



KRUGER PRODUCTS L.P.

**UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENT
FOR THE 3-MONTH PERIODS ENDED MARCH 26, 2017 AND MARCH 27, 2016**

Kruger Products L.P.

Unaudited Condensed Consolidated Statement of Financial Position

(tabular amounts are in thousands of Canadian dollars)

	March 26, 2017 \$	December 31, 2016 \$
Assets		
Current assets		
Cash and cash equivalents	34,844	36,511
Trade and other receivables	113,536	123,095
Receivables from related parties (note 11)	518	185
Current portion of advances to partners (note 9)	439	5,465
Inventories	181,572	179,543
Income tax recoverable	45	423
Prepaid expenses	12,927	7,286
	<u>343,881</u>	<u>352,508</u>
Non-current assets		
Property, plant & equipment (note 6)	769,586	762,270
Other long-term assets	5,945	6,075
Goodwill	160,939	160,939
Intangible assets	15,030	15,270
Deferred income taxes	37,188	39,913
	<u>1,332,569</u>	<u>1,336,975</u>
Liabilities		
Current liabilities		
Bank indebtedness (note 14)	-	9,007
Trade and other payables	183,426	201,477
Payables to related parties (note 11)	4,578	3,606
Income tax payable	766	1,779
Distributions payable (notes 9 and 11)	10,203	10,148
Current portion of provisions (note 8)	1,604	1,885
Current portion of long-term debt (note 13)	8,828	8,859
	<u>209,405</u>	<u>236,761</u>
Non-current liabilities		
Long-term debt (note 13)	443,471	415,379
Provisions (note 8)	6,730	6,487
Pensions (note 7)	94,953	92,646
Post-retirement benefits (note 7)	58,307	57,162
	<u>812,866</u>	<u>808,435</u>
Liabilities to non-unitholders		
Current portion of Partnership units liability (note 9)	8,611	8,611
Long-term portion of Partnership units liability (note 9)	131,214	137,296
	<u>139,825</u>	<u>145,907</u>
Total Partnership units liability		
	<u>952,691</u>	<u>954,342</u>
Total liabilities		
Equity		
Partnership units (note 9)	341,406	336,576
Deficit	(49,612)	(42,792)
Accumulated other comprehensive income	88,084	88,849
	<u>379,878</u>	<u>382,633</u>
Total equity	<u>379,878</u>	<u>382,633</u>
Total equity and liabilities	<u>1,332,569</u>	<u>1,336,975</u>
Subsequent events (note 9)		

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

Kruger Products L.P.
Unaudited Condensed Consolidated Statement of Comprehensive Income (Loss)
For the 3-month periods ended March 26, 2017 and March 27, 2016

(tabular amounts are in thousands of Canadian dollars)

	3-month period ended March 26, 2017 \$	3-month period ended March 27, 2016 \$
Revenue (note 11)	289,271	279,690
Expenses		
Cost of sales (note 11)	244,254	240,647
Selling, general and administrative expenses (note 11)	23,221	21,652
Loss on sale of non-financial assets	13	-
Restructuring costs, net (note 8)	11	-
Operating income	21,772	17,391
Interest expense	10,264	11,214
Other (income) expense (note 5)	1,945	(829)
Income before income taxes	9,563	7,006
Income taxes (note 10)	2,614	616
Net income for the period	6,949	6,390
Other comprehensive loss		
Items that will not be reclassified to net income:		
Remeasurements of pensions	(2,567)	(16,769)
Remeasurements of post-retirement benefits	(884)	121
Items that may be subsequently reclassified to net income:		
Available-for-sale investment	-	(290)
Cumulative translation adjustment	(765)	(13,981)
Total other comprehensive loss for the period	(4,216)	(30,919)
Comprehensive income (loss) for the period	2,733	(24,529)

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

Kruger Products L.P.
Unaudited Condensed Consolidated Statement of Changes in Equity

For the 3-month periods ended March 26, 2017 and March 27, 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 9)	-	-	(9,951)	-	(9,951)
Fair value adjustment (note 9)	-	(146)	146	-	-
Change in actuarial loss on pension	-	-	(16,769)	-	(16,769)
Change in actuarial gain on post-retirement benefits	-	-	121	-	121
Change in available-for-sale investment	-	-	-	(290)	(290)
Cumulative translation adjustment	-	-	-	(13,981)	(13,981)
Net income for the period	-	-	6,390	-	6,390
Issuance of partnership units (note 9)	442,929	4,558	-	-	4,558
As of March 27, 2016	55,283,022	322,424	(49,479)	85,534	358,479
As of January 1, 2017	56,376,788	336,576	(42,792)	88,849	382,633
Distributions payable (note 9)	-	-	(10,203)	-	(10,203)
Fair value adjustment (note 9)	-	115	(115)	-	-
Change in actuarial loss on pension	-	-	(2,567)	-	(2,567)
Change in actuarial loss on post-retirement benefits	-	-	(884)	-	(884)
Cumulative translation adjustment	-	-	-	(765)	(765)
Net income for the period	-	-	6,949	-	6,949
Issuance of partnership units (note 9)	309,196	4,715	-	-	4,715
As of March 26, 2017	56,685,984	341,406	(49,612)	88,084	379,878

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

Kruger Products L.P.

Unaudited Condensed Consolidated Statement of Cash Flows

For the 3-month periods ended March 26, 2017 and March 27, 2016

(tabular amounts are in thousands of Canadian dollars)

	3-month period ended March 26, 2017 \$	3-month period ended March 27, 2016 \$
Cash flows from (used in) operating activities		
Net income for the period	6,949	6,390
Items not affecting cash		
Depreciation	11,748	10,087
Amortization	240	284
Loss (gain) on sale of property, plant and equipment	(2)	1
Change in amortized cost of Partnership units liability (note 5)	2,529	1,234
Gain on sale of investment (note 5)	-	(324)
Foreign exchange gain (note 5)	(584)	(1,739)
Interest expense	10,264	11,214
Pension and post-retirement benefits	2,513	2,659
Provisions (note 8)	244	141
Income taxes	2,614	616
Loss on sale of non-financial assets	13	-
Total items not affecting cash	29,579	24,173
Net change in non-cash working capital (note 15)	(28,860)	(16,639)
Contributions to pension and post-retirement benefit plans	(3,738)	(5,843)
Provisions paid	(334)	(476)
Income tax payments	(1,507)	(865)
Net cash from operating activities	2,089	6,740
Cash flows from (used in) investing activities		
Purchases of property, plant and equipment	(12,734)	(16,189)
Capitalized interest paid	(222)	-
Proceeds on sale of investment (note 5)	-	1,439
Government assistance received	916	1,209
Purchases of software	-	(69)
Proceeds on sale of property, plant and equipment	1,043	-
Net cash used in investing activities	(10,997)	(13,610)
Cash flows from (used in) financing activities		
Proceeds from long-term debt	28,015	791
Repayment of long-term debt	(126)	(7,204)
Payment of deferred financing fees	(9)	(330)
Interest paid on long-term debt	(2,558)	(1,019)
Distributions and advances paid, net (note 9)	(9,018)	(6,547)
Net cash from (used in) financing activities	16,304	(14,309)
Effect of exchange rate changes on cash and cash equivalents held in foreign currency	(56)	(296)
Increase (decrease) in cash and cash equivalents during the period	7,340	(21,475)
Cash and cash equivalents - Beginning of period (note 14)	27,504	25,455
Cash and cash equivalents - End of period (note 14)	34,844	3,980

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

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 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 unaudited condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of interim financial statements, including International Accounting Standard (IAS) 34 - Interim Financial Reporting 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 unaudited condensed consolidated financial statements should be read in conjunction with the annual consolidated financial statements of the Partnership for the year ended December 31, 2016.

The 3-month period for 2017 is from January 1 to March 26, 2017 (85 days) and the 3-month period for 2016 is from January 1 to March 27, 2016 (87 days).

These unaudited condensed consolidated financial statements were approved by the board of directors of KPGP on May 3, 2017.

3 Summary of significant accounting policies

The significant accounting policies that have been used in the preparation of these unaudited condensed consolidated financial statements are described in the annual consolidated financial statements of the Partnership for the year ended December 31, 2016 and have been applied to all periods presented except the following accounting policies, which were adopted effective January 1, 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, which will be included in the annual consolidated financial statements, the application of the amendments to IAS 7 did not result in any changes to the presentation of the unaudited condensed 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 standard had no impact on the unaudited condensed 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 unaudited condensed consolidated financial statements.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

The impact of new standards, amendments to standards and interpretations that have been issued but not yet effective for financial periods beginning on or after January 1, 2018 and have not been early adopted have been discussed in the annual consolidated financial statements for the year ended December 31, 2016.

4 Critical accounting estimates and judgments

The preparation of these unaudited condensed 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 unaudited condensed consolidated financial statements and the disclosure of contingencies at the dates of the unaudited condensed consolidated statements of financial position, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The estimates and judgement applied by management that most significantly affect the unaudited condensed consolidated financial statements are the same as the ones that applied to the audited consolidated financial statements for the year ended December 31, 2016.

5 Other (income) expense

	3-month period ended March 26, 2017	3-month period ended March 27, 2016
	\$	\$
Foreign exchange gain	(584)	(1,739)
Change in amortized cost of Partnership units liability	2,529	1,234
Miscellaneous income	-	(324)
	<u>1,945</u>	<u>(829)</u>

During the 3-month period ended March 27, 2016, the available-for-sale investment was sold for proceeds of \$1.4 million. The sale resulted in a gain of \$0.3 million, which was reclassified from Accumulated other comprehensive income to Other income during the 3-month period ended March 27, 2016.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

6 Property, plant and equipment

	Land \$	Buildings \$	Machinery and equipment \$	Assets under construction or development \$	Total \$
As of January 1, 2017					
Cost	38,130	185,150	1,085,265	36,977	1,345,522
Accumulated depreciation and impairments	-	(80,840)	(502,412)	-	(583,252)
Net book value as of January 1, 2017	38,130	104,310	582,853	36,977	762,270
Additions	-	-	63	19,684	19,747
Capitalized interest	-	-	-	244	244
Disposals	-	-	(41)	-	(41)
Government assistance	-	-	(916)	-	(916)
Transfers	-	69	3,174	(3,243)	-
Depreciation	-	(1,121)	(9,133)	-	(10,254)
Exchange differences	(5)	(211)	(1,246)	(2)	(1,464)
As of March 26, 2017	38,125	103,047	574,754	53,660	769,586
As of March 26, 2017					
Cost	38,125	184,971	1,085,225	53,660	1,361,981
Accumulated depreciation and impairment	-	(81,924)	(510,471)	-	(592,395)
Net book value as of March 26, 2017	38,125	103,047	574,754	53,660	769,586

7 Pensions and post-retirement benefits

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

Assumptions	Pensions		Post-retirement benefit plans	
	March 26, 2017 %	December 31, 2016 %	March 26, 2017 %	December 31, 2016 %
Discount rate - accrued benefit obligation	3.67	3.77	3.67	3.77
Rate of compensation increases	3.25 - 4.00	3.25 - 4.00		

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

The net benefit pension plan expense included the following components:

	Pensions		Post-retirement benefit plans	
	3-month period ended March 26, 2017	3-month period ended March 27, 2016	3-month period ended March 26, 2017	3-month period ended March 27, 2016
	\$	\$	\$	\$
Net benefit plan expense				
Current service cost	1,956	2,252	433	407
Interest cost	5,127	5,233	444	457
Expected return on plan assets	(4,345)	(4,503)	-	-
Administrative cost	124	-	-	-
	<u>2,862</u>	<u>2,982</u>	<u>877</u>	<u>864</u>

8 Provisions

	Environmental and asset retirement obligations	Long-term incentives	Restructuring	Total
	\$	\$	\$	\$
	(a)	(b)	(c)	
Provisions as of January 1, 2017	5,887	1,047	1,438	8,372
Current	-	447	1,438	1,885
Non-current	<u>5,887</u>	<u>600</u>	<u>-</u>	<u>6,487</u>
Provisions as of January 1, 2017	5,887	1,047	1,438	8,372
Additional provisions	-	233	11	244
Paid during the period	-	-	(334)	(334)
Interest accretion	52	-	-	52
Provisions as of March 26, 2017	<u>5,939</u>	<u>1,280</u>	<u>1,115</u>	<u>8,334</u>
Current	-	489	1,115	1,604
Non-current	<u>5,939</u>	<u>791</u>	<u>-</u>	<u>6,730</u>

(a) Environmental and asset retirement obligations

The Partnership has made a provision for the potential obligation under a land lease at one of its plant locations to demolish the building and restore the land at the end of the lease to its original condition. The current lease ends in 2028 but an extension is currently being negotiated. The estimated undiscounted amount to settle this obligation would be between \$9.0 million and \$11.7 million. The liability is estimated using a discounted cash flow with a discount rate of 3.635% (December 31, 2016 – 3.635%).

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

(b) Long-term incentives

Long-term incentives include the Executive Long-Term Incentive Plan (LTIP) for the Partnership. The LTIP uses performance share units and results are based primarily on Adjusted EBITDA 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 March 26, 2017, the Partnership had incurred \$1.5 million of costs associated with this initiative and recorded a provision for the remaining \$0.6 million.

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 March 26, 2017, the Partnership had incurred \$3.2 million of the costs associated with this initiative and recorded a provision for the remaining \$0.5 million.

9 Distributions and Partnership units liability

	Partnership units liability
	\$
As of January 1, 2017	145,907
Change in amortized cost of Partnership units liability (note 5)	2,529
Tax Distributions	(8,611)
As of March 26, 2017	<u>139,825</u>

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:

Distribution Payment Date	3-month period ended March 26, 2017			
	Partnership unit distributions	Unit price	Issuance of Partnership units	Gross proceeds
	\$	\$	#	\$
January 16, 2017	<u>10,148</u>	15.25	<u>309,196</u>	<u>4,715</u>

Distribution Payment Date	3-month period ended March 27, 2016			
	Partnership unit distributions	Unit price	Issuance of Partnership units	Gross proceeds
	\$	\$	#	\$
January 15, 2016	<u>9,871</u>	10.29	<u>442,929</u>	<u>4,558</u>

On April 17, 2017, the Partnership paid a distribution of \$10.2 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 309,183 Partnership units at a price of \$15.30. During the 3-month period ended March 26, 2017, a fair value adjustment of \$0.1 million was recorded to reflect the market value of the Partnership units issued.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

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

Subsequent to March 26, 2017, the Partnership declared a distribution of \$10.3 million, payable on July 17, 2017.

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

	3-month period ended March 26, 2017			Total
	Tax	Advances	Partnership	
	Distributions		unit	
	\$	\$	\$	\$
Paid to Kruger Inc. ^(a)	2,665	368	4,256	7,289
Paid to KPGP	-	-	1	1
Paid to KPT ^(b)	481	71	1,176	1,728
Total paid	3,146	439	5,433	9,018

	3-month period ended March 27, 2016			Total
		Advances	Partnership	
		\$	unit	
	\$	\$	\$	
Paid to Kruger Inc. ^(a)	1,029	4,128	5,157	
Paid to KPGP	-	1	1	
Paid to KPT ^(b)	205	1,184	1,389	
Total paid	1,234	5,313	6,547	

(a) During the 3-month periods ended March 26, 2017 and March 27, 2016, Partnership unit distributions were paid to Kruger Inc. net of the DRIP reinvestment. During the 3-month period ended March 26, 2017, Kruger Inc.'s DRIP reinvestment was \$4.3 million (3-month period ended March 27, 2016 - \$4.1 million).

(b) During the 3-month periods ended March 26, 2017 and March 27, 2016, Partnership unit distributions were paid to KPT net of the DRIP reinvestment. During the 3-month period ended March 26, 2017, KPT's DRIP reinvestment was \$0.4 million (3-month period ended March 27, 2016 - \$0.4 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 3-month period ended March 26, 2017, pursuant to the Tax Distribution as defined in the Partnership Agreement, the Partnership made advances to its partners of \$0.4 million, of which \$0.07 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 in nature and will be settled when the Tax Distribution is declared annually.

10 Income taxes

The Partnership is not a tax paying entity for the 3-month periods ended March 26, 2017 and March 27, 2016. The income from the Partnership flows to the partners, Kruger Inc., KPGP, and KPT. However, the Partnership's subsidiaries Kruger Products (USA) Inc., K.T.G. (USA) Inc., TAD Canco Inc., Grupo Tissue de Mexico S de RL de CV and TAD Luxembourg S.A.R.L. are corporate entities and, therefore, are subject to tax.

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Income tax expense (recovery) was recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. The estimated weighted average annual income tax rate for the 3-month period ended March 26, 2017 was 27.3% (3-month period ended March 27, 2016 – 8.8%).

The components of income taxes were as follows:

	3-month period ended March 26, 2017	3-month period ended March 27, 2016
	\$	\$
Current tax expense	585	874
Deferred tax expense (recovery)	2,029	(258)
	<u>2,614</u>	<u>616</u>

11 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 3-month period ended March 26, 2017 were \$0.1 million (3-month period ended March 27, 2016 - \$0.3 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 3-month period ended March 26, 2017 were \$9.1 million (3-month period ended March 27, 2016 - \$7.9 million). Purchases of goods and services from subsidiaries of Kruger Inc. for the 3-month period ended March 26, 2017 were \$1.9 million (3-month period ended March 27, 2016 - \$2.3 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 unaudited condensed consolidated statement of comprehensive income (loss). During the 3-month period ended March 26, 2017, management fees of \$1.1 million (3-month period ended March 27, 2016 - \$1.1 million) were paid to Kruger Inc. for management services provided to the Partnership.

Balances due to and from related parties were as follows:

	March 26, 2017	December 31, 2016
	\$	\$
Receivables from Kruger Inc.	233	171
Receivables from subsidiaries of Kruger Inc.	14	14
Receivables from KPT	271	-
	<u>518</u>	<u>185</u>
Payables to Kruger Inc.	3,961	2,646
Payables to subsidiaries of Kruger Inc.	617	534
Payables to KPT	-	426
	<u>4,578</u>	<u>3,606</u>

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For the 3-month periods ended March 26, 2017 and March 27, 2016

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

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 March 26, 2017 and December 31, 2016. There were no loans outstanding with related parties as of March 26, 2017 and December 31, 2016.

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

	March 26, 2017	December 31, 2016
	\$	\$
Distribution payable to Kruger Inc.	8,560	8,511
Distribution payable to KPGP	1	1
Distribution payable to KPT	1,642	1,636
Total distribution payable	<u>10,203</u>	<u>10,148</u>

12 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. It also includes sales of recycled fibre primarily to its parent company.

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, and (x) 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 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.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

	3-month period ended March 26, 2017			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	238,927	48,674	1,670	289,271
Segment Adjusted EBITDA	32,972	655	155	33,782
Depreciation and amortization				11,988
Interest expense				10,264
Change in amortized cost of Partnership units liability				2,529
Gain on sale of property, plant and equipment				(2)
Loss on sale of non-financial assets				13
Restructuring costs				11
Foreign exchange gain				(584)
Income before income taxes				9,563
Income taxes				2,614
Net income				6,949

	3-month period ended March 27, 2016			
	Consumer	AFH	Other	Total
	\$	\$	\$	\$
Revenue from external customers	228,151	49,052	2,487	279,690
Segment Adjusted EBITDA	27,807	30	250	28,087
Depreciation and amortization				10,371
Interest expense				11,214
Change in amortized cost of Partnership units liability				1,234
Loss on sale of property, plant and equipment				1
Foreign exchange gain				(1,739)
Income before income taxes				7,006
Income taxes				616
Net income				6,390

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.

Revenue	Revenue	
	3-month period ended March 26, 2017	3-month period ended March 27, 2016
	\$	\$
Canada	173,877	163,772
US	104,649	103,786
Mexico	10,745	12,132
	289,271	279,690

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

	March 26, 2017			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	371,229	398,291	66	769,586
Goodwill	160,939	-	-	160,939
Intangible assets	15,030	-	-	15,030

	December 31, 2016			
	Canada	US	Mexico	Total
	\$	\$	\$	\$
Property, plant and equipment	357,689	404,581	-	762,270
Goodwill	160,939	-	-	160,939
Intangible assets	15,270	-	-	15,270

13 Financial instruments

Classification of financial instruments

As of March 26, 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	34,844	34,844
Trade and other receivables	loans and receivables	amortized cost	113,536	113,536
Receivables from related parties	loans and receivables	amortized cost	518	518
Advances to partners	loans and receivables	amortized cost	439	439
Trade and other payables	financial liabilities	amortized cost	(183,426)	(183,426)
Payables to related parties	financial liabilities	amortized cost	(4,578)	(4,578)
Distributions payable	financial liabilities	amortized cost	(10,203)	(10,203)
Long-term debt	financial liabilities	amortized cost	(452,299)	(458,156)
Partnership units liability	financial liabilities	amortized cost	(139,825)	(139,825)

The following table details the fair value hierarchy of financial instruments by level as of March 26, 2017:

	Level 1	Level 2	Level 3	Total
	\$	\$	\$	\$
Long-term debt	-	(458,156)	-	(458,156)
Partnership units liability	-	-	(139,825)	(139,825)

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

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 and other payables	financial liabilities	amortized cost	(201,477)	(201,477)
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)

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, trade and other payables, payables to related parties and distributions payable are short-term financial instruments whose fair value approximates the carrying amount, given they will mature in the near future. As of March 26, 2017, the fair values of the Credit Facility, the Nordea Facility and the Caisse Facility were \$217.0 million, \$26.5 million and \$196.2 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 March 26, 2017, the fair values of the Quebec PM Loan and the Ontario Loan were \$17.7 million and \$0.8 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.

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. There were no significant changes in the assumptions during the 3-month period ended March 26, 2017.

Kruger Products L.P.

Notes to Unaudited Condensed Consolidated Financial Statements

For the 3-month periods ended March 26, 2017 and March 27, 2016

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

14 Cash and cash equivalents

	March 26, 2017	December 31, 2016
	<u>\$</u>	<u>\$</u>
Cash and cash equivalents	34,844	36,511
Bank indebtedness	-	(9,007)
Cash and cash equivalents in the consolidated statement of cash flows	<u>34,844</u>	<u>27,504</u>

15 Non-cash working capital

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

	3-month period ended March 26, 2017	3-month period ended March 27, 2016
	<u>\$</u>	<u>\$</u>
Decrease (increase) in trade and other receivables	9,205	(16,815)
Increase in receivables from related parties	(333)	(99)
Increase in inventories	(3,749)	(1,737)
Increase in prepaid expenses	(5,025)	(4,480)
Decrease (increase) in other long-term assets	130	(107)
Decrease (increase) in income taxes	864	(709)
Increase (decrease) in trade and other payables	(30,924)	1,653
Increase in payables to related parties	972	5,655
	<u>(28,860)</u>	<u>(16,639)</u>