



**COLABOR GROUP INC.**

**MANAGEMENT'S DISCUSSION & ANALYSIS**

**YEAR AND 110-DAY PERIOD (4<sup>TH</sup> QUARTER) ENDED  
DECEMBER 31, 2009**

**FEBRUARY 24, 2010**



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**February 24, 2010**

## **1. Scope of MD&A**

This Management's Discussion & Analysis ("MD&A") of Colabor Group Inc. ("GCL", the "Company" or "Colabor") (formerly Colabor Income Fund (the "Fund")) discusses the operating results, financial situation and cash flows for the 110-day period (4<sup>th</sup> quarter) and the year ended December 31, 2009. These financial statements are in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The financial statements have been published on SEDAR at [www.sedar.com](http://www.sedar.com).

GCL's fiscal year comprises thirteen periods, the first three quarters comprise three periods each and the fourth quarter includes four periods. The Company's year end is December 31.

This report also contains information that is a non-GAAP measure of performance, such as the concept of earnings before financial expenses, amortization and income taxes (EBITDA). Since these concepts are not defined in Canadian GAAP, they may not be comparable with those of other companies.

## **2. Forward-Looking Statements**

The MD&A is intended to assist shareholders in understanding the nature and extent of changes and trends, as well as risks and uncertainties. Consequently, actual results may differ significantly from information reported or inferred in these statements. The main factors that could result in a significant difference between GCL's actual results and the projections or expectations set out in the forward-looking statements are described herein under *Risks and Uncertainties*.

## **3. General**

### **Corporate arrangement resulting in the creation of Colabor Group Inc.**

The Fund was an unincorporated, open-ended, limited purpose trust that was established under the laws of the Province of Quebec under a Declaration of Trust dated May 19, 2005. The Fund's units were traded on the Toronto Stock Exchange under the symbol CLB.UN.

On July 8, 2009, the Fund had announced its intention to convert from an income trust structure to a corporation (the "Conversion"). In order to effect the Conversion, Colabor had entered into an arrangement agreement (the "Arrangement Agreement") with ConjuChem Biotechnologies Inc. ("ConjuChem"), in order to conclude the Conversion pursuant to a statutory plan of arrangement of ConjuChem (the "Plan of Arrangement") under Section 192 of the *Canada Business Corporations Act* ("CBCA") and the Conversion was completed on August 25, 2009, further to the approval of the unitholders of the Fund, which was obtained at a special meeting held on August 19, 2009.

## **Rationale and Benefits of the Conversion**

Recent amendments to the Federal income tax rules relating to specified investment flow-through trusts ("SIFTs") allow for the conversion of a trust to a corporation to be effected on a tax deferred basis if completed prior to 2012.

Key benefits for the Fund of implementing the Conversion include:

- Greater access to equity capital markets and widening of potential investor base in light of the decreasing importance of the public business income trust market;
- GCL will have an estimated equivalent of about \$130M in tax losses following the Conversion;
- The Plan of Arrangement provides for an effective and efficient method to convert from an income trust to a corporation under existing legislation; and
- The Conversion resulted in a simplified capital structure, as a result of the elimination of a remaining minority interest in Colabor LP, and a more efficient corporate structure that will reduce overhead and administrative costs.

Other elements considered included the fact that GCL expects to be able to pay a quarterly dividend that will, on a quarterly basis, equal the Fund's pre-conversion cash distribution, the absence of negative tax impacts from the Conversion given the Fund's current tax status, and, lastly, the Conversion is tax deferred such that no income tax will be payable by the Fund or its unitholders as a result of the Conversion.

## **Details of the Conversion**

Following implementation of the Arrangement, the Fund's unitholders received one common share of GCL for every trust unit of the Fund held on the effective date of the Conversion. Furthermore, the exchangeable Colabor LP units held by Colabor Investments Inc. were acquired by GCL pursuant to the Arrangement in consideration of GCL common shares; Colabor Investments Inc., holds in the aggregate, 26% of GCL common shares following the acquisition of its exchangeable units. The elimination of the remaining minority interest in Colabor LP resulted in a simplified capital structure and an increase of approximately \$50M of the market capitalization of GCL compared to the previous market capitalization of the Fund.

After the Conversion, outstanding convertible debentures of the Fund, amounting to \$49M, became convertible into common shares of GCL on the same terms and conditions as were applicable to their conversion into trust units of the Fund prior to the Conversion.

Following completion of the Conversion, GCL indirectly owns and operates the existing businesses of Colabor LP and its subsidiaries, and the existing trustees of the Fund and management of Colabor LP became the directors and management of GCL.

On January 15, 2010, GCL paid the first dividend to its shareholders from the completion of the arrangement, August 25, 2009, to December 31, 2009.

Complete details of the terms of the Plan of Arrangement are set out in the Arrangement Agreement and the Fund's Information Circular about the Plan of Arrangement dated July 21, 2009 which the Fund filed on the SEDAR Internet site at [www.sedar.com](http://www.sedar.com).

### **Additional Information**

The shares of Colabor Group Inc. are traded on the Toronto Stock Exchange under the symbol *GCL-T*, while its convertible debentures are traded under the symbol *GCL.DB*.

Additional information on GCL, and previously the Fund, may be found on SEDAR at [www.sedar.com](http://www.sedar.com) and on its information sites: [www.colaborincomefund.com](http://www.colaborincomefund.com) (currently under reconstruction), [www.colabor.com](http://www.colabor.com), [www.summitfoods.com](http://www.summitfoods.com) and [www.dbertrand.ca](http://www.dbertrand.ca). The information on these last sites is not incorporated by reference in the MD&A.

## **4. Corporate Profile**

### **Activities**

Colabor was founded in 1962 and is a wholesaler and master food distributor serving the retail (small-sized grocery stores, convenience stores, etc.) and foodservice (cafeterias, restaurants, hotels, restaurant chains, etc.) markets.

It currently carries out its activities through two divisions:

#### ***Wholesale Segment:***

Sales of this Segment consist of food, food-related and non-food products that it purchases and supplies to wholesale distributors that, in turn, distribute these products to over 25,000 customers operating in the retail or foodservice market segments in Quebec and the Atlantic provinces.

Products are sold either directly from its distribution centre ("warehouse sales") or through direct delivery from manufacturers and suppliers to the warehouses of wholesale distributors ("direct sales").

This Segment generally sells its products at the manufacturers' and suppliers' list price. Accordingly, it generates gross profit on sales as follows:

#### **(a) From a profit on warehouse sales:**

Through a mark-up of the cost price of its private brand-name products and by making purchases from manufacturers and suppliers before a price increase and subsequently selling such products at the manufacturer's new price. There is no profit margin on direct sales.

#### **(b) Primarily from rebates from suppliers:**

These rebates consist of: (i) agreements with suppliers relating principally to distribution agreements, central billing, truck load allowance and other incentives, (ii) rebates received from suppliers based on buying volumes, (iii) cash discounts on purchases based on terms of sale, and (iv) net advertising funds received in connection with promotional activities.

This Segment operates a 371,120 square-foot distribution centre in Boucherville that employs about 150 people and could be expanded to 650,000 square feet.

Almost 90% of this Segment's sales are covered by long-term contracts.

### **Distribution Segment**

This Segment includes the following operating activities:

#### *1. Summit Food Service Distributors (Summit)*

Summit distributes more than 8,000 products from warehouses in Ottawa, London and Mississauga to more than 3,000 customers, including Cara (Swiss Chalet, Harvey's, Kelsey's Neighbourhood Bar and Grill, Montana's Cookhouse and Milestone's Grill and Bar), Compass, Extendicare, other foodservice chains and independent restaurants as well as to institutions, including hospitals, schools and government institutions. Summit's product line includes frozen products, dry staples, dairy products, meat, seafood, poultry and sanitation products.

This division services primarily the Ontario market, but also distributes Cara restaurant products in Quebec.

Prior to the acquisition of *Bruce Edmeades Foodservice Distribution* described below, this division, with about 500 employees, operated three distribution centres, including the London head office, where administrative services are located.

These warehouses cover a total of 345,016 square feet, allocated as follows:

Toronto: 127,961 square feet

London: 113,595 square feet (could be expanded)

Ottawa: 103,460 square feet (could be expanded)

On March 17, 2008, Colabor completed the acquisition of substantially all of the assets of Bruce Edmeades Foodservice Distribution, one of the leading foodservice distributors in the Canadian industry with annual revenues exceeding \$230 million for the year ended December 31, 2007.

Bruce Edmeades offers about 9,000 products and operates mainly out of an approximately 130,000 square-foot, HACCP-certified warehouse in Cambridge, Ontario. It distributes to customers primarily in Southern Ontario, but also across Canada, servicing several large and well-known customers, including Wendy's, Mr. Sub and Zehrs and other customers operating in the restaurant, healthcare and education industries.

During 2008, Bruce Edmeades was integrated into the Summit Division.

#### *2. Bertrand Food Distributor (Bertrand)*

On April 28, 2008, Colabor acquired all the outstanding shares of Gestion Bertrand & Frères Inc. (now called Bertrand Food Distributor), a leading independent food distributor in Eastern Quebec and one of Colabor's most important affiliated-wholesalers.

Bertrand, whose sales are approximately \$160M annually, is a major distributor to foodservice and retail customers in the Québec City and Saguenay regions. Bertrand, which employs approximately 400 people, distributes over 12,000 products from its two warehouses strategically

located in Lévis and Saguenay, totalling 231,000 (could be expanded to 331,000) and 133,000 square feet, respectively. Bertrand's customers consist primarily of foodservice operators, specialty food stores, institutional accounts such as healthcare institutions, schools and universities, certain other retail customers, in all reaching approximately 4,000 customers. With a complete product offering, including frozen products, dry staples, dairy products, fresh meat, fresh fish and seafood, poultry, fresh fruits and vegetables, disposables and sanitation products as well as meat processing and preparation services, Bertrand therefore offers its customers a “one-stop-shop” solution.

The Distribution Segment generates gross profit on sales as follows:

(a) From a profit on warehouse sales:

Generated primarily from a mark-up of the cost price of products pursuant to rates negotiated with its customers.

(b) From rebates from suppliers:

These rebates consist of: (i) rebates received from suppliers based on buying volumes, (ii) cash discounts on purchases and (iii) net advertising funds received in connection with promotional activities.

Almost 50% of this Segment's sales are covered by long-term contracts.

Over 55% of the sales activities of the Fund's two segments is secured by long-term agreements and manufacturers' and suppliers' cost increases which can be passed on to customers, thereby significantly reducing its risk.

## 5. Main Resources and Competencies

### 5.1 Board of Directors

The members of the Board of Directors are listed below:

| <u>Director</u>      | <u>Role</u>  | <u>Occupation</u>   |
|----------------------|--|---|
| Jacques Landreville  | Chairman   | Corporate Director  |
| Richard Lord         | Chairman, Human Resources and Corporate Governance Committee | President and Chief Executive Officer, Richelieu Hardware Ltd         |
| Robert Panet-Raymond | Chairman, Audit Committee                                    | Corporate Director  |
| Claude Gariépy       | Director   | Executive Vice-President and Chief Executive Officer, Familiprix Inc. |
| Donald Dubé          | Director   | President, Edfrex Inc.  |

### 5.2 Management

|                           |  |   |
|---------------------------|--|---|
| Gilles C. Lachance        | President and Chief Executive Officer      | Colabor Group Inc.                              |
| Michel Loignon CA         | Vice-President and Chief Financial Officer | Colabor Group Inc.                              |
| Jack Battersby            | President                                  | Colabor Limited Partnership, Summit Division    |
| Marko Potvin              | Vice-President, Corporate Purchasing       | Colabor Limited Partnership                     |
| Denis Melançon            | Vice-President and General Manager         | Colabor Group inc. Bertrand Division            |
| Louise Laforce            | Vice-President Human Resources             | Colabor Limited Partnership                     |
| Michel Delisle            | Vice-President Information Technology      | Colabor Limited Partnership                     |
| Geneviève Brouillette, CA | Vice-President and General Manager         | Colabor Limited Partnership, Wholesale Division |



## 5.3 Human Resource Development

The Board of Directors initiated a succession planning process through the Human Resources and Corporate Governance Committee and with the assistance of an external human resources consulting firm.

## 6. Performance Analysis

### 6.1 Executive Summary of Performance

#### Year Ended December 31, 2009

- Sales up 3.17% to \$1,183K
- EBITDA up 6.29% to \$42,800K
- Net earnings rose \$8,296K to \$16,671K
- Debt/EBITDA ratio: 1.31:1.00 (banking syndicate's requirement: <3.00:1.00)
- Interest coverage ratio: 6.83:1.00 (banking syndicate's requirement: >3.50:1.00)

If Colabor's conversion to a corporation had occurred on January 1, 2009, some of its results would have been:

- Earnings per share: basic:\$1.10; diluted: \$1.06
- Cash flows per share: basic:\$1.81; diluted: \$1.59
- Annual dividend: \$1.08
- Payout ratio: basic: 98.2%; diluted: 101.9%
- Cash flow payout ratio: basic: 60%; diluted: 68%

#### Share market price and return analysis

- Share price: as at January 1, 2009: \$8.49; as at December 31, 2009: \$11.07; High:\$11.25 (July 24); Low: \$7.37 (January 8)
- Share price increase from January 1, 2009 to December 31, 2009: 30.4%
- Dividend (distribution) yield on share price as at January 1, 2009: 12.7%
- Total return: 43.1%

### 6.2 Results of Operations

The results of operations below should be read in conjunction with the Current Economic Situation section presented further on in this MD&A and the following facts:

- The conversion to a corporation on August 25, 2009 impacted the consolidated earnings;
- Results subsequent to the Bruce Edmeades acquisition are only included since March 17, 2008 for the 2008 fiscal year, but are included since January 1 for the 2009 year;
- Results subsequent to the Bertrand, distributeur en alimentation acquisition are only included since April 28, 2008 for the 2008 fiscal year, but are included since January 1 for the 2009 year;
- The 2009 fourth quarter includes 110 days compared to 116 days in 2008.

Consolidated Earnings (in thousands of dollars, except per share / unit amounts)

|   | 2009-12-31<br>(365 days) |                     | 2008-12-31<br>(366 days) |                     | Variance            |                      |
|---|--------------------------|---------------------|--------------------------|---------------------|---------------------|----------------------|
|   | \$                       | %                   | \$                       | %                   | \$                  | %                    |
| <b>Sales</b>  | <u>1,182,481</u>         | <u>100.00%</u>      | <u>1,146,102</u>         | <u>100.00%</u>      | <u>36,379</u>       | <u>3.17%</u>         |
| Earnings before financial expenses, amortization and income taxes | 42,800                   | 3.62%               | 40,269                   | 3.51%               | 2,531               | 6.29%                |
| Financial expenses  | 6,265                    | 0.53%               | 7,263                    | 0.63%               | (998)               | -13.74%              |
| Amortization of property, plant and equipment                     | 3,864                    | 0.33%               | 4,039                    | 0.35%               | (175)               | -4.33%               |
| Amortization of intangible assets                                 | 9,450                    | 0.80%               | 8,706                    | 0.76%               | 744                 | 8.55%                |
|   | <u>19,579</u>            | <u>1.66%</u>        | <u>20,008</u>            | <u>1.74%</u>        | <u>(429)</u>        | <u>-2.14%</u>        |
| Restructuring and conversion to corporation expenses              | 23,221                   | 1.96%               | 20,261                   | 1.77%               | 2,960               | 14.61%               |
| Expenses related to the loss of a customer                        | 2,125                    | 0.18%               |                          |                     | 2,125               | N/A                  |
| Earnings before income taxes and non-controlling interest         | 416                      | 0.04%               |                          |                     | 416                 | N/A                  |
|   | <u>20,680</u>            | <u>1.75%</u>        | <u>20,261</u>            | <u>1.77%</u>        | <u>419</u>          | <u>2.07%</u>         |
| Income taxes: Current (recoverable)                               | (1,642)                  | -0.14%              | 4,405                    | 0.38%               | (6,047)             | -137.28%             |
| Future  | 1,650                    | 0.14%               | 863                      | 0.08%               | 787                 | 91.19%               |
|   | <u>8</u>                 | <u>0.00%</u>        | <u>5,268</u>             | <u>0.46%</u>        | <u>(5,260)</u>      | <u>-99.85%</u>       |
| Earnings before non-controlling interest                          | 20,672                   | 1.75%               | 14,993                   | 1.31%               | 5,679               | 37.88%               |
| Non-controlling interest  | 4,001                    | 0.34%               | 6,618                    | 0.58%               | (2,617)             | -39.54%              |
| <b>Net earnings</b>   | <u><b>16,671</b></u>     | <u><b>1.41%</b></u> | <u><b>8,375</b></u>      | <u><b>0.73%</b></u> | <u><b>8,296</b></u> | <u><b>99.06%</b></u> |
| Basic earnings per share / unit                                   | <u>\$ 1.03</u>           |                     | <u>\$ 0.64</u>           |                     |                     |                      |

  

|   | 2009-12-31<br>(110 days)<br>(unaudited) |                     | 2008-12-31<br>(116 days)<br>(unaudited) |                     | Variance            |                       |
|---|---|---------------------|---|---------------------|---------------------|-----------------------|
|   | \$                                      | %                   | \$                                      | %                   | \$                  | %                     |
| <b>Sales</b>  | <u>364,973</u>                          | <u>100.00%</u>      | <u>398,906</u>                          | <u>100.00%</u>      | <u>(33,933)</u>     | <u>-8.51%</u>         |
| Earnings before financial expenses, amortization and income taxes | 15,073                                  | 4.13%               | 15,472                                  | 3.88%               | (399)               | -2.58%                |
| Financial expenses  | 1,874                                   | 0.51%               | 2,399                                   | 0.60%               | (525)               | -21.88%               |
| Amortization of property, plant and equipment                     | 1,125                                   | 0.31%               | 1,543                                   | 0.39%               | (418)               | -27.09%               |
| Amortization of intangible assets                                 | 2,894                                   | 0.79%               | 3,613                                   | 0.91%               | (719)               | -19.90%               |
|   | <u>5,893</u>                            | <u>1.61%</u>        | <u>7,555</u>                            | <u>1.90%</u>        | <u>(1,662)</u>      | <u>-22.00%</u>        |
|   | 9,180                                   | 2.52%               | 7,917                                   | 1.98%               | 1,263               | 15.95%                |
| Expenses related to the loss of a customer                        | 416                                     | 0.11%               |   |                     | 416                 | N/A                   |
| Earnings before income taxes and non-controlling interest         | 8,764                                   | 2.40%               | 7,917                                   | 1.98%               | 847                 | 10.70%                |
| Income taxes: Current (recoverable)                               | (1,844)                                 | -0.51%              | 1,862                                   | 0.47%               | (3,706)             | -199.03%              |
| Future  | 1,606                                   | 0.44%               | (627)                                   | -0.16%              | 2,233               | -356.14%              |
|   | <u>(238)</u>                            | <u>-0.07%</u>       | <u>1,235</u>                            | <u>0.31%</u>        | <u>(1,473)</u>      | <u>-119.27%</u>       |
| Earnings before non-controlling interest                          | 9,002                                   | 2.47%               | 6,682                                   | 1.67%               | 2,320               | 34.72%                |
| Non-controlling interest  |   | 0.00%               | 2,356                                   | 0.59%               | (2,356)             | -100.00%              |
| <b>Net earnings</b>   | <u><b>9,002</b></u>                     | <u><b>2.47%</b></u> | <u><b>4,326</b></u>                     | <u><b>1.08%</b></u> | <u><b>4,676</b></u> | <u><b>108.09%</b></u> |
| Basic earnings per share / unit                                   | <u>\$ 0.53</u>                          |                     | <u>\$ 0.33</u>                          |                     |                     |                       |

## Sales

Sales consist of:

For the Wholesale Segment: Gross sales from the Boucherville warehouse and direct sales to affiliated-wholesalers, less rebates of 3% of the affiliated-wholesalers' sales, as provided in the agreement between Colabor LP and the affiliated-wholesalers and sales to other customers, less rebates, as provided in individual agreements with these customers.

For the Distribution Segment: Gross sales to customers from the London, Mississauga, Ottawa, Cambridge, Lévis and Saguenay warehouses less rebates, as provided in individual agreements with these customers.

Inter-segment sales are then eliminated. These are primarily sales by the Wholesale Segment to Summit and Bertrand in the Distribution Segment essentially for foodservice.

The following tables present a comparison of sales for the fiscal year and the fourth quarter, allocated between comparable sales and sales from the acquisitions, with the prior year's comparable periods.

Because the 2009 fourth quarter comprises 110 days, whereas the 2008 fourth quarter has 116 days, sales for the 2009 fourth quarter have been adjusted based on the number of days in 2008, i.e. 116 (see 2009-12-31 adjusted column), to display the actual organic growth.

|                             | 2009-12-31<br>(365 day) |                                    |             | Comparable sales         |          |       | Variance<br>(Total sales) |       |
|-----------------------------|-------------------------|------------------------------------|-------------|--------------------------|----------|-------|---------------------------|-------|
|                             | Comparable sales        | Sales attributable to acquisitions | Total sales | 2008-12-31<br>(366 days) | Variance |       | \$                        | %     |
|                             | \$                      | \$                                 | \$          | \$                       | \$       | %     | \$                        | %     |
| <b>Wholesale Segment</b>    |                         |                                    |             |                          |          |       |                           |       |
| Retail                      | 140,171                 |                                    | 140,171     | 138,763                  | 1,408    | 1.0%  | 1,408                     | 1.0%  |
| Foodservice                 | 371,921                 |                                    | 371,921     | 346,452                  | 25,469   | 7.4%  | 25,469                    | 7.4%  |
|                             | 512,092                 |                                    | 512,092     | 485,215                  | 26,877   | 5.5%  | 26,877                    | 5.5%  |
| Inter-segment elimination   | (79,988)                | (17,108)                           | (97,096)    | (64,338)                 | (15,650) | N/A   | (32,758)                  | N/A   |
|                             | 432,104                 | (17,108)                           | 414,996     | 420,877                  | 11,227   | 2.7%  | (5,881)                   | -1.4% |
| <b>Distribution Segment</b> |                         |                                    |             |                          |          |       |                           |       |
| Foodservice                 | 678,882                 | 88,603                             | 767,485     | 725,225                  | (46,343) | -6.4% | 42,260                    | 5.8%  |
|                             | 1,110,986               | 71,495                             | 1,182,481   | 1,146,102                | (35,116) | -3.1% | 36,379                    | 3.2%  |

**Sales** (in thousands of dollars)

|                              | 2009-12-31<br>(110 days)<br>(unaudited) |   |             | Comparable sales         |                          |          |       | Variance<br>(Total sales) |        |
|------------------------------|---|---|-------------|--------------------------|--------------------------|----------|-------|---------------------------|--------|
|                              | Comparable<br>sales                     | Sales<br>attributable<br>to<br>acquisitions | Total sales | 2009-12-31<br>(adjusted) | 2008-12-31<br>(116 days) | Variance |       | Variance<br>(Total sales) |        |
|                              |   |   |             | (unaudited)              | (unaudited)              | \$       | %     |                           |        |
| <b>Wholesale Segment</b>     |   |   |             |                          |                          |          |       |                           |        |
| Retail                       | 51,703                                  |   | 51,703      | 54,523                   | 52,594                   | 1,929    | 3.7%  | (891)                     | -1.7%  |
| Foodservice                  | 117,653                                 |   | 117,653     | 124,070                  | 127,816                  | (3,746)  | -2.9% | (10,163)                  | -8.0%  |
|                              | 169,356                                 |   | 169,356     | 178,594                  | 180,410                  | (1,816)  | -1.0% | (11,054)                  | -6.1%  |
| Inter-segment<br>elimination | (30,901)                                |   | (30,901)    | (32,587)                 | (37,155)                 | 4,568    | N/A   | 6,254                     | N/A    |
|                              | 138,455                                 |   | 138,455     | 146,007                  | 143,255                  | 2,752    | 1.9%  | (4,800)                   | -3.4%  |
| <b>Distribution Segment</b>  |   |   |             |                          |                          |          |       |                           |        |
| Foodservice                  | 226,518                                 |   | 226,518     | 238,874                  | 255,651                  | (16,777) | -6.6% | (29,133)                  | -11.4% |
|                              | 364,973                                 |   | 364,973     | 384,881                  | 398,906                  | (14,025) | -3.5% | (33,933)                  | -8.5%  |

Despite the serious recession in Canada, see the *Current Economic Situation* section, the Company has fared well in the past year, with a 3.2% growth in sales over 2008, taking into consideration growth in sales including sales from acquisitions and a year-over-year decrease of only 3.1% in comparable sales.

### Wholesale Segment

The recession had a lesser impact on this Segment, which services primarily distributors in Quebec and the Atlantic provinces, as evidenced by organic growth of 2.7% for the fiscal year and 1.9% for the fourth quarter.

Readers should bear in mind, when reading the above tables, that the 1.4% decrease for the year and the 3.4% decrease in total sales for 2009 compared to 2008 is solely attributable to the elimination of inter-segment sales.

#### *Retail*

This sector continues to benefit from the major procurement agreements signed in 2008 by affiliated-wholesalers in this sector, with, among others, an integrated oil company, which contributed to organic growth of 1% for the year and 3.7% for the quarter.

#### *Foodservice*

Considering that inter-segment eliminations relate to foodservices, organic growth of comparable foodservices sales was 3.4% for the year and 1.1% for the quarter. This is a fairly good achievement, in light of the serious recession and the poor weather conditions in the summer of 2009.

## **Distribution Segment**

The overall 3.1% decline in the Company's comparable sales is attributable to the Distribution Segment which posted a 6.4% decrease, primarily as a result of the Summit Division, whose activities are mainly in Ontario, the province that was likely the hardest hit by the recession, due to its manufacturing structure and where the restaurant segment, including fast food, cafeteria and independent restaurants was affected.

Additionally, as was the case for the Wholesale Segment, the poor weather conditions affected this Segment as well.

Lower sales are also attributable, to a lesser extent, to the Bertrand Division, which, in 2008, benefited from the 400<sup>th</sup> anniversary of the founding of Québec City. In 2009, tourism activity was not as strong in this region.

## **Earnings Before Financial Expenses, Amortization, Significant Non-recurring Items and Income Taxes (EBITDA)**

### *Gross profit*

Gross profit is composed of the following items

- Wholesale Segment: Profit on gross warehouse sales only, which consists primarily of a profit margin on private brand-name products and profit on inventory held. No profit margin is recognized on direct sales. Income is attributed on such sales for purposes of rebates from suppliers only.  
Distribution Segment: Product acquisition cost with a percentage mark-up that is market-driven or negotiated in current agreements.
- Rebates from suppliers  
A significant portion of Colabor's gross profit is derived from rebates from suppliers. These rebates consist of: (i) agreements with suppliers relating principally to distribution agreements, central billing, truck load allowance and other incentives, (ii) rebates received from suppliers based on buying volumes, (iii) cash discounts on purchases based on terms of sale, and (iv) net advertising funds received in connection with promotional activities.

### *Selling, operating and administrative expenses*

The main expenses consist of salaries and employee benefits, delivery costs for the Distribution Segment and occupancy costs relating to the Company's distribution centres.

The Company had to react promptly to address the decrease in comparable sales described above, particularly in the Distribution Segment.

The Company froze senior management salaries and took this opportunity to review its operating and administrative processes to eliminate operations with no added value for the enterprise.

It was therefore able to increase its EBITDA percentage from 3.51% for the 2008 year to 3.62% in 2009 and from 3.88% in the 2008 fourth quarter to 4.13% for the 2009 fourth quarter.

The increase is attributable to the following:

- Organic growth was maintained in the Wholesale Segment which generated superior agreements with suppliers.
- Summit purchases from certain suppliers are now billed under the Wholesale Segment, which increases the profitability of supplier agreements, as such agreements tend to be more significant when negotiated by the Wholesale Segment.
- Since the start of the year, each division has reviewed its operations, which has led to a significant reduction in certain types of expenses.
- The Bertrand acquisition, which made it possible to generate a number of purchasing synergies.
- Profitability of the Cambridge distribution centre, operated by Summit and acquired from Bruce Edmeades, operated at a loss in 2008.

## **Restructuring and Conversion to a Corporation Expenses**

As described under the General section, the Fund converted to a corporation on August 25, 2009. A number of expenses were incurred for this transaction, in particular, legal and accounting fees and the cost of registering on financial markets. Additional expenses were incurred to streamline the organization's overall legal structure, in particular, elimination of Colabor Income Fund and Colabor Operating Trust and the transformation of Bertrand Food Distributor Inc. into a division.

The Company's management recorded these expenses in accordance with EIC-170, Conversion of an Unincorporated Entity to an Incorporated Entity, published by the Canadian Institute of Chartered Accountants.

## **Expenses Related to the Loss of a Customer**

As mentioned in the 2009 third quarter MD&A and described under the *Subsequent Event* section, in early February 2010, the Company lost an important distribution agreement served by the Summit division.

While management has already initiated measures to replace this contract, it has also undertaken an operational reorganization to counter the impact of this situation on its earnings. The reorganization includes cost-cutting measures, particularly in the area of labour costs.

The Company has recognized a \$416,000 non-recurring expenses in its fourth quarter earnings in this respect.

## **Income Taxes**

The acquisition of the assets of Summit Food Service Distributors Inc. by the Fund was finalized and carried out on January 8, 2007. Since this transaction was considered an “undue expansion” by the Department of Finance in its ruling rendered at the end of 2007, the Fund became taxed immediately in 2007 instead of in 2011.

As explained under the General section, on August 25, 2009, the Fund became a corporation as a result of a Plan of Arrangement with Biotechnologies ConjuChem Inc., and acquired approximately \$130M in tax losses for \$5M.

Since the start of the year, the Company had recorded income taxes, however, subsequent to the above transaction, it recognized a current and future income taxes recovery to immediately benefit from the loss-carryforwards acquired in the ConjuChem transaction during the third quarter.

During the fourth quarter, the Company continued to use the tax losses to reduce current income taxes and recover some prior years’ taxes.

For future income taxes, the Company uses the liability method to account for its income taxes. Under this method, income tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of assets and liabilities. They are measured by applying enacted or substantively enacted tax rates and laws at the date of the financial statements for the years in which the temporary differences are expected to reverse.

Another future income tax item is attributable to the amortization of the ConjuChem purchase price, \$5,000,000, calculated proportionally to the utilization of the future income tax asset.

## **Non-controlling Interest**

Additionally, in connection with the conversion to a corporation described in the General section above, unitholders who had a non-controlling interest in the Fund converted their exchangeable Colabor LP units into shares of the Company and the Company therefore recorded the carrying amount of the non-controlling interest in capital stock.

An amount of \$4,001,000 has been recognized as a non-controlling interest for activities preceding the conversion.

No additional expenses will be recognized in earnings thereafter.

## **Basic and Diluted Earnings per Share; Basic and Diluted Cash Flows per Share; Payout Ratio;**

It is difficult for investors to assess these ratios for the year ended December 31, 2009 because, for part of the year, the Company operated as an income fund (January 1 to August 24) which included a non-controlling interest that was eliminated upon conversion to a corporation and, upon conversion current income taxes became nil through the acquisition of ConjuChem’s tax losses.

In order to provide investors with some insight into the calculation of earnings per share, basic and diluted cash flows per share and the basic and dilute payout ratio, **it was assumed that the Company was a corporation as of January 1, 2009**, which eliminated the non-controlling interest, current income taxes and the non-recurring items.

**EPS and cash flows per share**

|   | EPS<br>\$000         | Diluted<br>EPS<br>\$000 | Cash flows<br>\$000  | Diluted cash<br>flows<br>\$000 |
|---|----------------------|-------------------------|----------------------|--------------------------------|
| Net earnings  | 16,671               | 16,671                  | 16,671               | 16,671                         |
| Non-controlling interest                                      | 4,001                | 4,001                   | 4,001                | 4,001                          |
| Future income taxes   |                      |                         | 1,650                | 1,650                          |
| Current income taxes  | (1,642)              | (1,642)                 | (1,642)              | (1,642)                        |
| Expenses related to the loss of a customer                    | 416                  | 416                     | 416                  | 416                            |
| Restructuring and conversion to corporation expenses          | 2,125                | 2,125                   | 2,125                | 2,125                          |
| Amortization of intangible assets                             |                      |                         | 9,450                | 9,450                          |
| Amortization of property, plant and equipment                 |                      |                         | 3,864                | 3,864                          |
| Amortization of deferred financing expenses                   |                      |                         | 121                  | 121                            |
| Compensation cost from long-term incentive plan               |                      |                         | 514                  | 514                            |
| Amortization of debenture transaction costs                   |                      | 1,000                   | 1,000                | 1,000                          |
| Interest reduction if the debentures were converted to shares |                      | 3,434                   |                      | 3,434                          |
| Acquisition of property, plant and equipment                  |                      |                         | (2,670)              | (2,670)                        |
| Adjusted net earnings   | <u>21,571</u>        | <u>26,005</u>           |                      |                                |
| Cash flow   |                      |                         | <u>35,500</u>        | <u>38,934</u>                  |
| Shares outstanding, end of year                               | 19,659,632           | 19,659,632              | 19,659,632           | 19,659,632                     |
| Adjustment to take account of debenture conversion            |                      | 4,785,854               |                      | 4,785,854                      |
| Number of shares for calculation purposes                     | <u>19,659,632</u>    | <u>24,445,486</u>       | <u>19,659,632</u>    | <u>24,445,486</u>              |
| <b>EPS/cash flow per share</b>                                | <u><b>\$1.10</b></u> | <u><b>\$1.06</b></u>    | <u><b>\$1.81</b></u> | <u><b>\$1.59</b></u>           |
| Annual dividend   | <u><b>\$1.08</b></u> | <u><b>\$1.08</b></u>    | <u><b>\$1.08</b></u> | <u><b>\$1.08</b></u>           |
| <b>Dividend to EPS/cash flow per share ratio</b>              | 98.2%                | 101.9%                  | <u><b>60%</b></u>    | <u><b>68%</b></u>              |



## 6.3 Balance Sheets

### Consolidated Balance Sheets

(in thousands of dollars)

|   | 2009-12-31     | 2008-12-31     |
|---|----------------|----------------|
| <b>ASSETS</b>   | \$             | \$             |
| Current assets  |                |                |
| Accounts receivable   | 75,438         | 80,804         |
| Income taxes receivable   | 685            |                |
| Inventory   | 71,909         | 73,233         |
| Prepaid expenses  | 1,500          | 1,664          |
| Future income taxes   | 8,540          |                |
|   | <u>158,072</u> | <u>155,701</u> |
| Deferred financing expenses                                       | 158            | 279            |
| Share investment in Colabor Investments Inc., at cost             | 6,159          | 6,159          |
| Property, plant and equipment                                     | 13,835         | 15,029         |
| Intangible assets   | 133,869        | 143,319        |
| Goodwill  | 72,317         | 69,574         |
| Future income taxes   | 1,802          |                |
|   | <u>386,212</u> | <u>390,061</u> |
| <b>LIABILITIES</b>  |                |                |
| Current liabilities   |                |                |
| Bank overdraft  | 17,126         | 7,714          |
| Accounts payable and accrued liabilities                          | 65,762         | 85,945         |
| Income taxes payable  |                | 1,855          |
| Balance of purchase price payable, bearing interest of 4.5%       | 3,750          | 3,750          |
| Balance of purchase price payable                                 | 6,331          | 6,353          |
| Dividends payable   | 7,453          |                |
| Distributions payable to unitholders                              |                | 1,307          |
| Distributions payable to holders of exchangeable Colabor LP units |                | 456            |
| Sales rebates payable   | 13,808         | 15,166         |
| Deferred revenue  | 961            | 1,115          |
| Deferred credit   | 7,290          |                |
| Instalments on long-term debt                                     | 636            | 707            |
|   | <u>123,117</u> | <u>124,368</u> |
| Bank loan   | 49,335         | 47,501         |
| Balance of purchase price payable, bearing interest of 4.5%       |                | 3,750          |
| Long-term debt  | 307            | 942            |
| Debentures  | 46,711         | 45,725         |
| Accrued benefit liability for employee benefits                   | 787            | 772            |
| Deferred credit   | 19,875         |                |
| Future income taxes   |                | 17,414         |
| Non-controlling interest  |                | 29,713         |
|   | <u>240,132</u> | <u>270,185</u> |
| <b>SHAREHOLDERS' EQUITY/UNITHOLDERS' EQUITY</b>                   |                |                |
| Capital stock/unitholders' capital account                        | 143,018        | 135,323        |
| Option to convert debentures                                      | 2,314          | 2,315          |
| Contributed surplus   | 447            | 349            |
| Shares/units held for the long-term incentive plan                | (1,248)        | (875)          |
| Retained earnings (deficit)                                       | 1,549          | (17,236)       |
|   | <u>146,080</u> | <u>119,876</u> |
|   | <u>386,212</u> | <u>390,061</u> |

As a result of the conversion to a corporation, the recognition and presentation of certain balance sheet items was modified.

The main changes were:

- Recognition of a future income tax asset and deferred credit:  
Since the Company is virtually certain it will recover some \$130M in tax losses acquired in connection with the Plan of Arrangement with ConjuChem, an income tax asset and the offsetting deferred credit were recognized on a current and long-term basis to reflect the recovery period of these assets (see Notes 3 and 18 to the financial statements).
- Future income taxes previously displayed in long-term liabilities have been partly offset by future income tax assets (see Note 8 to the financial statements).
- The non-controlling interest reported under long-term liabilities has been fully eliminated by transferring this interest to capital stock (see Notes 2 and 18 to the financial statements).
- The deficit was totally eliminated through a reduction of capital stock further to a decision of the Board of Directors. The accounting treatment resulted because the accrued deficit resulted from distributions to unitholders in excess of the Fund's net earnings, since the Fund's cash distributions were greater than its net earnings under the income fund structure, which provided a return of capital (see Note 18 to the financial statements).

## 6.4 Cash Flow

Consolidated Cash Flows (in thousands of dollars)

|   | 2009-12-31<br>(110 days)<br>(unaudited) | 2008-12-31<br>(116 days)<br>(unaudited) | 2009-12-31<br>(365 days) | 2008-12-31<br>(366 days) |
|---|---|---|--------------------------|--------------------------|
|   | \$                                      | \$                                      | \$                       | \$                       |
| <b>OPERATING ACTIVITIES</b>                                     |   |   |                          |                          |
| Net earnings  | 9,002                                   | 4,326                                   | 16,671                   | 8,375                    |
| Non-cash items  |   |   |                          |                          |
| Amortization of property, plant and equipment                   | 1,125                                   | 1,543                                   | 3,864                    | 4,039                    |
| Amortization of intangible assets                               | 2,894                                   | 3,613                                   | 9,450                    | 8,706                    |
| Amortization of deferred financing expenses                     | 37                                      | 38                                      | 121                      | 110                      |
| Non-controlling interest  |   | 2,356                                   | 4,001                    | 6,618                    |
| Future income taxes   | 1,606                                   | (627)                                   | 1,650                    | 863                      |
| Compensation cost from long-term incentive plan                 | 163                                     | 126                                     | 514                      | 384                      |
| Amortization of transaction costs related to debentures         | 301                                     | 286                                     | 1,000                    | 910                      |
|   | <u>15,128</u>                           | <u>11,661</u>                           | <u>37,271</u>            | <u>30,005</u>            |
| Changes in operating assets and liabilities                     |   |   |                          |                          |
| Accounts receivable   | 19,205                                  | 18,928                                  | 5,366                    | (1,825)                  |
| Income taxes receivable   | (685)                                   | 518                                     | (685)                    |                          |
| Inventory   | (6,541)                                 | (9,844)                                 | 1,324                    | (8,492)                  |
| Prepaid expenses  | 817                                     | 2,127                                   | 164                      | 20                       |
| Accounts payable and accrued liabilities                        | (12,555)                                | (2,885)                                 | (20,183)                 | 14,532                   |
| Income taxes payable  | (1,413)                                 | 783                                     | (1,855)                  | 178                      |
| Sales rebates payable   | 3,186                                   | 5,007                                   | (1,358)                  | 1,713                    |
| Deferred revenue  | (508)                                   | (786)                                   | (154)                    | 656                      |
| Accrued benefit liability for employee benefits                 | 15                                      | 20                                      | 15                       | 20                       |
|   | <u>1,521</u>                            | <u>13,868</u>                           | <u>(17,366)</u>          | <u>6,802</u>             |
| Cash flows from operating activities                            | <u>16,649</u>                           | <u>25,529</u>                           | <u>19,905</u>            | <u>36,807</u>            |
| <b>INVESTING ACTIVITIES</b>                                     |   |   |                          |                          |
| Transaction with ConjuChem                                      |   |   | (5,000)                  |                          |
| Business acquisitions   |   | 1,242                                   |                          | (69,182)                 |
| Payment of balances of purchase price                           |   |   | (6,515)                  |                          |
| Property, plant and equipment                                   | (1,468)                                 | (1,462)                                 | (2,670)                  | (2,340)                  |
| Cash flows from investing activities                            | <u>(1,468)</u>                          | <u>(220)</u>                            | <u>(14,185)</u>          | <u>(71,522)</u>          |
| <b>FINANCING ACTIVITIES</b>                                     |   |   |                          |                          |
| Bank loan   | (26,757)                                | (17,239)                                | 1,834                    | 21,352                   |
| Financing expenses  |   |   |                          | (225)                    |
| Distributions paid to unitholders                               | (1,011)                                 | (5,228)                                 | (11,467)                 | (14,011)                 |
| Distributions paid on exchangeable Colabor LP units             | (353)                                   | (1,825)                                 | (4,004)                  | (5,476)                  |
| Repayment of long-term debt                                     | (230)                                   | (373)                                   | (706)                    | (779)                    |
| Purchase of units held by the Fund for long-term incentive plan |   |   | (789)                    | (575)                    |
| Issue of trust units  |   |   |                          | 38,022                   |
| Unit issue expenses   |   | (384)                                   |                          | (1,534)                  |
| Cash flows from financing activities                            | <u>(28,351)</u>                         | <u>(25,049)</u>                         | <u>(15,132)</u>          | <u>36,774</u>            |
| <b>Net change in bank overdraft</b>                             | <u>(13,170)</u>                         | <u>260</u>                              | <u>(9,412)</u>           | <u>2,059</u>             |
| Bank overdraft, beginning of year                               | <u>(3,956)</u>                          | <u>(7,974)</u>                          | <u>(7,714)</u>           | <u>(9,773)</u>           |
| Bank overdraft, end of year                                     | <u>(17,126)</u>                         | <u>(7,714)</u>                          | <u>(17,126)</u>          | <u>(7,714)</u>           |

## **Credit Facilities**

The Company has entered into a three-year agreement with a banking syndicate for operating credit facilities for an authorized amount of \$100M secured by a first ranking hypothec on the Company's assets.

Under the terms of the credit agreement, the Fund is required to maintain (i) a prescribed ratio of total debt (excluding the debentures) to EBITDA less than 3.00:1.00 and (ii) a prescribed ratio of EBITDA to interest expenses greater than 3.50:1.00.

Based on the banking syndicate's method of calculation, the debt/EBITDA ratio is 1.31:1.00 and the interest coverage ratio is 6.83:1.00 times.

During the year, the operating credit increased \$1.8M to \$49.3M. Cash in the amount of \$5M was used to pay ConjuChem on the conversion to a corporation and \$6.5M to repay balances of sale price.

## **Distributions/Dividends**

On September 15, 2009, the Fund made a final distribution to unitholders of record on August 31 on a prorata basis for the number of days in the period of August 1 to August 24 calculated on the previous monthly distribution of \$0.0897 per unit.

Following its conversion to a corporation, Colabor will now make quarterly dividend payments. The first dividend was paid on January 15, 2010 to shareholders of record on December 31, 2009 and amounted to \$7,452,966. The dividend was calculated on an annual basis of \$1.08 per share for the period of August 25, the conversion date, to December 31, 2009. This amount is included as a dividend payable in the December 31, 2009 balance sheet. Thereafter, a quarterly dividend of \$0.27 will be paid, which is equivalent to an annual dividend of \$1.08.

In management's opinion, cash flows from operating activities and the funds from operating credits are sufficient to support planned capital expenditures, working capital requirements, quarterly dividends of \$0.27 per share and will comply with the banking syndicate's ratio requirements.

## **6.5 Standardized Distributable Cash**

Management has decided that, in light of the conversion to a corporation, it is no longer appropriate to report distributable cash, which is a measure of profitability applicable to an income fund.

Since the Fund became a corporation, performance is now measured in terms of earnings per share, basic and diluted cash flows per share and the dividend payout ratio. These calculations are presented in the *Performance Analysis* and *Results of Operations* sections.

## 7. Contractual Obligations

| (\$000)                                | Payments due per period |                             |                              |                              |                             |
|--|-------------------------|-----------------------------|------------------------------|------------------------------|-----------------------------|
|  | <u>Total</u>            | <u>Less than<br/>1 year</u> | <u>From 1 to 3<br/>years</u> | <u>From 4 to 5<br/>years</u> | <u>5 years<br/>and over</u> |
| <b>Contractual obligations</b>         |                         |                             |                              |                              |                             |
| Bank loan                              | \$49,335                |                             | \$49,335                     | \$ -                         | \$ -                        |
| Long-term debt                         | \$943                   | \$636                       | \$307                        |                              |                             |
| Balance of purchase price payable      | \$10,081                | \$10,081                    |                              |                              |                             |
| Debentures (par value)                 | \$49,055                |                             | \$49,055                     |                              |                             |
| Operating leases and service contracts | <u>\$93,373</u>         | <u>\$11,829</u>             | <u>\$21,860</u>              | <u>\$18,411</u>              | <u>\$41,273</u>             |
| Total                                  | <u>\$202,787</u>        | <u>\$22,546</u>             | <u>\$120,557</u>             | <u>\$18,411</u>              | <u>\$41,273</u>             |

Although the debentures are included in the above contractual obligations, one of their characteristics is that they are convertible into shares in 2010 or 2011.

The debentures are redeemable between December 31, 2009 and December 31, 2010, with advance notice, at a price that corresponds to the principal plus accrued and unpaid interest, provided the current market price is at 125% of the conversion price.

After December 31, 2010, they are redeemable, with advance notice, at a price that is equivalent to the principal plus accrued and unpaid interest.

## 8. Summary of Past Quarters

| ('000)                                    | 2009-12-31<br>(110 days) | 2009-09-12<br>(84 days) | 2009-06-20<br>(84 days) | 2009-03-28<br>(87 days) | 2008-12-31<br>(116 days) | 2008-09-06<br>(84 days) | 2008-06-14<br>(84 days) | 2008-03-22<br>(82 days) |
|---|--------------------------|-------------------------|-------------------------|-------------------------|--------------------------|-------------------------|-------------------------|-------------------------|
|   | \$                       | \$                      | \$                      | \$                      | \$                       | \$                      | \$                      | \$                      |
| <b>Sales</b>                              | 364,973                  | 276,841                 | 283,722                 | 256,945                 | 398,906                  | 288,446                 | 278,721                 | 180,029                 |
| EBITDA                                    | 15,073                   | 10,026                  | 9,977                   | 7,724                   | 15,472                   | 10,014                  | 9,428                   | 5,355                   |
| <b>Net earnings</b>                       | 9,002                    | 4,710                   | 1,744                   | 1,215                   | 4,326                    | 2,311                   | 1,147                   | 591                     |
| Basic and diluted earnings per share/unit | \$0.53                   | \$0.30                  | \$0.12                  | \$0.08                  | \$0.33                   | \$0.16                  | \$0.09                  | \$0.06                  |

Readers should bears in mind that the quarter ended September 12, 2009 includes income tax recoveries calculated for the quarters ended June 20, 2009 and March 28, 2009 following conversion to a corporation and the acquisition of ConjuChem's tax losses.

## 9. Related Party Transactions

Following the initial public offering on June 28, 2005, the Fund had indirectly acquired a 53.2% interest in Colabor LP, with the remaining 46.8% interest in Colabor LP being held by Colabor Investments Inc. ("Investments") as exchangeable Colabor LP units.

Subsequent to the Summit and Bertrand acquisitions, Investments held an undiluted 26% interest and a diluted 21% interest in Colabor LP.

Subsequent to the conversion into a corporation, Investments now holds an undiluted 26% and a diluted 21% interest in Colabor Group inc., which enables it to exercise significant influence over GCL.

Related party transactions include the following:

- Sales to customers controlled by directors, which are on the same terms and conditions as sales to other customers of the Fund;
- Rebates to affiliated- and preferred wholesalers of Investments at the rate of 3% of their sales, as provided in the agreement in effect until 2015;
- Until 2022, the Company leases the building in which its head office and the Boucherville distribution centre are located from Investments;
- Under an agreement expiring in 2015, the Company pays fees to a subsidiary of Investments for IT services;
- Bertrand uses a subsidiary of Investments for its IT development and support.

All of these transactions were concluded in the normal course of business and are measured at the exchange amount.

Related party transactions (in thousands of dollars)

|  | 2009-12-31<br>(110 days)<br>(unaudited) | 2008-12-31<br>(116 days)<br>(unaudited) | 2009-12-31<br>(365 days) | 2008-12-31<br>(366 days) |
|--|---|---|--------------------------|--------------------------|
|  | \$                                      | \$                                      | \$                       | \$                       |
| Sales to customers controlled by directors | 5,348                                   | 6,448                                   | 17,179                   | 17,337                   |
| Rebates                                    | 6,394                                   | 5,662                                   | 14,066                   | 13,731                   |
| Rent                                       | 624                                     | 624                                     | 2,028                    | 2,028                    |
| IT services                                | 586                                     | 409                                     | 1454                     | 740                      |

## 10. Off-balance Sheet Transactions

The Company does not have any off-balance sheet transaction obligations, other, primarily, than a \$2,028,000 bank letter of guarantee supporting one year of leasing the Boucherville distribution centre.

# **11. Current Economic Situation, Development Strategies and Outlook**

## **Current Economic Situation**

Colabor's activities are in Eastern Canada, principally in Quebec and Ontario. During 2009, the Canadian economy underwent one of the most severe economic downturns in the past 40 years, leading to job losses of 239,700 across the country, with 26,800 in Quebec and 141,600 in Ontario. Ontario accounted for 59% of job losses in Canada due to the provinces weakened manufacturing sector.

Job losses are synonymous with less disposable income for meals away from home. There is no doubt that the employment situation in Ontario is a major factor in the Summit Division's weak sales, as explained under *Performance Analysis, Results of Operations, Sales*.

A recent Desjardins Economic Studies Bulletin's indicated that there were some positive signs in Quebec pointing to a recovery. The real estate market is stabilizing, job losses are slowing and consumer confidence is improving.

In Ontario, however, the automobile industry restructuring will prolong the recession in the coming months. Because of its strong manufacturing base, this province is the hardest hit by the recession. Additionally, a rapid depreciation of the Canadian dollar would slow the resurgence of exports. We believe the economic downturn will continue during the first half of the 2010 fiscal year, with a modest upswing during the second half, depending, however, on the recovery of its automobile industry.

Colabor's management is well aware of this situation and has prepared its budgets to deal with it. It has already taken the necessary measures to cope with the situation, in particular, reviewing processes and operating expenses and limiting capital spending solely to projects that will contribute to increasing productivity.

Nevertheless, Colabor is better able to resist a recession since it operates in the food distribution sector, an industry that is less at risk than many others.

Colabor has prepared its business plan, described below, and believes that the current situation could offer business opportunities that it is prepared to analyse for their potential to contribute to sound sales growth, with the objective of providing added value for the shareholders.

## **Development Strategies**

The Company's management is firmly convinced that there are major channels which could be used to increase its penetration of the food services market in Canada.

### *Affiliated-wholesalers network in Quebec and the Atlantic Provinces*

In light of the Wholesale Segment as described under the *Results of Operations* section, it is clear that these loyal, entrepreneurial, customer-service-driven affiliated-wholesalers will continue to grow their market share in their respective regions.

### *Consolidation of food distribution services*

The Summit acquisition has made it possible for the Company to gain a foothold in Ontario, the most important foodservices market in Canada. The Company could acquire other distributors operating in Ontario and use its business model to integrate any new acquisitions. This strategy has proven beneficial, for example, with the Bruce Edmeades acquisition.

The Company could also acquire affiliated-wholesalers' networks in Quebec, using its Bertrand division to integrate the new acquisitions, and in the Atlantic Provinces. This would allow it to complete its distribution network in Eastern Canada.

### *Geographic expansion*

At this time, the Company is not present in Western Canada. Since this region was experiencing the fastest economic growth in the country in recent years, there is no doubt that expansion into this region could be beneficial, although it must be considered carefully in light of the labour availability issues. Additionally, a prerequisite to expansion in this region is developing a solid customer base before investing in new infrastructure.

### *Related sectors*

The Company's mission is to provide its customers with one-stop shopping in the food distribution services market.

In the future, the Company could add a meat, fish, fruit and vegetables, packaged goods and natural and organic products distribution network.

### *Convenience stores and small-sized grocery stores*

The Company believes that, in the medium term, there will be opportunities to acquire convenience store networks currently owned by major food chains wishing to return to their original niche, serving medium- and large-sized grocery stores.

## **Outlook**

Despite the economic downturn, these acquisition opportunities would make it possible for the Company to significantly increase its purchasing power and ability to generate cost savings in order to increase its net earnings.



## 12. Risks and Uncertainties

The Company's activities are subject to numerous risks and uncertainties that are described in detail in its Annual Information Form. In addition to those risks, the Company wishes to emphasize the industry-related risks that could impact profitability and return on investments and that are beyond management's control.

### **Industry-related risks that could impact profitability and that are beyond management's control:**

- *Dependence on affiliated-wholesalers*

Sales generated by affiliated-wholesalers account for a significant portion of the Company's sales. The loss of a significant number of these wholesalers could have a negative impact on Colabor's earnings.

This risk has been mitigated by the execution of agreements to amend the affiliate agreements to provide for an initial ten-year period, renewal provisions for two additional terms of five years and also provide for the granting of a right of first refusal by the affiliated-wholesalers to Colabor LP on their businesses and through the recent acquisition of Bertrand, one of its main customers. However, there is no assurance that Colabor LP will be able to finance the exercise of such right of first refusal. Moreover, incentives are built in the contractual relationships existing between the affiliated-wholesalers, Colabor LP and Investments to encourage the affiliated-wholesalers to increase their purchases from Colabor.

- *Absence of long-term agreements between affiliated-wholesalers and their customers*

In accordance with general industry practice, affiliated-wholesalers do not normally enter into long-term agreements with their customers. As a result, customers may, without notice or penalty, terminate their relationship with the affiliated-wholesalers. In addition, even if customers should decide to continue their relationship with the affiliated-wholesalers, there is no guarantee they will purchase the same volume of products as in the past or that they will pay the same price for those products as they have in the past. Any loss of customers by the affiliated-wholesalers, or decrease in the volume purchased or the price paid by them for products, could affect the Company's sales and have an adverse effect on its financial condition and results of operations. In the past, affiliated wholesalers, relying on their knowledge of their respective markets, have been able to differentiate themselves from their competitors by providing personalized services to their customers, in particular, flexible delivery schedules and a product line tailored to their customers' needs. In management's view, there will be no change in this regard in the future.

- *Customer choices*

Colabor's success also depends on the continuing interests of customers in its products. A change in customer choices could affect demand for Colabor's products.

- *Dependence on Cara and other chains*

Subsequent to the Summit acquisition, sales to Cara (including franchisees of Cara) represented a significant portion of the Company's sales. The loss of Cara as a customer, a decrease in purchases by Cara or a decrease in Cara's market share in the foodservice industry could have a material and adverse effect on the Company's financial condition, results of operations and liquidity. This risk has been mitigated by the execution of a ten-year distribution agreement, with a five-year renewal option with Cara and through the recent acquisition of Bruce Edmeades and Bertrand.

- *Integration of acquired companies*

While some acquisitions will be managed with little change, some could result in major streamlining. Difficulties encountered with such integrations could have an impact on the Company's results.

- *Product recall*

Colabor could have to deal with product recalls due to sanitation issues encountered by certain manufacturers, such as the listeriosis problems during 2008. Such recalls can trigger a decrease in sales of certain types of products for a period of time and cause a slump in sales figures. At this time, Colabor has the necessary mechanisms in place to quickly trace contaminated products, return them to the manufacturer and recover the cost of the contaminated products from these manufacturers.

### **Return on investment**

The return on an investment in Colabor Group Inc. is not comparable to the return on an investment in a fixed-income security. The return is based on many assumptions. Although the Company intends to pay quarterly dividends, such dividends may be reduced or suspended. The dividends paid will depend on numerous factors, in particular, the inherent industry risks described above and other risks described in the Company's Annual Information Form. Additionally, the market value of the shares could decline significantly if the Company is unable to respect its dividend payment objectives, in particular, non-compliance with the financial ratio requirements under the credit agreement described under the *Cash Flow* section.

### **Climate change**

Colabor has very little climate change risk exposure.

## **13. Significant Accounting Measurements**

Some of the amounts in the financial statements are based on estimates made by management using its knowledge of current or anticipated economic events. Significant estimates relate exclusively to the allowance for excess or obsolete inventory, accounting for rebates from suppliers, goodwill and intangible assets.

- *Allowance for excess or obsolete inventory*

Inventory is valued at the lower of net realizable value or cost calculated using the first-in first-out method. The Company records an allowance for obsolescence that is calculated on the basis of assumptions relating to future demand for its products and conditions in the markets in which its products are sold. The allowance, which reduces inventory to the net realizable value, is then applied against inventory in the balance sheet. Management has to make estimates and exercise judgement when determining these allowances. If actual market conditions are less favourable than management's assumptions, additional allowances may be required.

- *Accounting for rebates from suppliers*

Colabor negotiates procurement contracts with its suppliers providing for the payment of rebates based on volumes purchased. The procurement contracts with suppliers are reviewed periodically and rebates adjusted according to prevailing market conditions.

- *Goodwill and intangible assets*

Goodwill is the excess of the cost of an acquired enterprise over the net of the amounts assigned to assets acquired and liabilities assumed. Goodwill is not amortized. Each year, or more often if events or changes in circumstances indicate a decrease in fair value, it is tested for impairment. The impairment test involves comparing the fair value of the Company's business with its carrying amount. If the carrying amount of the business exceeds its fair value, the Company compares the fair value of any goodwill relating to the business to its carrying amount. An impairment loss equal to the amount of the excess is charged to earnings. The fair value of the business is calculated using discounted cash flows.

Intangible assets include customer relationships and trademarks. Customer relationships are amortized on the straight-line basis over their estimated useful lives of 20 years for relationships with affiliated-wholesalers, 15 years for customer relationships with Cara and 10 years for relationships with other customers. Trademarks are not amortized.

## **14. Disclosure Controls and Processes**

To ensure that the consolidated financial statements and MD&A present fairly, in all material respects, the financial position of the Company and the results of its operations, it is the responsibility of management to establish and maintain appropriate internal control over financial reporting. Internal control over financial reporting is a process designed by the President and Chief Executive Officer and the Chief Financial Officer, or under their supervision. It is implemented by the Board of Directors, management and other employees to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A policy on the disclosure of information provides a framework for the financial reporting process in annual and interim filings, and other reports filed or sent in accordance with securities legislation. The Disclosure Committee ensures compliance with this policy.

In light of the inherent limitations of any control system, the Company's management acknowledges that control and reporting processes cannot prevent and detect all misstatements resulting from fraud or error. However, based on the work performed, the Company's management is required to provide reasonable assurance that important information is provided to it on a timely basis so it is able to report complete and reliable information to investors.

### **Controls and Reporting Processes**

The preparation of the financial statements and MD&A is based on a framework of controls and reporting processes implemented by management. During the 2009 fiscal year, the design and operation of these controls and processes were subject to an evaluation that confirmed the effectiveness of both the design and operation of controls and reporting processes as at December 31, 2009. This evaluation was consistent with the criteria in the control framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) adopted by the Company and in accordance with the guidance of the Canadian Securities Administrators described in *Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*.

The financial statements, MD&A and Annual Information Form were reviewed by the Audit Committee and the Board of Directors, who approved them prior to publication.

### **Internal Controls over Financial Reporting**

The Company's Audit Committee supervises the documentation, evaluation of the design and operation of internal controls over financial reporting supporting the Company's main transaction and accounting processes. This work serves to improve the design of internal controls.

As was the case for the evaluation of controls and reporting processes, the evaluation of the design and operation of internal controls over financial reporting is carried out in accordance with the COSO control framework and the guidance in Multilateral Instrument 52-109. As at December 31, 2009, based on the work carried out, management concluded that internal control over financial reporting was designed and operating effectively to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements in accordance with GAAP.

Management also determined that there were no material weaknesses in the Company's internal control over financial disclosures as at December 31, 2009.

### **Transition to International Accounting Standards**

On February 13, 2008, the Accounting Standards Board confirmed the date of the changeover from GAAP to International Financial Reporting Standards (IFRSs). Canadian publicly accountable enterprises must adopt IFRSs for their interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date to produce comparative information for the conversion year is January 1, 2010.

Following the initial diagnostic phase, the Company set up a project structure. A task force analyzes, recommends accounting policy choices and implements each IFRS standard. The Company's Audit Team ensures that management fulfills its responsibilities and successfully achieves the conversion to IFRSs. Additionally, a work plan was developed, whose phases, activities, deadlines and progress are summarized below:

| <b>Phase 1 Diagnostic</b>        |   |
|----------------------------------|---|
| Activities                       | <p>Identification of IFRSs that will result in changes in the consolidated financial statement measurements and disclosures.</p> <p>Classification of the standards according to their expected impact on the consolidated financial statements and the implementation effort required.</p>   |
| Deadline                         | June 30, 2009   |
| Progress                         | Finished  |
| <b>Phase 2 Detailed Analysis</b> |   |
| Activities                       | <p>Detailed analysis of the differences between GAAP and IFRSs.</p> <p>Selection of accounting policies.</p> <p>Selection of IFRS 1 exemptions at the date of transition</p> <p>Calculation of the quantitative impact on the consolidated financial statements.</p> <p>Disclosure analysis.</p> <p>Inventory of systems, documents and spreadsheets currently used to collate information.</p> <p>Analysis of the impact of applying the new standards on:</p> <ul style="list-style-type: none"> <li>• Information systems and spreadsheets</li> <li>• Policies and procedures</li> <li>• Internal control activities</li> <li>• Processes relating to Colabor Group Inc.'s compliance with applicable laws and regulations.</li> <li>• Business processes</li> </ul> |
| Deadline                         | December 31, 2009   |
| Progress                         | Finished  |

| <b>Phase 3 Solution et implantation</b> |  |
|---|--|
| Activities                              | Preparation of the January 1, 2010 opening balance sheet.<br>Changes to documents used to collate information, spreadsheets and procedures.<br>Preparation of IFRS financial statements for the comparative year and for each interim period.<br>Preparation of first interim period financial statements.<br>Preparation of IFRS financial statements for the year of conversion.<br>Preparation of a questionnaire on financial disclosures. |
| Deadline                                | December 31, 2010  |
| Progress                                | In progress  |

On the basis of the work performed to date, that is the detailed standards analysis, conversion to IFRSs will only results in changes in financial disclosures. The analyses have not identified any significant impact on the previous recognition of Group Colabor Inc.'s assets, liabilities or results or on its information systems and other business processes.

The Company should be able to comply with the instructions of the Autorité des marchés financiers and the Canadian Institute of Chartered Accountants on the application dates stipulated by these entities.

## **15. Subsequent Event**

On October 6, 2009, the Company's management was informed that it would lose an important distribution agreement served by the Summit division with a fast-food chain. For the fiscal year, sales to this customer totalled \$129,382,000, or 11 % of sales of \$1,182,481,000. EBITDA generated by this contract was about \$900,000 (profitability of 0.7%) or 2 % of its EBITDA of \$42,800,000.

The Company's management is now re-evaluating the operations of the Summit division and evaluate certain business opportunities that could help replace this contract.