financial statements.

Net Loss

Net loss was \$18.0 million in Q4 2017 compared to \$4.5 million in Q4 2016, an increase in the net loss of \$13.5 million. The increase in the net loss was primarily due to lower Adjusted EBITDA of \$9.2 million, an increase in tax expense of \$5.8 million, a decrease in the gain on sale of non-financial assets of \$2.5 million and a change in fair value of derivatives of \$0.4 million in Q4 2017. These items were partially offset by a decrease in the change in amortized cost of Partnership units liability of \$3.3 million and lower depreciation expense of \$0.5 million.

Segment Information Q4 2017 compared to Q4 2016

(C\$ millions, unless otherwise noted)	Q4 2017	Q4 2016	Q4 2017 vs. Q4 2016	
			\$ Change	% Change
Segment Revenue				
Consumer	276.4	278.0	(1.6)	-0.6%
AFH	62.2	59.5	2.7	4.5%
Other	1.4	2.1	(0.7)	-33.3%
Total segment revenue	340.0	339.6	0.4	0.1%
Segment Adjusted EBITDA				
Consumer	32.2	41.9	(9.7)	
AFH	1.4	1.0	0.4	
Other	0.1	-	0.1	
Total segment Adjusted EBITDA	33.7	42.9	(9.2)	

Consumer Segment

Q4 2017 compared to Q4 2016

Consumer segment revenue was \$276.4 million in Q4 2017 compared to \$278.0 million in Q4 2016, a decrease of \$1.6 million or 0.6%, due primarily to lower consumer sales volume in Canada and the unfavourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.27 in Q4 2017 compared to 1.33 in Q4 2016), partially offset by the selling price increase implemented in Canada in Q4 2017. Consumer segment revenue decreased in Canada and increased in the U.S.

Consumer Segment Adjusted EBITDA was \$32.2 million in Q4 2017 compared to \$41.9 million in Q4 2016, a decrease of \$9.7 million. The decrease was primarily due to significantly higher pulp costs and also increased freight costs, partially offset by lower SG&A expenses.

AFH Segment

Q4 2017 compared to Q4 2016

AFH segment revenue was \$62.2 million in Q4 2017 compared to \$59.5 million in Q4 2016, an increase of \$2.7 million or 4.5%, due primarily to increased sales volume and favourable sales mix, which was partially offset by the unfavourable impact of foreign exchange fluctuations on U.S. sales (USD average 1.27 in Q4 2017 compared to 1.33 in Q4 2016). AFH segment revenue increased in Canada and decreased in the U.S.

AFH Segment Adjusted EBITDA was \$1.4 million in Q4 2017 compared to \$1.0 million in Q4 2016, an increase of \$0.4 million. This increase was due primarily to increased revenue, partially offset by higher fibre and warehousing costs.

Other Segment

Q4 2017 compared to Q4 2016

Other segment revenue was \$1.4 million in Q4 2017 compared to \$2.1 million in Q4 2016, a decrease of \$0.7 million due to lower parent roll sales in the quarter.

Other Segment Adjusted EBITDA was \$0.1 million in Q4 2017 compared to nil in Q4 2016, an increase of \$0.1 million primarily due to favourable sales mix related to the sale of parent rolls.

SHARE INFORMATION

KPT's authorized share capital consists of an unlimited number of Common Shares. As of March 7, 2018, there were 9,251,035 Common Shares issued and outstanding. Pursuant to the Exchange Agreement, Kruger has the right to exchange KPLP Units it holds from time to time for Common Shares on the basis of one KPLP Unit for one Common Share, subject to adjustment as set out in the Exchange Agreement. If Kruger were to exchange all KPLP Units held by it as of March 7, 2018 for Common Shares, it would hold approximately 84.1% of the issued and outstanding Common Shares. As of March 7, 2018, there were no potentially dilutive instruments outstanding.

Pursuant to the Limited Partnership Agreement, KPLP may issue an unlimited number of KPLP Units. As of March 7, 2018, there were 58,036,213 KPLP Units issued and outstanding.

RISK FACTORS

For a detailed description of risk factors associated with KPT and KPLP, refer to the "Risk Factors" section of the 2017 Annual Information Form dated March 9, 2018 available on SEDAR at www.sedar.com. KPLP Management is not aware of any significant changes to the risk factors associated with KPT and KPLP from those disclosed at that time.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures and Internal Control over Financial Reporting

Disclosure controls and procedures within KPT and KPLP (collectively, the Corporations) have been designed to provide reasonable assurance that all relevant information is identified to its Chief Executive Officer (CEO), its Chief Financial Officer (CFO) and its Disclosure Policy Committee to ensure appropriate and timely decisions are made regarding public disclosure.

Internal controls over financial reporting have been designed by management, under the supervision of, and with the participation of the Corporations' CEO and CFO, to provide reasonable assurance regarding the reliability of the Corporations' financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

The Corporations will file certifications, signed by the Corporations' CEO and CFO, with the Canadian Securities Administrators (CSA) upon filing of the Corporations' Annual Information Form. In those filings, the Corporations' CEO and CFO will certify, as required by National Instrument 52-109, the appropriateness of the financial disclosure, the design and effectiveness of the Corporations' disclosure controls and procedures and the design and effectiveness of internal controls over financial reporting. The Corporations' CEO and CFO also certify the appropriateness of the financial disclosures in the Corporations' interim filings with securities regulators. In those interim filings, the Corporations' CEO and CFO also certify the design of the Corporations' disclosure controls and procedures and the design of internal controls over financial reporting.

The Corporations' Audit Committees reviewed this MD&A and the financial statements and notes of KPT and the consolidated financial statements and notes of KPLP, and the Corporations' Boards of Directors approved these documents prior to their release.

Management's Report on Disclosure Controls and Procedures

Management, under the supervision of and with the participation of the Corporations' CEO and CFO, evaluated the effectiveness of the Corporations' disclosure controls and procedures (as defined under National Instrument 52-109) and concluded, as of December 31, 2017, that such disclosure controls and procedures were effective.

Management's Report on Internal Controls over Financial Reporting

Management, under the supervision of and with the participation of the Corporations' CEO and CFO, evaluated the effectiveness of the Corporations' internal controls over financial reporting (as defined under National Instrument 52-109). In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commissions (COSO) in Internal Control - Integrated Framework (2013). Based on that evaluation, management and the CEO and CFO have concluded that, as of December 31, 2017, the Corporations' internal controls over financial reporting were effective. This evaluation took into consideration the Corporations' Corporate Disclosure Policy and the functioning of its Disclosure Policy Committee.

ADDITIONAL INFORMATION

Additional information relating to KPT and KPLP, including the Annual Information Form, is available on SEDAR at www.sedar.com.



KRUGER PRODUCTS L.P.

AUDITED CONSOLIDATED FINANCIAL STATEMENT

FOR THE YEARS ENDED DECEMBER 31, 2017 AND DECEMBER 31, 2016

Kruger Products L.P

#200 – 1900 Minnesota Court, Mississauga Ontario L5N 5R5

www.krugerproducts.ca

March 7, 2018

Independent Auditor's Report

To the Unitholders of Kruger Products L.P.

We have audited the accompanying consolidated financial statements of Kruger Products L.P. and its subsidiaries, which comprise the consolidated statements of financial position as at December 31, 2017 and December 31, 2016 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Kruger Products L.P. and its subsidiaries as at December 31, 2017 and December 31, 2016 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants
Toronto, Ontario

Kruger Products L.P.

Consolidated Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	December 31, 2017	December 31, 2016
	\$	\$
Assets		
Current assets		
Cash and cash equivalents (note 25)	8,837	36,511
Trade and other receivables (note 6)	113,194	123,095
Receivables from related parties (note 16)	85	185
Current portion of advances to partners (note 14)	1,928	5,465
Inventories (note 7)	192,394	179,543
Income tax recoverable (note 15)	522	423
Prepaid expenses	8,007	7,286
	<u>324,967</u>	<u>352,508</u>
Non-current assets		
Advances to partners (note 14)	4,489	-
Property, plant and equipment (note 8)	761,610	762,270
Other long-term assets	6,331	6,075
Goodwill (note 9)	160,939	160,939
Intangible assets (note 9)	15,327	15,270
Deferred income taxes (note 15)	26,092	39,913
	<u>1,299,755</u>	<u>1,336,975</u>
Total assets		
Liabilities		
Current liabilities		
Bank indebtedness (note 25)	9,051	9,007
Trade and other payables (note 11)	190,698	201,477
Payables to related parties (note 16)	2,596	3,606
Income tax payable (note 15)	498	1,779
Distributions payable (notes 14 and 16)	10,382	10,148
Current portion of provisions (note 12)	333	1,885
Current portion of long-term debt (note 13)	190,947	8,859
	<u>404,505</u>	<u>236,761</u>
Non-current liabilities		
Long-term debt (note 13)	225,368	415,379
Provisions (note 12)	5,973	6,487
Pensions (note 10)	119,558	92,646
Post-retirement benefits (note 10)	60,457	57,162
	<u>815,861</u>	<u>808,435</u>
Liabilities to non-unitholders		
Current portion of Partnership units liability (note 14)	1,928	8,611
Long-term portion of Partnership units liability (note 14)	158,381	137,296
	<u>160,309</u>	<u>145,907</u>
Total Partnership units liability		
	<u>976,170</u>	<u>954,342</u>
Total liabilities		
Equity		
Partnership units (note 14)	356,240	336,576
Deficit	(99,742)	(42,792)
Accumulated other comprehensive income	67,087	88,849
	<u>323,585</u>	<u>382,633</u>
Total equity		
Total equity and liabilities	<u>1,299,755</u>	<u>1,336,975</u>
Commitments and contingencies (note 17)		
Subsequent events (note 14)		
Approved by the Board of Directors		
<u>/s/ James Hardy</u>	<u>/s/ David Spraley</u>	
Director	Director	

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

Kruger Products L.P.

Consolidated Statement of Comprehensive Income (Loss)

For years ended December 31, 2017 and December 31, 2016

(tabular amounts are in thousands of Canadian dollars)

	2017 \$	2016 \$
Revenue (notes 16 and 24)	1,280,014	1,227,896
Expenses		
Cost of sales (notes 16 and 18)	1,098,086	1,031,647
Selling, general and administrative expenses (notes 16 and 18)	90,076	92,763
Gain on sale of non-financial assets (note 8)	(75)	(2,939)
Restructuring costs, net (note 12)	(180)	552
Operating income	92,107	105,873
Interest expense (note 13)	42,021	44,000
Other expense (note 5)	21,990	22,754
Income before income taxes	28,096	39,119
Income taxes (note 15)	12,838	3,629
Net income for the year	15,258	35,490
Other comprehensive loss		
Items that will not be reclassified to net income:		
Remeasurements of pensions	(27,563)	(8,491)
Remeasurements of post-retirement benefits	(2,763)	94
Items that may be subsequently reclassified to net income:		
Available-for-sale investment	-	(290)
Cumulative translation adjustment	(21,762)	(10,666)
Total other comprehensive loss for the year	(52,088)	(19,353)
Comprehensive income (loss) for the year	(36,830)	16,137

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

Kruger Products L.P.

Consolidated Statement of Changes in Equity

For the years ended December 31, 2017 and December 31, 2016

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

	Partnership units		Deficit	Accumulated other comprehensive income	Total equity
	#	\$	\$	\$	\$
As of January 1, 2016	54,840,093	318,012	(29,416)	99,805	388,401
Distributions payable (note 14)	-	-	(10,148)	-	(10,148)
Distributions paid (note 14)	-	-	(30,054)	-	(30,054)
Fair value adjustment (note 14)	-	267	(267)	-	-
Change in actuarial loss on pension	-	-	(8,491)	-	(8,491)
Change in actuarial gain on post-retirement benefits	-	-	94	-	94
Change in available-for-sale investment	-	-	-	(290)	(290)
Cumulative translation adjustment	-	-	-	(10,666)	(10,666)
Net income for the year	-	-	35,490	-	35,490
Issuance of partnership units (note 14)	1,536,695	18,297	-	-	18,297
As of December 31, 2016	56,376,788	336,576	(42,792)	88,849	382,633
As of January 1, 2017	56,376,788	336,576	(42,792)	88,849	382,633
Distributions payable (note 14)	-	-	(10,382)	-	(10,382)
Distributions paid (note 14)	-	-	(30,786)	-	(30,786)
Fair value adjustment (note 14)	-	714	(714)	-	-
Change in actuarial loss on pension	-	-	(27,563)	-	(27,563)
Change in actuarial loss on post-retirement benefits	-	-	(2,763)	-	(2,763)
Cumulative translation adjustment	-	-	-	(21,762)	(21,762)
Net income for the year	-	-	15,258	-	15,258
Issuance of partnership units (note 14)	1,298,251	18,950	-	-	18,950
As of December 31, 2017	57,675,039	356,240	(99,742)	67,087	323,585

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

Kruger Products L.P.
Consolidated Statement of Cash Flows
For the years ended December 31, 2017 and December 31, 2016

(tabular amounts are in thousands of Canadian dollars)

	2017	2016
	\$	\$
Cash flows from (used in) operating activities		
Net income for the year	15,258	35,490
Items not affecting cash		
Depreciation	51,289	47,436
Amortization	1,092	1,146
Loss (gain) on sale of property, plant and equipment	(3)	139
Change in amortized cost of Partnership units liability (note 5)	23,013	23,363
Gain on sale of investment (note 5)	-	(324)
Foreign exchange gain (note 5)	(1,387)	(285)
Change in fair value of derivatives (note 5)	364	-
Interest expense	42,021	44,000
Pension and post-retirement benefits (note 10)	10,111	10,402
Provisions (note 12)	278	1,338
Income taxes	12,838	3,629
Gain on sale of non-financial assets (note 8)	(75)	(2,939)
Total items not affecting cash	139,541	127,905
Net change in non-cash working capital (note 26)	(35,194)	1,386
Contributions to pension and post-retirement benefit plans	(15,137)	(18,335)
Provisions paid	(1,648)	(2,267)
Income tax payments	(3,592)	(1,970)
Net cash from operating activities	99,228	142,209
Cash flows from (used in) investing activities		
Purchases of property, plant and equipment	(68,127)	(81,460)
Capitalized interest paid	(497)	(222)
Proceeds on sale of investment (note 5)	-	1,439
Government assistance received	4,646	2,400
Purchases of software	(1,149)	(563)
Proceeds on sale of property, plant and equipment	1,180	5,399
Net cash used in investing activities	(63,947)	(73,007)
Cash flows from (used in) financing activities (note 27)		
Proceeds from long-term debt	28,834	9,609
Repayment of long-term debt	(26,039)	(17,882)
Payment of deferred financing fees	(12)	(745)
Interest paid on long-term debt	(33,101)	(34,162)
Distributions and advances paid, net (note 14)	(31,547)	(22,862)
Net cash used in financing activities	(61,865)	(66,042)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	(1,134)	(1,111)
Increase (decrease) in cash and cash equivalents during the year	(27,718)	2,049
Cash and cash equivalents - Beginning of year (note 25)	27,504	25,455
Cash and cash equivalents - End of year (note 25)	(214)	27,504

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

(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. (ultimate parent), KPGP Inc. (KPGP), and KP Tissue Inc. (KPT). The Partnership manufactures, sells and distributes tissue products for household, industrial and commercial use. The Partnership has plants in New Westminster, British Columbia; Crabtree, Quebec; Sherbrooke, Quebec; Gatineau, Quebec; Scarborough and Trenton, Ontario and Memphis, Tennessee. The Partnership's headquarters are located in Mississauga, Ontario, Canada.

2 Basis of presentation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), and with interpretations of the International Financial Reporting Committee which the Canadian Accounting Standards Board has approved for incorporation into Part 1 of the CPA Canada Handbook - Accounting. These consolidated financial statements were approved by the board of directors of KPGP Inc. on March 7, 2018.

The Partnership consolidates all entities which it controls.

The principal subsidiaries of the Partnership are as follows:

K.T.G. (USA) Inc. (KTG)
Kruger Products (USA) Inc. (KP USA)
Grupo Tissue de Mexico S de RL de CV (GTM)
TAD Luxembourg S.A.R.L
TAD Canco Inc.
Kruger Products Real Estate Holdings Inc.

3 Summary of significant accounting policies

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

(a) Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention, except for the available-for-sale investment and derivative liabilities which are measured at fair value through profit or loss and accounting for pensions (note 3(s)).

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

(b) Consolidation

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

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

(c) *Segment reporting*

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

(d) *Foreign currency translation*

(i) Functional and presentation currency

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

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

(e) *Cash and cash equivalents*

The Partnership considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

(f) *Trade receivables*

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

(g) *Inventories*

Inventories of raw materials and spare parts are valued at the lower of weighted average cost and net realizable value. Finished products and work-in-process are valued at the lower of standard cost and net realizable 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 statement 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, US State tax credits, government grants and accumulated impairment loss. Cost includes expenditures that are directly attributable to the acquisition of the asset and an estimate of the asset retirement obligation. The Partnership allocates the amount initially recognized to an item of property, plant and equipment to its segregated parts and depreciates each of these segregated parts separately. The Partnership also capitalizes interest 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

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 statement 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 SG&A expenses.

(j) *Goodwill*

Goodwill arises on the acquisition of subsidiaries 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.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

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

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

(k) *Intangible assets*

(i) Trademarks

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

(ii) Software and licences

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

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

(l) *Impairment of non-financial assets*

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

(m) *Related party transactions*

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

(n) *Leases*

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

(o) Provisions

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

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

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

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

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

(q) Revenue recognition

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

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

(r) Cost of sales and SG&A expenses

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

(s) Pensions and post-retirement benefits

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

- Past-service costs from plan amendments are recognized immediately to the extent the benefits are vested in net income (loss) 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 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 SG&A expenses; and (ii) the interest cost on the benefit obligation offset by the expected return on plan assets is recorded within interest expense on the consolidated statement of comprehensive income (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 (loss), 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 from the Partnership flows to the partners, Kruger Inc., KPGP and KPT. Accordingly no provision for income taxes has been made for the Partnership's income. The U.S. entities, KP USA and KTG are subject to tax on the basis of the tax laws enacted in the U.S. where the entities operate and generate taxable income. The remaining entities, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L., are subject to tax on the basis of the laws enacted in Canada, Mexico and Luxembourg, respectively.

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

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

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

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

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

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an intention to settle the balances on a net basis. Deferred income tax assets and liabilities are presented as non-current.

(u) *Financial instruments*

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

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

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

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

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statement of comprehensive income (loss) in SG&A expenses. Financial assets and liabilities at fair value through profit or loss are classified as current, except for the portion expected to be realized or paid beyond 12 months of the dates of the consolidated statement of financial position, which are classified as non-current.

- (ii) *Financial assets and liabilities at fair value through other comprehensive income or loss:* A financial asset or liability is classified in this category if acquired for the purpose of holding the investment for a long-term period. The financial instruments classified in this category would include the available-for-sale investment, which was sold during the year ended December 31, 2016.

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

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

- (iv) *Financial liabilities at amortized cost:* Financial liabilities at amortized cost include bank indebtedness, trade payables, accrued expenses, merchandising accruals, payables to related parties, distributions payable, long-term debt and the Partnership units liability. Payables are initially recognized at the amount required to be

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paid less, when material, a discount to reduce the payables to fair value. Subsequently, bank indebtedness, payables to related parties, distributions payable, trade payables, accrued expenses, and merchandising accruals 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) *Derivative financial instruments*

The Partnership uses derivative financial instruments to manage foreign currency risk. Foreign exchange swaps and foreign exchange forwards are used to manage U.S. dollar borrowings. As these derivatives do not qualify for hedge accounting, the changes in their fair value are recorded in the consolidated statement of comprehensive income (loss) in Other (income) expense. The derivative liabilities mature within one year and are recorded in the consolidated statement of financial position in Trade and other payables.

(x) *Dividend reinvestment plan*

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

(y) *Accounting standards implemented for the year ended December 31, 2017*

- (i) IAS 7, Statement of Cash Flows. In January 2016, the IASB issued an amendment to require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Other than the aforementioned additional disclosures, included in note 27, the application of the amendments to IAS 7 did not result in any changes to the presentation of the consolidated statement of cash flows.
- (ii) IAS 12, Income Taxes – Deferred Tax. In February 2016, the IASB issued an amendment to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendment clarifies the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. Certain other aspects of accounting for deferred tax assets are also clarified. The adoption of this

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standard had no impact on the consolidated financial statements.

- (iii) In December 2016, the IASB issued an amendment clarifying the scope of IFRS 12, Disclosure of Interests in Other Entities. The amendment clarified that the disclosures requirement of IFRS 12 are applicable to interest in entities classified as held for sale, except for summarized financial information. The adoption of this standard had no impact on the consolidated financial statements.

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

The following revised standards and amendments are effective for annual periods beginning on or after January 1, 2018, with earlier application permitted where indicated. Management continues to assess the impact of these standards and amendments and has not yet determined whether it will early adopt them, except as noted below.

- (i) IFRS 15, Revenue from Contracts with Customers, was issued by the IASB in May 2014. The standard specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with some informative, relevant disclosures. The standard supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations. Application of the standard is mandatory for all IFRS reporters and it applies to nearly all contracts with customers: the main exceptions being leases, financial instruments and insurance contracts. In September 2015, the IASB issued an amendment to defer the mandatory effective date to interim periods beginning on or after January 1, 2018, with early adoption permitted. In April 2016, the IASB issued an amendment to clarify the guidance on identifying performance obligations, licences of intellectual property and principal versus agent, and to provide additional practical expedients on transition. The amendment is effective for annual periods beginning on or after January 1, 2018.

Management has performed an assessment of IFRS 15 adoption and does not expect a significant impact on the consolidated financial statements. It is expected that the application of IFRS 15 will result in a change in the revenue recognition related to dispensers and related revenue. Management will adopt IFRS 15 using the modified retrospective approach. A transitional adjustment of \$6.3 million to reduce the balance related to the dispensers currently recorded in Other long term assets will be recognized in retained earnings (deficit) on the date of initial application, January 1, 2018.

- (ii) IFRS 9, Financial Instruments. In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 would be annual periods beginning on or after January 1, 2018, with early adoption permitted. Management has performed a preliminary assessment of IFRS 9 adoption and does not expect a significant impact on the consolidated financial statements.
- (iii) IFRS 16, Leases. In January 2016, the IASB issued IFRS 16, Leases which replaces the current guidance in IAS 17, Leases. IFRS 16 requires lessees to recognize a right-of-use asset and a lease liability reflecting future lease payments for virtually all lease contracts. IFRS 16 must be applied to an entity's first annual IFRS financial statements for periods beginning on or after January 1, 2019, with early adoption permitted. Management can elect to adopt IFRS 16 using either the full retrospective approach or the modified retrospective approach.

Management has performed a preliminary assessment of IFRS 16 adoption and expects a significant impact on the consolidated financial statements. The right-of-use asset and lease liability are expected to be material to the consolidated statement of financial position. There is expected to be a change in presentation on the consolidated statement of comprehensive income (loss) and a significant impact on Adjusted EBITDA. IFRS 16 replaces operating lease expense (recorded in Cost of sales and Selling, general and administrative expenses) with a depreciation charge for right-of-use assets and interest expense on lease liabilities. The

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amount related to the depreciation charge and interest expense will differ from the previous operating lease expense. Both the depreciation charge and interest expense are excluded from the calculation of Adjusted EBITDA, while the operating lease expense was previously included in the calculation. Changes to systems and processes are expected to be required, in order to collect the new data requirements.

Management is evaluating the potential implications on data systems, internal controls over financial reporting, information technology, business processes, and financing and compensation arrangements. Management is also evaluating the transition approach it will apply and whether it will use the optional exemptions or practical expedients under the standard. Additional details, including the transition approach, practical expedients elected and estimated quantitative impact on the consolidated financial statements are expected to be disclosed before the adoption of IFRS 16.

- (iv) IFRIC 23, Uncertainty over income tax treatments. In June 2017, the IFRS Interpretation Committee issued an interpretation which clarifies how the recognition and measurement requirements of IAS 12 Income taxes, are applied where there is uncertainty over income tax treatments. The interpretation is effective for annual periods beginning on or after January 1, 2019. Management has performed a preliminary assessment of IFRIC 23 adoption and does not expect a significant impact on the consolidated financial statements.

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 pensions and post-retirement obligations, the Partnership units liability, and income taxes. Actual results could differ from those estimates. When adjustments become necessary, they are reported in earnings in the period in which they occur. The following are the estimates and judgments applied by management that most significantly affect the Partnership's consolidated financial statements.

Pensions and post-retirement benefit obligations

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

Other key assumptions for pension obligations are based in part on current market conditions. Additional information is disclosed in note 10.

Partnership units

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year. KPLP determined that it was appropriate to reclassify a portion of its equity to Partnership units liability, since the Tax Distribution represents a contractual obligation to deliver cash and, as such, meets the definition of a financial liability for accounting purposes under IFRS. As of December 31, 2017, \$160.3 million was recorded as a liability in respect of this obligation (December 31, 2016 - \$145.9 million).

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The Change in amortized cost of Partnership units liability of \$23.0 million has been included in Other expense, which includes an increase of \$21.1 million (2016 - \$22.2 million) for the reassessment performed as of December 31, 2017. The reassessment reflects KPLP's estimate of the net present value of the financial liability arising from the obligation to make the Tax Distribution using estimates of tax payable by the partners and a discount rate and terminal growth rate of 11.75% and 2.0% (December 31, 2016 – 11.50% and 2.0%), respectively. The change in the discount rate resulted in a decrease in liability of \$4.4 million. The provisions are based on management's best estimate of expected future Tax Distributions. Projections of tax payable are based on additional assumptions including estimates of taxable income and tax rates. Taxable income can differ significantly from accounting income as a result of both timing and permanent tax differences based on enacted tax legislation and therefore changes in the Partnership units obligation are not necessarily indicative of a change in the expected future profitability of KPLP. An increase/decrease in the discount rate by 0.5% would result in a decrease/increase in the Partnership units liability of approximately \$8.1 million and \$9.0 million, respectively. The discount rate reflects the risks associated with the business, which operates primarily in Canada.

The Partnership units liability was also adjusted during the year ended December 31, 2017 to reflect the current year advances made to the partners required to allow KPT to make tax installment payments. During the year ended December 31, 2017, pursuant to the Tax Distribution as defined in the Partnership Agreement, the Partnership made advances to its partners of \$6.4 million, of which \$1.0 million was used to pay the monthly tax installment on behalf of KPT and the remaining was advanced to Kruger Inc. and KPGP. The advances are non-interest bearing and non-recourse in nature and are settled when the Tax Distribution is declared annually. The advances of \$6.4 million were partially offset against the Tax Distributions of \$1.9 million declared and paid by the Partnership on February 28, 2018. The excess advances over the Tax distributions in the amount of \$4.5 million are repayable by the partners to the Partnership by March 31, 2019. Additional information is disclosed in note 14.

Impairment tests

The Partnership performs an annual impairment test for goodwill and indefinite lived trademarks. As of December 31, 2017, no impairments were identified as a result of these tests. Recoverable amounts are determined based on management's best estimate of value in use. The estimates of value in use are based on the present value of forecasted future cash flows. Additional assumptions include estimates of the discount rate, forecasted Adjusted EBITDA, growth rates, and foreign exchange rates.

Income taxes

The Partnership computes its income taxes in each jurisdiction in which its subsidiaries operate. Estimation of income taxes includes evaluating the recoverability of the deferred tax assets and the income taxes recoverable based on an assessment of the ability to use the underlying tax deductions and credits against future taxable income. The assessment requires an estimate of future taxable income compared to the net operating loss carry forwards and U.S. State tax credits. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period. During the year ended December 31, 2017, the Partnership assessed its ability to utilize the U.S. State tax credits. As a result of this assessment, a reversal of \$2.8 million (December 31, 2016 – nil) of the U.S. State tax credits was recorded in the consolidated statement of comprehensive income (loss). The impact of U.S. tax reform on the consolidated financial statements for the year ended December 31, 2017 was an increase in deferred tax expense of \$6.2 million on the consolidated statement of comprehensive income (loss) and a corresponding drawdown of the deferred income tax asset of \$6.2 million on the consolidated statement of financial position. The impact on the consolidated financial statements was a result of a decrease in the U.S. federal tax rate from 35% to 21%, effective for taxation years beginning after December 31, 2017. Management has used the best information available to assess the implications of the U.S. tax reform for periods beginning January 1, 2018. However, as more guidance becomes available in respect of the implications of the U.S. tax reform, further adjustments may be required to the consolidated financial statements.

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5 Other expense

	2017	2016
	\$	\$
Foreign exchange gain	(1,387)	(285)
Change in amortized cost of Partnership units liability	23,013	23,363
Change in fair value of derivatives	364	-
Miscellaneous income	-	(324)
	<u>21,990</u>	<u>22,754</u>

6 Trade and other receivables

	December 31, 2017	December 31, 2016
	\$	\$
Trade receivables	102,803	115,729
Other receivables	10,685	7,882
Employee loans	9	25
Less: Allowance for doubtful accounts	(303)	(541)
	<u>113,194</u>	<u>123,095</u>

7 Inventories

	December 31, 2017	December 31, 2016
	\$	\$
Finished products	88,639	78,436
Work-in-process	30,201	32,952
Raw materials and supplies	38,944	36,328
Spare parts	34,610	31,827
	<u>192,394</u>	<u>179,543</u>

Total inventories recognized as cost of sales during the year ended December 31, 2017 were \$933.3 million (2016 – \$882.4 million). The Partnership wrote-off inventories during the year ended December 31, 2017 totalling \$2.3 million (2016 - \$2.7 million). Inventory provisions as of December 31, 2017 were \$6.6 million (December 31, 2016 - \$6.4 million).

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8 Property, plant and equipment

	Land \$	Buildings \$	Machinery and equipment \$	Assets under construction or development \$	Total \$
As of January 1, 2016					
Cost	40,612	187,572	1,019,346	35,635	1,283,165
Accumulated depreciation and impairment	-	(76,554)	(468,903)	-	(545,457)
Net book value as of January 1, 2016	40,612	111,018	550,443	35,635	737,708
Additions	-	-	-	85,237	85,237
Capitalized interest	-	-	-	222	222
Disposals	(2,435)	-	(164)	-	(2,599)
Government assistance	-	-	(2,400)	-	(2,400)
Transfers	-	137	83,656	(83,793)	-
Depreciation	-	(4,948)	(38,791)	-	(43,739)
Exchange differences	(47)	(1,897)	(9,891)	(324)	(12,159)
As of December 31, 2016	38,130	104,310	582,853	36,977	762,270
As of December 31, 2016					
Cost	38,130	185,150	1,085,265	36,977	1,345,522
Accumulated depreciation and impairment	-	(80,840)	(502,412)	-	(583,252)
Net book value as of December 31, 2016	38,130	104,310	582,853	36,977	762,270
Additions	-	-	63	74,892	74,955
Capitalized interest	-	204	551	-	755
Disposals	(61)	-	(41)	-	(102)
Government assistance	-	-	(4,646)	-	(4,646)
Transfers	-	15,187	77,349	(92,536)	-
Depreciation	-	(4,911)	(40,719)	-	(45,630)
Exchange differences	(101)	(3,855)	(21,972)	(64)	(25,992)
As of December 31, 2017	37,968	110,935	593,438	19,269	761,610
As of December 31, 2017					
Cost	37,968	195,832	1,127,282	19,269	1,380,351
Accumulated depreciation and impairment	-	(84,897)	(533,844)	-	(618,741)
Net book value as of December 31, 2017	37,968	110,935	593,438	19,269	761,610

During the year ended December 31, 2016, the Partnership sold certain timber lands for proceeds of \$5.4 million. The sale resulted in a recovery of non-financial assets of \$2.9 million, which was recorded in the consolidated statement of comprehensive income (loss).

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9 Goodwill and intangible assets

	Trademarks \$	Software \$	Total \$
As of January 1, 2016			
Cost	11,825	7,390	19,215
Accumulated amortization	-	(3,362)	(3,362)
Net book value as of January 1, 2016	11,825	4,028	15,853
Additions	-	563	563
Amortization	-	(1,146)	(1,146)
Net book value as of December 31, 2016	11,825	3,445	15,270
As of January 1, 2017			
Cost	11,825	7,953	19,778
Accumulated amortization	-	(4,508)	(4,508)
Net book value as of January 1, 2017	11,825	3,445	15,270
Additions	-	1,149	1,149
Amortization	-	(1,092)	(1,092)
Net book value as of December 31, 2017	11,825	3,502	15,327
As of December 31, 2017			
Cost	11,825	9,102	20,927
Accumulated amortization	-	(5,600)	(5,600)
Net book value as of December 31, 2017	11,825	3,502	15,327

The carrying value of goodwill as of December 31, 2017 was \$160.9 million (December 31, 2016 - \$160.9 million).

Impairment tests

The Partnership performs an annual impairment test for goodwill and indefinite lived trademarks. As of December 31, 2017 and December 31, 2016, no impairments were identified. Goodwill of \$152.0 million is allocated to the Canada Consumer CGU and \$8.9 million is allocated to the AFH CGU. The recoverable amount of the CGU is determined based on management's best estimate of 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 the CGUs. Based on the sensitivity analysis, no reasonable change in assumptions would result in an impairment.

10 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 \$96.5 million as of December 31, 2017 (December 31, 2016 -

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\$70.2 million) is included in Pensions on the consolidated statement of financial position. The solvency deficiency of the defined benefit plan for the Crabtree members is supported by a letter of credit in the amount of \$4.6 million (December 31, 2016 - \$4.6 million).

The Partnership has a Supplementary Retirement Plan (SRP) for designated employees. The accrued benefit liability, net of plan assets related to the SRP of \$15.1 million as of December 31, 2017 (December 31, 2016 - \$14.4 million) is included in Pensions on the consolidated statement of financial position, and is supported by irrevocable letters of credit in the amount of \$21.0 million (December 31, 2016 - \$21.0 million).

The Partnership also sponsors a Term Annuity Arrangement for the Western Manufacturing Division, which provides hourly employees with a bridging supplement commencing at age 61 and payable up to but not including age 65. The Term Annuity Arrangement is unfunded and the pension obligation of \$8.0 million as of December 31, 2017 (December 31, 2016 - \$8.0 million) is included in Pensions on the consolidated statement of financial position.

The Partnership's hourly employees at the Western Manufacturing Division are members of an industry multi-employer pension plan to which the Partnership contributes monies. During the year ended December 31, 2017, the Partnership contributed and expensed \$2.8 million (2016 - \$2.7 million) related to this defined benefit plan. Sufficient information regarding the Partnership's share of the defined benefit obligation is not available and accordingly the Partnership accounts for the multi-employer plan as a defined contribution plan.

The Partnership sponsors a defined contribution plan which covers substantially all of its salaried employees. During the year ended December 31, 2017, the Partnership recorded an expense of \$2.6 million (2016 - \$2.6 million) related to this plan.

KTG sponsors a defined contribution plan that covers substantially all of its employees. During the year ended December 31, 2017, the Partnership recorded an expense of \$0.6 million (2016 - \$0.7 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, 2016, the aggregate solvency deficit of the defined benefit plans was \$105.2 million (December 31, 2015 - \$108.3 million). The next actuarial valuations are required as of December 31, 2018. 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.

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The cumulative actuarial losses recognized in the deficit as of December 31, 2017 and December 31, 2016 were as follows:

	December 31, 2017	December 31, 2016
	\$	\$
Pensions	123,235	95,672
Post-retirement benefits	20,311	17,548
Total	143,546	113,220

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

	Pensions		Post-retirement benefit plans	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$
Change in defined benefit obligation:				
As of January 1	654,745	641,972	57,162	57,346
Current service cost	7,780	8,404	1,732	1,626
Past service cost	-	(172)	-	-
Interest cost	20,511	20,875	1,776	1,829
Employee contributions	3,484	3,768	-	-
Benefits paid	(34,301)	(34,084)	(2,976)	(3,545)
Remeasurements:				
Losses/(Gains) from changes in experience	792	(3,051)	(4,959)	-
Losses/(Gains) from changes in economic assumptions	41,912	13,231	3,725	(848)
Losses/(Gains) from changes in demographic assumptions	-	3,802	3,997	754
As of December 31	694,923	654,745	60,457	57,162
Change in plan assets at fair value:				
As of January 1	562,099	554,808	-	-
Expected return on plan assets	17,380	17,870	-	-
Remeasurements:				
Gains on plan assets	15,141	5,491	-	-
Administrative costs	(599)	(544)	-	-
Employer contributions	12,161	14,790	2,976	3,545
Employee contributions	3,484	3,768	-	-
Benefits paid	(34,301)	(34,084)	(2,976)	(3,545)
As of December 31	575,365	562,099	-	-
Accrued benefit liability				
Funded status - deficit	119,558	92,646	60,457	57,162

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

	December 31, 2017	December 31, 2016
	%	%
Fixed income	38.8	39.2
Public equities	31.2	29.9
Hedge funds	17.8	18.5
Private equity	5.7	5.8
Real assets	6.5	6.6
Total	100.0	100.0
Quoted on an active market	70.0	70.0
Unquoted	30.0	30.0
	100.0	100.0

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

	Pensions		Post-retirement benefit plans	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	%	%	%	%
Assumptions				
Discount rate - accrued benefit obligation	3.36	3.77	3.36	3.77
Rate of compensation increases	3.25 - 4.00	3.25 - 4.00		

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.

Post-retirement benefit plan

For measurement purposes, the trend factor for all health-care expenses, excluding medication, was assumed to be 3.0%. The trend factor for medication was assumed to be 4.85% the first year, with an annual 0.05% reduction for 17 years, and 4.0% thereafter.

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

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The effect of a 1% increase in the health care cost trend rate, a 1% reduction in the discount rate and a one-year change in the life expectancy rate were:

	Health care		Discount rate		Life expectancy	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$	\$	\$
Increase in Post-retirement benefit obligation	7,067	5,804	10,819	10,035	1,581	1,518

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 the life expectancy rate were:

	Discount rate		Rate of compensation		Life expectancy	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$	\$	\$
Increase in Pension obligation	113,176	101,776	10,297	8,355	18,229	15,359

Contributions to the defined benefit pension plans for the year ending December 31, 2018 are expected to be \$13.4 million.

The net benefit pension plan expense included the following components:

	Pensions		Post-retirement benefit plans	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$
Net benefit plan expense				
Current service cost	7,780	8,404	1,732	1,626
Interest cost	20,511	20,875	1,776	1,829
Expected return on plan assets	(17,380)	(17,870)	-	-
Administrative cost	599	544	-	-
Past service cost ^(a)	-	(172)	-	-
	<u>11,510</u>	<u>11,781</u>	<u>3,508</u>	<u>3,455</u>

(a) Recognition of past service cost relating to contract amendments.

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The following amounts are recognized in other comprehensive loss:

	Pensions		Post-retirement benefit plans	
	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
	\$	\$	\$	\$
Gains (losses) from changes in experience	(792)	3,051	4,959	-
Gains (losses) from changes in economic assumptions	(41,912)	(13,231)	(3,725)	848
Gains (losses) from changes in demographic assumptions	-	(3,802)	(3,997)	(754)
Gains on plan assets	15,141	5,491	-	-
	<u>(27,563)</u>	<u>(8,491)</u>	<u>(2,763)</u>	<u>94</u>

11 Trade and other payables

	December 31, 2017	December 31, 2016
	\$	\$
Trade payables	104,558	88,163
Accrued expenses	47,283	65,139
Merchandising accruals	38,493	48,175
Derivative liabilities	364	-
	<u>190,698</u>	<u>201,477</u>

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12 Provisions

	Environmental and asset retirement obligations	Long-term incentives	Restructuring	Total
	\$	\$	\$	\$
	(a)	(b)	(c)	
Provisions as of				
January 1, 2016	5,862	773	2,641	9,276
Additional provisions	(173)	786	552	1,165
Paid during the year	-	(512)	(1,755)	(2,267)
Interest accretion	198	-	-	198
Provisions as of				
December 31, 2016	5,887	1,047	1,438	8,372
Current	-	447	1,438	1,885
Non-current	5,887	600	-	6,487
Provisions as of				
January 1, 2017	5,887	1,047	1,438	8,372
Additional provisions	(911)	458	(180)	(633)
Paid during the year	-	(443)	(1,205)	(1,648)
Interest accretion	215	-	-	215
Provisions as of				
December 31, 2017	5,191	1,062	53	6,306
Current	-	280	53	333
Non-current	5,191	782	-	5,973

(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 an extension is currently being negotiated. The estimated undiscounted amount to settle this obligation would be between \$8.1 million and \$10.7 million. The liability is estimated using a discounted cash flow with a discount rate of 4.165% (December 31, 2016 – 3.635%).

(b) Long-term incentives

Long-term incentives include the Executive Long-Term Incentive Plan (LTIP) for the Partnership. The LTIP uses performance share units and results are based primarily on Adjusted EBITDA (note 19) return on capital employed using a three year average, along with other components. The LTIP is paid in cash in May of the year following the three year period it is earned. The compensation expense is recognized over the same three year period.

(c) Restructuring

During the first quarter of 2014, the Partnership undertook a review of corporate overhead costs and identified a number of cost reduction opportunities. As of December 31, 2017, all remaining obligations had been settled and the initiative is complete.

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In response to market cost pressures, in the first half of 2015, senior management undertook a comprehensive review of its cost structure and identified a number of cost reduction opportunities. As of December 31, 2017 there was a remaining provision of \$0.1 million relating to this program.

13 Long-term debt

		December 31, 2017	December 31, 2016
	Maturity	\$	\$
Revolving credit facility ^(a)	2020	181,055	196,682
Nordea facility ^(b)	2019	16,405	26,244
Caisse facility ^(c)	2018	181,761	192,084
Ontario loan ^(d)	2026	2,513	820
Quebec PM loan ^(e)	2026	34,581	8,408
		416,315	424,238
Less: Current portion of long-term debt		190,947	8,859
		225,368	415,379

a) Revolving credit facility

On September 28, 2015, the Partnership entered into the fifth amended and restated credit agreement, as amended by a consent letter dated as of March 8, 2016 and by a first Supplemental Credit Agreement dated as of August 9, 2016 (the Credit Agreement) related to its revolving credit facility (the Credit Facility). The Credit Facility was increased to \$300.0 million from \$125.0 million. The borrowings under the Credit Facility bear interest at a base rate of Canadian prime rate, U.S. base rate, banker's acceptance rates or LIBOR, plus a margin varying between 0.20% and 2.375% depending on the ratio of funded debt to EBITDA (as defined in the Credit Agreement) and the type of advance. The Credit Agreement is for a five year period and will mature on September 25, 2020. The Credit Agreement provides for certain restrictive undertakings and covenants to be complied with by the Partnership.

As of December 31, 2017, unamortized deferred financing fees were \$0.9 million (December 31, 2016 - \$1.3 million).

The Credit Agreement is guaranteed by KP USA, GTM, KP AFH 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, 2017, the Partnership had \$83.0 million (net of letters of credit of \$25.9 million) available on the Credit Facility (December 31, 2016 - \$67.0 million, net of letters of credit of \$26.0 million). The weighted average interest rate for the year ended December 31, 2017 was 3.20% (2016 - 3.35%).

b) Nordea facility

On July 8, 2011, the Partnership entered into a credit agreement with Nordea Bank AB (the Nordea Facility), providing for a term loan in the principal amount of approximately U.S.\$46.2 million, to be used for the financing of a TAD tissue machine in its subsidiary, KTG. The Nordea Facility has a term of seven years and bears interest at a fixed interest rate of 2.87% 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

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instalments of principal together with interest commencing on June 28, 2013. As of December 31, 2017, U.S.\$13.2 million was outstanding related to the facility (December 31, 2016 – U.S.\$19.8 million). As of December 31, 2017 unamortized deferred financing fees were \$0.2 million (December 31, 2016 - \$0.3 million). On September 28, 2015, the Partnership entered into the third amended credit agreement (the “Nordea Credit Agreement”) related to its Nordea Facility, in connection with amendments to the Credit Facility. No significant changes were made to the Nordea Facility.

c) 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 Memphis TAD machine and expansion of the tissue plant. Under the terms of the Caisse Facility, draws were only permitted until February 15, 2014, at which time the Partnership had drawn U.S. \$125.0 million.

The Caisse Facility is for a seven-year term, maturing on August 16, 2018. The Caisse Facility bears interest at a base rate of 8% per annum, with an applicable margin rate set each period based on KTG’s net debt to EBITDA (as defined in the Caisse Facility) 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 Memphis TAD machine service commencement date and KTG Excess cash flow has become positive, and (ii) thereafter, if the net debt to KTG EBITDA (as defined in the Caisse Facility) 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 14.77% for the year ended December 31, 2017 (2016 – 14.84%).

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

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.

d) Ontario loan

On July 1, 2015, the Partnership entered into a conditional loan agreement with the Government of Ontario (Ontario loan), for financing related to the expansion project at its Trenton facility. The Ontario loan is secured with assets acquired for the expansion. The agreement provides for a maximum loan amount of \$10.0 million, with up to one-half the loan available as a grant. The Ontario Loan has a moratorium on repayment of the principal for the initial 5 years following the date of the first loan disbursement, after which the principal is to be repaid in 5 equal annual payments. A portion of the loan interest is forgivable, subject to prescribed conditions. As of December 31, 2017, the Partnership had drawn \$6.0 million on the loan (December 31, 2016 – \$2.0 million).

e) Quebec PM loan

On August 9, 2016, the Partnership entered into an agreement with Investissement Quebec (Quebec PM loan), for financing related to the acquisition, relocation and installation of a paper machine to be located at the Crabtree facility (PM Project). The Quebec PM loan is secured by the acquired paper machine and the portion of the property on which the paper machine will be installed. The security is second ranking immediately after the security granted in favour of the Credit Facility. The agreement provides for a maximum loan amount of \$39.5

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million. Borrowings under the Quebec PM Loan bear interest at a fixed interest rate of 2.5% per annum for a period of seven years from the date of the first loan disbursement. The interest rate thereafter increases to a fixed rate of 3.5% per annum until the eighth anniversary of the first loan disbursement, a fixed rate of 4.5% per annum until the ninth anniversary of the first loan disbursement, and a fixed rate of 5.5% per annum thereafter. Monthly interest payments commence the month following the first loan disbursement. The loan has a moratorium on repayment of the principal for the initial 24 months following the date of the first loan disbursement, after which the principal is to be repaid in 96 monthly consecutive payments. The monthly repayments are reduced, in the reverse order of maturity, by repayments to Investissement Quebec corresponding to the Partnership's receipt of Government of Quebec electricity tariff rebates. As of December 31, 2017, \$39.4 million had been drawn and was outstanding (December 31, 2016 – \$9.7 million).

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

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

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

	\$
Less than 1 year	193,110
Between 1 and 5 years	216,888
More than 5 years	13,374
	<u>423,372</u>

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

	2017 \$	2016 \$
Interest expense on long-term debt	36,899	38,968
Interest accredited on provisions and other liabilities	215	198
Pension and post-retirement benefits, net	4,907	4,834
	<u>42,021</u>	<u>44,000</u>

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14 Distributions and Partnership units liability

	Partnership units liability
	\$
As of January 1, 2016	125,176
Change in amortized cost of Partnership units liability (note 5)	23,363
Tax Distributions	(2,632)
As of December 31, 2016	145,907
As of January 1, 2017	145,907
Change in amortized cost of Partnership units liability (note 5)	23,013
Tax Distributions	(8,611)
As of December 31, 2017	160,309

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

	2017			
	Partnership unit distributions	Unit price	Issuance of Partnership units	Gross proceeds
Distribution Payment Date	\$	\$	#	\$
January 16, 2017	10,148	15.25	309,196	4,715
April 17, 2017	10,203	15.30	309,183	4,731
July 17, 2017	10,259	13.23	357,887	4,735
October 16, 2017	10,324	14.81	321,985	4,769
	40,934		1,298,251	18,950
	2016			
	Partnership unit distributions	Unit price	Issuance of Partnership units	Gross proceeds
Distribution Payment Date	\$	\$	#	\$
January 15, 2016	9,871	10.29	442,929	4,558
April 15, 2016	9,951	12.31	359,138	4,421
July 15, 2016	10,016	11.75	394,797	4,639
October 17, 2016	10,087	13.77	339,831	4,679
	39,925		1,536,695	18,297

On January 15, 2018, the Partnership paid a distribution of \$10.4 million to partners. Pursuant to the Partnership's Distribution Reinvestment Plan (DRIP), a portion of the distribution was reinvested by the partners, resulting in the Partnership issuing 361,174 Partnership units at a price of \$13.50. During the year ended December 31, 2017, a fair value adjustment of \$0.7 million was recorded to reflect the market value of the Partnership units issued.

Subsequent to December 31, 2017, the Partnership declared a distribution of \$10.4 million, payable on April 16, 2018.

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

	2017		
	Tax Distributions	Advances paid	Partnership unit distributions
	\$	\$	\$
Paid to Kruger Inc. ^(a)	2,665	5,377	17,175
Paid to KPGP	-	-	3
Paid to KPT ^(b)	481	1,040	4,806
Total paid	<u>3,146</u>	<u>6,417</u>	<u>21,984</u>
			2016
		Advances paid	Partnership unit distributions
		\$	\$
Paid to Kruger Inc. ^(a)		1,029	16,717
Paid to KPGP		-	3
Paid to KPT ^(b)		205	4,908
Total paid		<u>1,234</u>	<u>21,628</u>

(a) During the years ended December 31, 2017 and December 31, 2016, Partnership unit distributions were paid to Kruger Inc. net of the DRIP reinvestment. During the year ended December 31, 2017, Kruger Inc.'s DRIP reinvestment was \$17.2 million (2016 - \$16.7 million).

(b) During the years ended December 31, 2017 and December 31, 2016, Partnership unit distributions were paid to KPT net of the DRIP reinvestment. During the year ended December 31, 2017, KPT's DRIP reinvestment was \$1.8 million (2016 - \$1.6 million).

Tax Distributions

On February 28, 2017, the Partnership declared a Tax Distribution of \$8.6 million, of which \$1.4 million was used to settle the advances to KPT and pay the final tax instalment on behalf of KPT. The remaining \$7.2 million was used to settle Kruger Inc.'s and KPGP's respective advances, with the balance paid to Kruger Inc. and KPGP.

During the year ended December 31, 2017, pursuant to the Tax Distribution as defined in the Partnership Agreement, the Partnership made advances to its partners of \$6.4 million, of which \$1.0 million was used to pay the monthly tax instalment on behalf of KPT and the remaining was advanced to Kruger Inc. and KPGP. The advances are non-interest bearing and non-recourse and were partially offset against the Tax Distributions of \$1.9 million paid by the Partnership on February 28, 2018. The excess advances over the Tax Distributions in the amount of \$4.5 million are repayable by the partners to the Partnership by March 31, 2019.

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15 Income taxes

The Partnership is not a tax paying entity for the years ended December 31, 2017 and December 31, 2016. The income (loss) from the Partnership flows to the partners, Kruger Inc., KPGP, and KPT. However, the Partnership's subsidiaries KP USA, KTG, TAD Canco Inc., GTM and TAD Luxembourg S.A.R.L. are corporate entities and, therefore, are subject to tax.

The consolidated income tax expense for the Partnership of \$12.8 million for the year ended December 31, 2017 (2016 – \$3.6 million) related to KP USA, KTG, TAD Luxembourg S.A.R.L and GTM.

The components of income taxes were as follows:

	2017	2016
	\$	\$
Current tax expense	2,346	3,250
Deferred tax expense	10,492	379
	<u>12,838</u>	<u>3,629</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:

	2017		2016	
	\$	%	\$	%
Combined federal and provincial income tax rates after manufacturing and processing credits	7,361	26.2	10,288	26.3
Income tax in partners' hands	(4,917)	(17.5)	(7,540)	(19.3)
Difference in statutory income tax rate of foreign operations	906	3.2	733	1.9
U.S. State tax credits not recognized	2,756	9.8	-	-
Change in U.S. tax rates	6,205	22.1	-	-
Investment tax credits	-	-	(337)	(0.9)
Permanent and other	527	1.9	485	1.3
	<u>12,838</u>	<u>45.7</u>	<u>3,629</u>	<u>9.3</u>

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

	December 31, 2017	December 31, 2016
	\$	\$
Property, plant and equipment	(53,509)	(74,045)
Net operating losses	56,340	80,424
Long term debt and deferred financing charges	7,208	10,536
Inventory and accrued liabilities	2,238	4,282
U.S. State tax credits	11,978	16,902
Other	1,837	1,814
	<u>26,092</u>	<u>39,913</u>

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

	December 31, 2017	December 31, 2016
	\$	\$
Deferred tax asset to be recovered within 12 months	2,238	4,282
Deferred tax asset to be recovered after 12 months	23,854	35,631
	<u>26,092</u>	<u>39,913</u>

In addition to the above, the Partnership has deferred tax assets of \$33.9 million related to net operating loss carry-forwards and \$7.8 million related to U.S. State tax credits which have not been recognized in the consolidated financial statements.

The Partnership had the following net operating loss carry-forwards available as of December 31, 2017:

	U.S. Federal		U.S. State		Canada	
	\$	Expiry date	\$	Expiry date	\$	Expiry date
2003	6	2023	-	2018	-	
2004	5,036	2024	1,177	2019	-	
2005	26	2025	-	2020	-	
2006	5,561	2026	5,558	2021	-	
2009	1,530	2029	-	2024	-	
2011	600	2031	55	2026	1,154	2031
2012	2,657	2032	5,294	2027	10,689	2032
2013	55,995	2033	58,114	2028	22,076	2033
2014	61,587	2034	62,638	2029	23,198	2034
2015	35,746	2035	37,654	2030	22,435	2035
2016	28,940	2036	30,678	2031	24,128	2036
2017	16,997	2037	17,213	2032	23,865	2037
	<u>214,681</u>		<u>218,381</u>		<u>127,545</u>	

The Partnership had the following U.S. State tax credits available for carry-forward as of December 31, 2017:

	U.S. State	
	\$	Expiry date
2012	1,609	2027
2013	13,034	2028
2014	1,701	2029
2015	1,586	2030
2016	1,811	2031
	<u>19,741</u>	

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

The impact of U.S. tax reform on the consolidated financial statements for the year ended December 31, 2017 was an increase in deferred tax expense of \$6.2 million on the consolidated statement of comprehensive income (loss) and a corresponding drawdown of the deferred income tax asset of \$6.2 million on the consolidated statement of financial position. The impact on the consolidated financial statements was a result of a decrease in the U.S. federal tax rate from 35% to 21%, effective for taxation years beginning after December 31, 2017. Management has used the best

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information available to assess the implications of the U.S. tax reform for periods beginning January 1, 2018. However, as more guidance becomes available in respect of the implications of the U.S. tax reform, further adjustments may be required to the consolidated financial statements.

16 Related party transactions

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

Sales of goods to Kruger Inc. for the year ended December 31, 2017 were \$1.1 million (2016 - \$0.9 million). Goods are sold based on the price lists in force and terms that would be available to third parties.

Purchases of goods and services from Kruger Inc. for the year ended December 31, 2017 were \$36.2 million (2016 - \$33.1 million). Purchases of goods and services from subsidiaries of Kruger Inc. for the year ended December 31, 2017 were \$10.5 million (2016 - \$8.3 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 selling, general and administrative expenses in the consolidated statement of comprehensive income (loss). During the year ended December 31, 2017, management fees of \$4.3 million (2016 - \$4.2 million) were paid to Kruger Inc. for management services provided to the Partnership.

Balances due to and from related parties were as follows:

	December 31, 2017 \$	December 31, 2016 \$
Receivables from Kruger Inc.	33	171
Receivables from subsidiaries of Kruger Inc.	-	14
Receivables from KPT	52	-
	<u>85</u>	<u>185</u>
Payables to Kruger Inc.	2,202	2,646
Payables to subsidiaries of Kruger Inc.	394	534
Payables to KPT	-	426
	<u>2,596</u>	<u>3,606</u>

The receivables from and payables to related parties are based on commercial terms agreed on between the parties, unsecured and non-interest bearing. There were no provisions related to the receivables from related parties as of December 31, 2017 and December 31, 2016. There were no loans outstanding with related parties as of December 31, 2017 and December 31, 2016.

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The Partnership had declared distributions which are payable to its related parties as follows:

	December 31, 2017	December 31, 2016
	\$	\$
Distribution payable to Kruger Inc.	8,723	8,511
Distribution payable to KPGP	1	1
Distribution payable to KPT	1,658	1,636
Total distribution payable	10,382	10,148

17 Commitments and contingencies

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

	December 31, 2017	December 31, 2016
	\$	\$
Less than 1 year	14,631	13,698
Between 1 and 5 years	41,127	44,509
More than 5 years	32,866	38,865
	88,624	97,072

Operating lease expense recognized in the consolidated statement of comprehensive income during the year ended December 31, 2017 was \$15.1 million (2016 - \$14.6 million).

As of December 31, 2017, the Partnership had commitments under service contracts of \$6.0 million for 2018, \$4.9 million for 2019, and \$4.1 million for 2020 and beyond.

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. The installation is expected to be complete during the year ended December 31, 2018.

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, 2017, the Partnership had irrevocable letters of credit outstanding of \$25.9 million (December 31, 2016 - \$26.0 million), which included letters of credit for the pension plans disclosed in note 10.

As of December 31, 2017, the Partnership had foreign exchange swaps outstanding of \$31.5 million (December 31, 2016 - nil) and foreign exchange forwards outstanding of \$19.0 million (December 31, 2016 - nil), with settlement dates ranging from January 3, 2018 to January 31, 2018.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

18 Expense by nature

	2017	2016
	\$	\$
Materials and production costs	590,481	547,699
Salaries, wages and other employee benefit expenses	280,134	280,781
Energy costs	59,832	60,237
Depreciation and amortization	52,381	48,582
Freight and warehousing	151,349	136,013
Marketing, selling and administrative expenses	53,985	51,098
	<u>1,188,162</u>	<u>1,124,410</u>

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

	2017	2016
	\$	\$
Cost of sales	1,098,086	1,031,647
SG&A expenses	90,076	92,763
	<u>1,188,162</u>	<u>1,124,410</u>

19 Segment information

Reportable segments

Management has determined the operating segments based on the reports reviewed by the Chief Executive Officer who is considered to be the Chief Operating Decision Maker. The Partnership operates in three industry segments: Consumer, AFH and Other.

(a) Consumer

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

(b) AFH

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

(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 and sales of recycled fibre primarily to its parent company. It also includes start-up costs related to capital projects.

Segment operating income is the earnings (loss) for each such segment before (i) interest expense, (ii) income taxes, (iii) depreciation, (iv) amortization, (v) impairment (gain on sale) of non-financial assets, (vi) loss (gain) on disposal of property, plant and equipment, (vii) foreign exchange loss (gain), (viii) costs related to restructuring activities, (ix) changes in amortized cost of Partnership units liability, (x) change in fair value of derivatives, and (xi) one-time costs due to pension revaluations related to past service. "Consumer Segment Adjusted EBITDA", "AFH Segment Adjusted

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

EBITDA” and “Other Segment Adjusted EBITDA” means in each case the Segment operating income for the respective reportable segment of KPLP.

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.

				2017
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	1,040,428	233,321	6,265	1,280,014
Segment Adjusted EBITDA	138,158	6,235	(163)	144,230
Depreciation and amortization				52,381
Interest expense				42,021
Change in amortized cost of Partnership units liability				23,013
Change in fair value of derivatives				364
Gain on sale of property, plant and equipment				(3)
Gain on sale of non-financial assets				(75)
Restructuring costs, net				(180)
Foreign exchange gain				(1,387)
Income before income taxes				28,096
Income taxes				12,838
Net income				15,258

				2016
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	986,881	227,062	13,953	1,227,896
Segment Adjusted EBITDA	146,367	5,217	947	152,531
Depreciation and amortization				48,582
Interest expense				44,000
Change in amortized cost of Partnership units liability				23,363
Loss on sale of property, plant and equipment				139
Gain on sale of non-financial assets				(2,939)
Restructuring costs, net				552
Foreign exchange gain				(285)
Income before income taxes				39,119
Income taxes				3,629
Net income				35,490

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

Geographic segments

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

				2017
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Revenue	774,587	452,837	52,590	1,280,014
Property, plant and equipment	397,133	364,435	42	761,610
Goodwill	160,939	-	-	160,939
Intangible assets	15,327	-	-	15,327

				2016
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Revenue	746,483	429,627	51,786	1,227,896
Property, plant and equipment	357,689	404,581	-	762,270
Goodwill	160,939	-	-	160,939
Intangible assets	15,270	-	-	15,270

20 Compensation of key management

	2017	2016
	\$	\$
Compensation awarded to key management included:		
Salaries and other short-term employee benefits	5,268	6,444
Post-employment benefits	538	537
Other long-term benefits	534	728
	6,340	7,709

Key management includes the Partnership's senior executives.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

21 Financial instruments

Classification of financial instruments

As of December 31, 2017, 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	8,837	8,837
Trade and other receivables	loans and receivables	amortized cost	113,194	113,194
Receivables from related parties	loans and receivables	amortized cost	85	85
Advances to partners	loans and receivables	amortized cost	6,417	6,417
Bank indebtedness	financial liabilities	amortized cost	(9,051)	(9,051)
Trade payables	financial liabilities	amortized cost	(104,558)	(104,558)
Accrued expenses	financial liabilities	amortized cost	(47,283)	(47,283)
Merchandising accruals	financial liabilities	amortized cost	(38,493)	(38,493)
Derivative liabilities	financial liabilities	fair value	(364)	(364)
Payables to related parties	financial liabilities	amortized cost	(2,596)	(2,596)
Distributions payable	financial liabilities	amortized cost	(10,382)	(10,382)
Long-term debt	financial liabilities	amortized cost	(416,315)	(419,940)
Partnership units liability	financial liabilities	amortized cost	(160,309)	(160,309)

The following table details the fair value hierarchy of financial instruments by level as of December 31, 2017:

	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Derivative liabilities	-	(364)	-	(364)
Long-term debt	-	(419,940)	-	(419,940)
Partnership units liability	-	-	(160,309)	(160,309)

As of December 31, 2016, 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	36,511	36,511
Trade and other receivables	loans and receivables	amortized cost	123,095	123,095
Receivables from related parties	loans and receivables	amortized cost	185	185
Advances to partners	loans and receivables	amortized cost	5,465	5,465
Mortgage receivable	loans and receivables	amortized cost	1,000	1,000
Bank indebtedness	financial liabilities	amortized cost	(9,007)	(9,007)
Trade payables	financial liabilities	amortized cost	(88,163)	(88,163)
Accrued expenses	financial liabilities	amortized cost	(65,139)	(65,139)
Merchandising accruals	financial liabilities	amortized cost	(48,175)	(48,175)
Payables to related parties	financial liabilities	amortized cost	(3,606)	(3,606)
Distributions payable	financial liabilities	amortized cost	(10,148)	(10,148)
Long-term debt	financial liabilities	amortized cost	(424,238)	(431,041)
Partnership units liability	financial liabilities	amortized cost	(145,907)	(145,907)

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

The following table details the fair value hierarchy of financial instruments by level as of December 31, 2016:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Mortgage receivable	-	-	1,000	1,000
Long-term debt	-	(431,041)	-	(431,041)
Partnership units liability	-	-	(145,907)	(145,907)

Fair value

Cash and cash equivalents, trade and other receivables, receivables from related parties, advances to partners, mortgage receivable, bank indebtedness, trade payables, accrued expenses, merchandising accruals, 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, 2017, the fair values of the Credit Facility, the Nordea Facility and the Caisse Facility were \$182.0 million, \$16.6 million and \$183.9 million (December 31, 2016 – \$198.0 million, \$26.6 million and \$196.8 million), respectively, which approximates the current principal amount outstanding as the interest rate approximates current market interest rates. As of December 31, 2017, the fair values of the Quebec PM Loan and the Ontario Loan were \$34.9 million and \$2.5 million (December 31, 2016 – \$8.8 million and \$0.8 million), respectively, which are recorded on discounted future cash flows using a market rate of 4.4%, net of the government grant recorded on the below-market rate of interest.

The fair value of the derivative liabilities was based on foreign exchange rates in the active market. The change in the fair value of the derivative liabilities of \$0.4 million loss during the year ended December 31, 2017 (2016 – nil) was recorded in the consolidated statement of comprehensive income (loss) in Other expense. The valuation methodology used was categorized as a Level 2 methodology.

Fair value of the Partnership units liability

The Partnership units liability is classified as a financial liability at amortized cost. Management has estimated the fair value of the Partnership units liability using a discounted cash flow model. Significant assumptions include the income tax obligation, discount rate and an industry capitalization rate (note 4). There were no significant changes in the assumptions during the year ended December 31, 2017.

Objectives and policies relating to financial risk management

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

Credit risk

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

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

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

	December 31, 2017	December 31, 2016
	\$	\$
Trade receivables	102,803	115,729
Less: Allowance for doubtful accounts	(303)	(541)
Total trade receivables, net	102,500	115,188
Trade receivables, net		
0 to 60 days	101,546	110,024
61 to 90 days	728	2,625
Over 90 days	529	3,080
Less: Allowance for doubtful accounts	(303)	(541)
	102,500	115,188

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

Currency risk

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

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

The Partnership uses derivative financial instruments to manage foreign currency risk. Foreign exchange swaps and foreign exchange forwards are used to manage U.S. dollar borrowings. As of December 31, 2017, the Partnership had foreign exchange swaps outstanding of \$31.5 million (December 31, 2016 – nil) and foreign exchange forwards outstanding of \$19.0 million (December 31, 2016 – nil) with settlement dates ranging from January 3, 2018 to January 31, 2018. Assuming the Canadian dollar strengthened (weakened) by 5% against the U.S. dollar, with all other variables held constant, the result on net income before tax during the year ended December 31, 2017 would have been a (decrease) increase of approximately \$2.4 million (2016 – nil).

As of December 31, 2017, the Partnership has net liabilities denominated in U.S. dollars of \$23.2 million (December 31, 2016 - \$33.0 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, 2017 would have been an increase/decrease of \$1.2 million (2016 - \$1.7 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 \$83.0 million as of December 31, 2017 (December 31, 2016 - \$67.0 million). The Partnership prepares projections to ensure it has sufficient funds to fulfill its obligations. The Partnership monitors the covenants on its credit facilities in the normal course of business. Refinancing risks are minimized by ensuring the Credit Facility will not mature for two years. On March 8, 2016, the Partnership obtained an amendment to provide for an increase in the maximum ratio of funded debt to EBITDA to be complied with by the Partnership during the year ended December 31, 2016. Additional information is disclosed in note 13. 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 \$190.7 million (December 31, 2016 - \$201.5 million) are all due for payment within 12 months of the dates of the consolidated statement of financial position.

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

As of December 31, 2017, the Caisse Facility, which matures on August 16, 2018, has been classified as short-term debt, resulting in a working capital deficit. Management fully expects to refinance all or part of the indebtedness prior to the maturity date and is currently exploring various refinancing alternatives. Subject to refinancing being obtained, the Partnership believes its cash flows generated from operations combined with its available cash and credit facilities provide sufficient funding to meet its obligations.

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

	December 31, 2017		
	Less than 1 year	1 to 5 years	Greater than 5 years
	\$	\$	\$
Long-term debt ^(a)	215,546	233,285	14,064
Trade and other payables	190,698		
Payables to related parties	2,596		
Distributions payable	10,382		

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

	December 31, 2016		
	Less than 1 year	1 to 5 years	Greater than 5 years
	\$	\$	\$
Long-term debt ^(a)	42,251	458,150	4,858
Trade and other payables	201,477		
Payables to related parties	3,606		
Distributions payable	10,148		

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

The above table excludes the Partnership units liability. Payments on the Partnership units liability are made upon the declaration of the Tax Distribution, which for 2017 was \$1.9 million (2016 - \$8.6 million) and paid the following February. The Partnership units liability is estimated based on expected future Tax Distributions and is an obligation that will continue into perpetuity (note 4).

Interest rate risk

As of December 31, 2017, the Partnership had variable rate debts of \$181.1 million (December 31, 2016 - \$196.7). These loans bear interest at a base rate of Canadian prime rate, U.S. base rate, banker's acceptance rates or LIBOR, plus a margin varying between 0.20% and 2.375%. A 1% increase/decrease in the market rate of interest would result in a decrease/increase in income before income taxes of \$1.8 million for the year ended December 31, 2017 (2016 - \$2.0 million). On March 8, 2016, the Partnership obtained an amendment which provides for the borrowings under the Credit Facility to bear interest during the year ended December 31, 2016 at a base rate of Canadian prime rate, U.S. base rate, banker's acceptance rates or LIBOR, plus a margin varying between 0.20% and 2.875% depending on the ratio of funded debt to EBITDA and the type of advance. Additional information is disclosed in note 13.

22 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 and bank indebtedness, less cash and cash equivalents) and equity (including the Partnership units classified as a liability). The Partnership monitors externally imposed debt covenants

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

as established pursuant to its credit facility agreements. The requirements include a quarterly debt to EBITDA ratio and EBITDA to interest expense coverage ratio (as defined in the Credit Agreement).

23 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.

24 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, 2017, the Partnership had two major customers which represented 30.8% (2016 – 30.7%) of total revenues, and of these customers, one represented 19.2% (2016 – 21.2%) of the total revenues. The Partnership's concentration of credit risk primarily arises from exposure to these two customers and amounted to approximately 34.8% of the trade receivables as of December 31, 2017 (December 31, 2016 – 31.0%). These customers are included in the consumer segment.

25 Cash and cash equivalents

	December 31, 2017	December 31, 2016
	\$	\$
Cash and cash equivalents	8,837	36,511
Bank indebtedness	(9,051)	(9,007)
Cash and cash equivalents in the consolidated statement of cash flows	(214)	27,504

26 Non-cash working capital

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

	2017	2016
	\$	\$
Decrease (increase) in trade and other receivables	1,217	(17,298)
Decrease in receivables from related parties	100	-
Increase in inventories	(22,650)	(1,517)
Decrease (increase) in prepaid expenses	(1,334)	1,181
Decrease (increase) in other long-term assets	(256)	127
Decrease (increase) in income taxes	987	(427)
Increase (decrease) in trade and other payables	(12,248)	19,489
Decrease in payables to related parties	(1,010)	(169)
	(35,194)	1,386

Kruger Products L.P.

Notes to Consolidated Financial Statements

December 31, 2017 and December 31, 2016

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

27 Cash flows from (used in) financing activities

The change in financing activities on the consolidated statement of cash flows comprised the following:

	Advances to partners \$	Prepaid interest \$	Accrued interest \$	Distributions payable \$	Long-term debt \$	Partnership units \$	Total \$
As of January 1, 2016	(6,863)	(1,093)	292	9,871	436,042	318,012	756,261
Proceeds from long-term debt	-	-	-	-	9,609	-	9,609
Repayment of long-term debt	-	-	-	-	(17,882)	-	(17,882)
Payment of deferred financing fees	-	-	-	-	(745)	-	(745)
Interest paid on long-term debt	-	(7,288)	(26,874)	-	-	-	(34,162)
Distributions and advances paid, net	(1,234)	-	-	(39,925)	-	18,297	(22,862)
Interest expense on long-term debt	-	7,232	27,629	-	4,107	-	38,968
Foreign exchange	-	-	(292)	-	(6,893)	-	(7,185)
Distributions declared	-	-	-	40,202	-	-	40,202
Tax Distributions declared	2,632	-	-	-	-	-	2,632
Fair value adjustment	-	-	-	-	-	267	267
As of December 31, 2016	(5,465)	(1,149)	755	10,148	424,238	336,576	765,103
Proceeds from long-term debt	-	-	-	-	28,834	-	28,834
Repayment of long-term debt	-	-	-	-	(26,039)	-	(26,039)
Payment of deferred financing fees	-	-	-	-	(12)	-	(12)
Interest paid on long-term debt	-	(6,519)	(26,582)	-	-	-	(33,101)
Distributions and advances paid, net	(9,563)	-	-	(40,934)	-	18,950	(31,547)
Interest expense on long-term debt	-	7,045	26,949	-	2,905	-	36,899
Foreign exchange	-	-	(311)	-	(13,611)	-	(13,922)
Distributions declared	-	-	-	41,168	-	-	41,168
Tax Distributions declared	8,611	-	-	-	-	-	8,611
Fair value adjustment	-	-	-	-	-	714	714
As of December 31, 2017	(6,417)	(623)	811	10,382	416,315	356,240	776,708



KP TISSUE INC.

AUDITED FINANCIAL STATEMENT

FOR THE YEARS ENDED DECEMBER 31, 2017 AND DECEMBER 31, 2016

March 7, 2018

Independent Auditor's Report

To the Shareholders of KP Tissue Inc.

We have audited the accompanying financial statements of KP Tissue Inc., which comprise the statements of financial position as at December 31, 2017 and December 31, 2016 and the statements of comprehensive loss, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of KP Tissue Inc. as at December 31, 2017 and December 31, 2016 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

(signed) PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants
Toronto, Ontario

KP Tissue Inc.

Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	December 31, 2017	December 31, 2016
	\$	\$
Assets		
Current assets		
Distributions receivable	1,658	1,636
Receivable from Partnership	-	426
Income taxes recoverable	826	-
	2,484	2,062
Non-current assets		
Investment in associate (note 5)	98,674	117,349
Total Assets	101,158	119,411
Liabilities		
Current liabilities		
Dividend payable (note 7)	1,658	1,636
Payable to Partnership	52	-
Current portion of advances from Partnership (note 6)	309	914
Income tax payable	-	884
	2,019	3,434
Non-current liabilities		
Advances from Partnership (note 6)	731	-
Deferred income taxes (note 6)	1,483	893
Total liabilities	4,233	4,327
Equity		
Common shares (note 7)	15,014	13,176
Contributed surplus	144,819	144,819
Deficit	(74,952)	(58,729)
Accumulated other comprehensive income	12,044	15,818
Total equity	96,925	115,084
Total liabilities and equity	101,158	119,411
Subsequent events (note 7)		

Approved by the Board of Directors

/s/ James Hardy
Director

/s/ Michel Letellier
Director

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

KP Tissue Inc.

Statement of Comprehensive Loss

For the years ended December 31, 2017 and December 31, 2016

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

	2017	2016
	\$	\$
Equity loss (note 5)	(3,440)	(124)
Dilution gain (note 7)	190	191
Income (loss) before income taxes	(3,250)	67
Income taxes (note 6)	2,191	1,789
Net loss for the year	(5,441)	(1,722)
Other comprehensive loss		
net of tax expense (recovery) (note 8)		
Items that will not be reclassified to net loss:		
Remeasurements of pensions	(3,846)	(1,195)
Remeasurements of post-retirement benefits	(270)	9
Items that may be subsequently reclassified to net loss:		
Available-for-sale investment	-	(41)
Cumulative translation adjustment	(3,774)	(2,251)
Total other comprehensive loss for the year	(7,890)	(3,478)
Comprehensive loss for the year	(13,331)	(5,200)
Basic loss per share	(0.59)	(0.19)
Weighted average number of shares outstanding	9,162,508	9,037,833

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

KP Tissue Inc.

Statement of Changes in Equity

For the years ended December 31, 2017 and December 31, 2016

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

	Common shares		Contributed surplus	Deficit	Accumulated other comprehensive income	Total equity
	#	\$	\$	\$	\$	\$
As of January 1, 2016	8,958,590	11,577	144,819	(49,291)	18,110	125,215
Issuance of common shares (note 7)	133,008	1,580	-	-	-	1,580
Dividends payable	-	-	-	(1,636)	-	(1,636)
Dividends paid	-	-	-	(4,875)	-	(4,875)
Fair value adjustment (note 7)	-	19	-	(19)	-	-
Remeasurements of pensions	-	-	-	(1,195)	-	(1,195)
Remeasurements of post-retirement benefits	-	-	-	9	-	9
Available-for-sale investment	-	-	-	-	(41)	(41)
Cumulative translation adjustment	-	-	-	-	(2,251)	(2,251)
Net loss for the year	-	-	-	(1,722)	-	(1,722)
As of December 31, 2016	<u>9,091,598</u>	<u>13,176</u>	<u>144,819</u>	<u>(58,729)</u>	<u>15,818</u>	<u>115,084</u>
As of January 1, 2017	9,091,598	13,176	144,819	(58,729)	15,818	115,084
Issuance of common shares (note 7)	121,315	1,772	-	-	-	1,772
Dividends payable	-	-	-	(1,658)	-	(1,658)
Dividends paid	-	-	-	(4,942)	-	(4,942)
Fair value adjustment (note 7)	-	66	-	(66)	-	-
Remeasurements of pensions	-	-	-	(3,846)	-	(3,846)
Remeasurements of post-retirement benefits	-	-	-	(270)	-	(270)
Cumulative translation adjustment	-	-	-	-	(3,774)	(3,774)
Net loss for the year	-	-	-	(5,441)	-	(5,441)
As of December 31, 2017	<u>9,212,913</u>	<u>15,014</u>	<u>144,819</u>	<u>(74,952)</u>	<u>12,044</u>	<u>96,925</u>

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

KP Tissue Inc.

Statement of Cash Flows

For the years ended December 31, 2017 and December 31, 2016

(tabular amounts are in thousands of Canadian dollars)

	2017	2016
	\$	\$
Cash flows from (used in) operating activities		
Net loss for the year	(5,441)	(1,722)
Items not affecting cash		
Equity loss	3,440	124
Dilution gain	(190)	(191)
Income taxes	2,191	1,789
Total items not affecting cash	5,441	1,722
Net change in non-cash working capital (note 10)	478	-
Tax payments	(1,999)	(205)
Tax Distribution received	481	-
Advances received	1,040	205
Net cash from (used in) operating activities	-	-
Cash flows from investing activities		
Partnership unit distributions received	4,806	4,908
Net cash from investing activities	4,806	4,908
Cash flows used in financing activities		
Dividends paid (note 11)	(4,806)	(4,908)
Net cash used in financing activities	(4,806)	(4,908)
Increase (decrease) in cash and cash equivalents during the year	-	-
Cash and cash equivalents - Beginning of year	-	-
Cash and cash equivalents - End of year	-	-

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

KP Tissue Inc.

Notes to Financial Statements

December 31, 2017 and December 31, 2016

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

1 General information

KP Tissue Inc. (KPT or the Corporation) was incorporated by articles of incorporation under the Canadian Business Corporations Act on October 1, 2012. As of December 31, 2017, the Corporation held a 16.0% (December 31, 2016 – 16.1%) interest in Kruger Products L.P. (KPLP or the Partnership), whose principal business is to produce, distribute, market and sell a wide range of disposable tissue products, including bathroom tissue, facial tissue, paper towels and napkins for both the consumer and away-from-home markets in North America. The Corporation's headquarters are located in Mississauga, Ontario, Canada.

2 Basis of presentation

The financial statements have been prepared in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board (IASB), and with interpretations of the International Financial Reporting Committee which the Canadian Accounting Standards Board has approved for incorporation into Part 1 of the CPA Canada Handbook - Accounting. The financial statements have been prepared using the historical cost convention. The financial statements were approved by the board of directors on March 7, 2018.

3 Summary of significant accounting policies

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

(a) Investments in associates

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

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

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

(b) Income tax

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

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

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax is not recognized if it

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

arises from the initial recognition of goodwill or the 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 provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the Corporation and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

(c) Share capital

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

(d) Earnings per share

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

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

(e) Accounting standards implemented for the year ended December 31, 2017

- (i) IAS 7, Statement of Cash Flows. In January 2016, the IASB issued an amendment to require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. Other than the aforementioned additional disclosures, included in note 11, the application of the amendments to IAS 7 did not result in any changes to the presentation of the statement of cash flows.
- (ii) IAS 12, Income Taxes – Deferred Tax. In February 2016, the IASB issued an amendment to clarify the requirements for recognizing deferred tax assets on unrealized losses. The amendment clarifies the accounting for deferred tax where an asset is measured at fair value and that fair value is below the asset's tax base. Certain other aspects of accounting for deferred tax assets are also clarified. The adoption of this standard had no impact on the financial statements.
- (iii) In December 2016, the IASB issued an amendment clarifying the scope of IFRS 12, Disclosure of Interests in Other Entities. The amendment clarified that the disclosures requirement of IFRS 12 are applicable to interest in entities classified as held for sale, except for summarized financial information. The adoption of this standard had no impact on the financial statements.

(f) Accounting standards issued but not yet applied

- (i) IFRIC 23, Uncertainty over income tax treatments. In June 2017, the IFRS Interpretation Committee issued an interpretation which clarifies how the recognition and measurement requirements of IAS 12 Income taxes, are applied where there is uncertainty over income tax treatments. The interpretation is effective for annual

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

periods beginning on or after January 1, 2019. Management has performed a preliminary assessment of IFRIC 23 adoption and does not expect a significant impact on the financial statements.

4 Critical accounting estimates and judgments

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

Equity method of accounting

The equity method of accounting is being applied by the Corporation as it relates to its investment in KPLP. The conclusion to account for an investment using the equity method, particularly when the percentage of ownership is below 20%, is based on an assessment of several facts and circumstances and ultimately requires significant judgment in reaching a conclusion. Management has reviewed the agreements and made an assessment of the rights of the Corporation. Based on the Corporation having three of nine seats on the board of directors of KPGP Inc. (KPGP), management has concluded that the Corporation has the ability to exercise significant influence over KPLP.

Partnership units

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year.

Income taxes

The Corporation has not recognized at the date of acquisition the deferred tax assets and liabilities related to the differences between the accounting and tax basis of KPLP's assets and liabilities. Accordingly, the Corporation is tracking temporary differences that are subject to the initial recognition exemption and recognizes newly created temporary differences as they arise. The determination of the temporary differences that are subject to the initial recognition exemption requires significant judgment.

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

5 Investment in associate

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

	December 31, 2017	December 31, 2016
	\$	\$
Opening balance	117,349	126,643
Investment in associate	1,772	1,580
Share of income	2,448	5,750
Depreciation of fair value increments	(5,888)	(5,874)
Share of other comprehensive loss	(9,202)	(3,998)
Dilution gain	190	191
Tax Distribution	(1,395)	(432)
Partnership unit distributions	(6,600)	(6,511)
Closing balance	<u>98,674</u>	<u>117,349</u>

The equity loss was comprised of the following components:

	2017	2016
	\$	\$
Share of income	2,448	5,750
Depreciation of fair value increments	(5,888)	(5,874)
	<u>(3,440)</u>	<u>(124)</u>

The following summarizes financial information about the assets, liabilities, revenue and net income of KPLP, in which the Corporation holds a 16.0% interest as of December 31, 2017 (December 31, 2016 – 16.1%). The financial information was derived from the consolidated financial statements of KPLP for the year ended December 31, 2017. The assets and liabilities disclosed include the fair value adjustments made to the carrying amount of the assets and liabilities of the associate on its acquisition.

	December 31, 2017		
	KPLP basis of		KPT basis of
	accounting	FV increment	accounting
	\$	\$	\$
Current assets	324,967	-	324,967
Non-current assets	974,788	497,088	1,471,876
Liabilities to non-unitholders	815,861	-	815,861
Partnership units liability	160,309	-	160,309
Net assets	323,585		
	Year ended		
	December 31, 2017		
	\$		
Revenue	1,280,014		
Net income	15,258		
Other comprehensive loss	(52,088)		
Total comprehensive loss	(36,830)		

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

			December 31, 2016
	KPLP basis of accounting	FV increment	KPT basis of accounting
	\$	\$	\$
Current assets	352,508	-	352,508
Non-current assets	984,467	538,840	1,523,307
Liabilities to non-unitholders	808,435	-	808,435
Partnership units liability	145,907	-	145,907
Net assets	382,633		
	Year ended December 31, 2016		
	\$		
Revenue	1,227,896		
Net income	35,490		
Other comprehensive loss	(19,353)		
Total comprehensive income	16,137		

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

	December 31, 2017	December 31, 2016
	\$	\$
KPLP consolidated equity	323,585	382,633
Add back: Inception value of Partnership units liability	118,562	118,562
Less: Equity pertaining to Kruger Inc. and KPGP	(295,622)	(343,935)
Equity pertaining to KPT	146,525	157,260
Investment in associate recorded in KPT	98,674	117,349
Reconciling difference	47,851	39,911
Reconciling items since inception:		
Equity issuance costs	(11,110)	(11,110)
Depreciation of FV increments	31,629	25,741
Currency translation adjustment in fair value increments	(3,066)	(3,913)
Tax Distribution	3,566	2,171
Gain on exercise of overallotment option	(375)	(375)
Dilution gain	(793)	(603)
Impairment in investment in associate	28,000	28,000
	-	-

With respect to KPT's investment in KPLP, the liability of KPT for the debts, liabilities and other obligations of KPLP is limited to KPT's capital contribution to KPLP.

On January 16, 2017, April 17, 2017, July 17, 2017, and October 16, 2017, in connection with the Corporation Distribution Reinvestment Plan (DRIP), the portion of the distributions received by the shareholders was used to acquire an additional 121,315 units of KPLP for proceeds of \$1.8 million (note 7).

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

6 Income taxes

The Corporation is required to pay income tax on its share of the taxable income of KPLP. The Corporation has not recognized at the date of acquisition the deferred tax assets and liabilities related to the differences between the accounting and tax basis of KPLP's assets and liabilities. Accordingly, the Corporation is tracking the temporary differences that were subject to the initial recognition exemption and recognizes newly created temporary differences as they arise.

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

	2017	2016
	\$	\$
Current tax expense	289	1,383
Deferred tax expense	1,902	406
	<u>2,191</u>	<u>1,789</u>

Details of the provision for income taxes were as follows:

	2017	2016
	\$	\$
Income tax at statutory rate of 26%	(845)	17
Permanent differences and other	(5)	(4)
Dilution gain	(49)	(50)
Taxed in hands of subsidiaries	145	(283)
Realization of previously unrecognized tax attributes	1,748	1,589
Change in basis of investment in associate	1,197	520
	<u>2,191</u>	<u>1,789</u>

Components of the deferred income tax liability were as follows:

	December 31, 2017	December 31, 2016
	\$	\$
Deferred tax liability (asset)		
Pensions	(540)	(417)
Deferred finance fees	(46)	(50)
Property, plant and equipment	4,970	3,546
Other	(2,901)	(2,186)
	<u>1,483</u>	<u>893</u>

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

The analysis of the deferred tax liability was as follows:

	December 31, 2017	December 31, 2016
	<u>\$</u>	<u>\$</u>
Deferred tax liabilities to be realized greater than 12 months	1,483	893
	<u>1,483</u>	<u>893</u>

In addition to the above, the Corporation has a deferred tax asset of \$5.1 million (December 31, 2016 - \$3.4 million) related to the Investment in associate which has not been recognized in the financial statements.

The movement in the deferred tax liability was as follows:

	Year ended	Year ended
	December 31, 2017	December 31, 2016
	<u>\$</u>	<u>\$</u>
Opening balance	893	1,007
Charge to net loss	1,902	406
Charge to other comprehensive loss		
- remeasurements of cumulative translation adjustment	(564)	(337)
Charge to other comprehensive loss		
- remeasurements of post-retirement benefits	(173)	6
Charge to other comprehensive loss		
- remeasurements of pensions	(575)	(183)
Charge to other comprehensive loss		
- mark-to-market on Available-for-sale investment	-	(6)
	<u>1,483</u>	<u>893</u>

On December 13, 2012, in connection with the issuance of Partnership units to KPT, the Limited Partnership Agreement was amended to require KPLP, subject to compliance with contractual obligations and applicable law, to make distributions to its partners in such amounts as would enable KPT to discharge its obligation to pay federal and provincial income taxes (the Tax Distribution). Each partner is entitled to its share of the Tax Distribution made in respect of any given year.

On February 28, 2017, KPT received a Tax Distribution of \$1.4 million from KPLP for purposes of settling its obligation for federal and provincial taxes for the year ended December 31, 2016, and settle the advance to KPT recorded during the year ended December 31, 2016.

During the year ended December 31, 2017, pursuant to the Tax Distribution as defined in the Partnership Agreement, KPT received an advance from KPLP of \$1.0 million to pay the monthly tax instalments. The advance is non-interest bearing and non-recourse and was partially offset against KPT's portion of the Tax Distribution of \$0.3 million, paid by KPLP on February 28, 2018. The excess advance over KPT's portion of the Tax Distribution in the amount of \$0.7 million is repayable by KPT to KPLP by March 31, 2019.

KP Tissue Inc.

Notes to Financial Statements

December 31, 2017 and December 31, 2016

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

7 Dividends

During the years ended December 31, 2017 and December 31, 2016, the Corporation paid a quarterly dividend of \$0.18 per common share to shareholders. Pursuant to the Corporation Dividend Reinvestment Plan (DRIP), a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing common shares. The proceeds were used to acquire additional units of KPLP. The dividends paid, the additional common shares issued at the share price, and the gross proceeds were as follows:

				2017
	Dividends paid	Share price	Issuance of Common shares	Gross proceeds
Dividend Payment Date	\$	\$	#	\$
January 16, 2017	1,636	15.25	30,162	460
April 17, 2017	1,642	15.30	29,419	450
July 17, 2017	1,647	13.23	32,447	429
October 16, 2017	1,653	14.81	29,287	433
	<u>6,578</u>		<u>121,315</u>	<u>1,772</u>

				2016
	Dividends paid	Share price	Issuance of Common shares	Gross proceeds
Dividend Payment Date	\$	\$	#	\$
January 15, 2016	1,613	10.29	41,671	429
April 15, 2016	1,620	12.31	20,791	256
July 15, 2016	1,624	11.75	37,733	444
October 17, 2016	1,631	13.77	32,813	451
	<u>6,488</u>		<u>133,008</u>	<u>1,580</u>

On January 15, 2018, the Corporation paid a dividend of \$1.7 million to shareholders at \$0.18 per common share. Pursuant to the Corporation DRIP, a portion of the dividend was reinvested by the shareholders, resulting in the Corporation issuing 38,122 common shares at a price of \$13.50.

Subsequent to December 31, 2017, the Corporation declared a dividend of \$0.18 per common share to shareholders, payable on April 16, 2018.

As a result of the DRIP and Kruger's reinvestment of its distribution from KPLP in units of KPLP, a dilution gain of \$0.2 million was recorded during the year ended December 31, 2017 (2016 - \$0.2 million).

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

8 Income tax recovery on other comprehensive loss

Income tax recovery on other comprehensive loss was as follows:

	2017	2016
	\$	\$
Items that will not be reclassified to net loss:		
Remeasurements of pensions	(4,421)	(1,378)
Income tax recovery	575	183
Net of income tax recovery	<u>(3,846)</u>	<u>(1,195)</u>
 Remeasurements of post-retirement benefits	 (443)	 15
Income tax recovery (expense)	173	(6)
Net of income tax recovery (expense)	<u>(270)</u>	<u>9</u>
 Items that may be subsequently reclassified to net loss:		
Available-for-sale investment	-	(47)
Income tax recovery	-	6
Net of income tax recovery	<u>-</u>	<u>(41)</u>
 Cumulative translation adjustment	 (4,338)	 (2,588)
Income tax recovery	564	337
Net of income tax recovery	<u>(3,774)</u>	<u>(2,251)</u>
 Total other comprehensive loss for the year	 <u><u>(7,890)</u></u>	 <u><u>(3,478)</u></u>

9 Economic dependence

The Corporation is economically dependent upon the Partnership.

10 Non-cash working capital

	2017	2016
	\$	\$
Decrease in receivable from Partnership	426	-
Increase in payable to Partnership	52	-
	<u>478</u>	<u>-</u>

KP Tissue Inc.
Notes to Financial Statements
December 31, 2017 and December 31, 2016

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

11 Cash flows used in financing activities

The change in financing activities on the statement of cash flows comprised the following:

	Dividend payable \$	Common shares \$	Total \$
As of January 1, 2016	1,613	11,577	13,190
Dividends paid	(6,488)	1,580	(4,908)
Dividends declared	6,511	-	6,511
Fair value adjustment	-	19	19
As of December 31, 2016	1,636	13,176	14,812
Dividends paid	(6,578)	1,772	(4,806)
Dividends declared	6,600	-	6,600
Fair value adjustment	-	66	66
As of December 31, 2017	1,658	15,014	16,672

Shareholder Information

Corporate Address

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Telephone: 905-812-6900
Fax: 905-812-6910
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Investor Relations

Mike Baldesarra
Director of Investor Relations
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Transfer Agent and Registrar

TSX Trust Company
200 University Avenue
Suite 300
Toronto, Ontario M5H 4H1
Telephone: 1 866 393-4891
Fax: 416 361-0470
www.tsxtrust.com

Stock Exchange Listing

Toronto Stock Exchange
Stock Symbol: KPT

Auditors

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

Board of Directors

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

Michael Korenberg (Chair and Independent Director) ^{(1) (3) (4)}
James Hardy (Independent Director) ^{(1) (3) (4) (5)}
Michel Letellier (Independent Director) ^{(1) (2) (3)}
David Spraley (Director) ⁽²⁾

- ⁽¹⁾ Member of the Corporation Audit Committee and the KPGP Audit Committee.
- ⁽²⁾ Member of the KPGP HR & Compensation Committee.
- ⁽³⁾ Member of the Corporation Nominating and Governance Committee.
- ⁽⁴⁾ Member of the KPGP Governance Committee.
- ⁽⁵⁾ Chair of the Corporation Audit Committee and the KPGP Audit Committee.

For complete information about Board Members and Corporate Governance, please visit www.kptissueinc.com

Annual Meeting of Shareholders

Gallery Room
TMX Broadcast Center
130 King Street West
Toronto, Ontario M5H 1A1
May 10, 2018 at 3:00 p.m. (EST).

Designed and written by

MaisonBrison Communications



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of softness to the court.

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