



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
FOR THE THREE AND TWELVE-MONTH PERIODS ENDED DECEMBER 31, 2012**

*The following management's discussion and analysis of financial condition and results of operations ("MD&A"), dated March 11, 2013, of Supremex Inc. (the "Company") should be read together with the accompanying audited consolidated financial statements and related notes of the Company for the year ended December 31, 2012. These consolidated financial statements of the Company have been prepared by management in accordance with International Financial Reporting Standards ("IFRS"). The fiscal year of the Company ends on December 31. The Company's reporting currency is the Canadian dollar. Per share amounts are calculated using the weighted average number of shares outstanding for the three and twelve-month periods ended December 31, 2012.*

*This MD&A contains forward-looking statements. Please see "Forward-Looking Statements" for a discussion of the risks, uncertainties and assumptions relating to these statements. In addition to our results reported in accordance with IFRS, the MD&A may contain other non-IFRS financial measures. Terms by which non-IFRS financial measures are identified include, but are not limited to, "EBITDA" or other similar expressions. Non-IFRS financial measures are used to provide management and investors with additional measures of performance. However, non-IFRS financial measures do not have standard meanings prescribed by IFRS and therefore may not be directly comparable to similar measures used by other companies and should not be viewed as alternatives to measures of financial performance prepared in accordance with IFRS. See "Definition of EBITDA and Non-IFRS Measures" and "Selected Consolidated Financial Information" for the reconciliation of EBITDA to net earnings.*

**Conversion to a Corporation**

On January 1, 2011 (the "Effective Date"), Supremex Income Fund (the "Fund") completed its conversion from an income trust structure to a corporation. On May 7, 2010, the unitholders of the Fund approved the plan of arrangement (the "Arrangement") pursuant to which the Fund will convert from an income trust structure to a public corporation named Supremex Inc. The final order of the Superior Court of Québec with respect to the Arrangement was obtained on May 10, 2010.

Under the Arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of Supremex.

The Arrangement has been accounted for as a continuity of interests of the Fund since Supremex continues to operate the business of the Fund and there were no ownership changes. Under the continuity of interests' method of accounting, the transfer of the assets, liabilities and equity of the Fund to Supremex is recorded at the net book value as at the Effective Date of the transaction. As a result, for accounting purposes, the transaction is required to be accounted for as though the Company was a continuation of the Fund but with its capital reflecting the exchange of Fund units for Supremex common shares. Therefore, certain terms such as shareholder/unitholder, dividend/distribution and share/unit may be used interchangeably throughout this MD&A. For the periods reported up to the Effective Date of the conversion, all payments to unitholders were in the form of fund unit distributions, and after that date all payments to shareholders were in the form of dividends.

Any references to the Fund for periods after January 1, 2011 shall mean Supremex Inc. as the successor of the Fund. References to "company", "share", "dividends" and "shareholders" means "fund", "unit", "distributions" and "unitholders" for transactions that occurred before the conversion of the Fund to a corporation.

Pursuant to the Arrangement, the stated capital for the common shares was reduced to an amount of \$10 million as of the Effective Date.

## **Overview**

Supremex is Canada's leading manufacturer and marketer of a broad range of stock and custom envelopes and related products. Supremex employs approximately 550 people and is the only national envelope manufacturer in Canada, with seven manufacturing facilities across six provinces. This national presence allows Supremex to meet the manufacturing needs of large national customers, such as large Canadian corporations, nationwide resellers and government bodies, as well as paper merchants and solution and process providers.

## **Overall Performance**

Revenue in the fourth quarter of 2012 amounted to \$33.7 million compared with \$36.7 million in the fourth quarter of 2011, representing a decrease of \$3.0 million or 8.1%. In the fourth quarter, the Canadian volume was down 9.5% and was spread in most of the accounts with bigger decline seen in the forms resellers and large corporation markets. The US revenue remained stable in the fourth quarter.

EBITDA for the fourth quarter of 2012 was \$7.2 million compared with \$7.4 million for the same period in 2011, representing a decrease of \$0.2 million or 2.7%. EBITDA margin was 21.4% compared with 21.3% in the fourth quarter of 2011. The margin improvement is mainly attributable to the various cost reduction measures put in place including the conversion, for future service, of its defined benefit pension plans into defined contribution plans since July 1, 2012 partially offset by the impact of reduced volume.

For the year ended December 31, 2012, EBITDA before restructuring expenses was \$25.1 million or 19.0% of revenue compared with \$29.5 million or 20.5% of revenue in 2011. The decrease is mainly attributable to the reduced volume sold generally spread in all accounts partially offset by the cost reduction measures put in place.

During the third quarter of 2012, several new indicators have shown that the volume decrease in North America's envelope industry was higher than expected and that this decline was expected to continue in the upcoming years. Therefore, the Company has had to revise its financial projections plan and perform a goodwill impairment test as at September 30, 2012. The Company has concluded that the recoverable value, determined on the basis of value in use, was less than its carrying value and a goodwill impairment charge of \$28.9 million was recorded in the third quarter of 2012.

### Key Factors Affecting the Business

The Company's operating results and financial condition are subject to a number of risks and uncertainties, and are affected by a number of factors outside management's control. See "Risk Factors" for a discussion of these risks.

### Summary of Quarterly Results

Supremex's revenue is subject to the seasonal advertising and mailing patterns of its customers. The number of units sold by Supremex is generally higher during fall and winter mainly due to the higher number of mailings related to events including the return to school, fund-raising, and the holiday and tax seasons. The number of units sold by Supremex is generally lower during spring and summer in anticipation of a slowdown in mailing activities of businesses during the summer. As a result, Supremex's revenue and financial performance for any single quarter may not be indicative of revenue and financial performance which may be expected for the full year. To maintain production efficiencies, Supremex utilizes warehouse capabilities to inventory envelopes as required to counter these predictable seasonal variations in sales volume.

The following table presents a summary of operating results of the Company on a quarterly basis from January 1, 2011 to December 31, 2012.

*(In thousands of dollars, except for per share amounts)*

	<b>Dec. 31, 2012</b>	Sept. 30 2012	June 30, 2012	Mar. 31, 2012	Dec. 31, 2011	Sept. 30, 2011	June 30, 2011	Mar. 31, 2011
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	<b>33,737</b>	30,703	31,831	35,604	36,699	34,024	34,068	39,101
EBITDA <sup>(1)</sup>	<b>7,233</b>	6,199	5,247	6,413	7,432	6,486	6,638	7,893
Earnings (loss) before income taxes	<b>4,213</b>	(25,661)	1,915	3,755	3,960	1,520	2,037	3,995
Net earnings (loss)	<b>3,232</b>	(26,039)	1,402	2,716	2,950	1,040	1,452	2,873
Net earnings (loss) per share	<b>0.1111</b>	(0.8895)	0.0478	0.0927	0.1007	0.0355	0.0496	0.0980

<sup>(1)</sup> See "Definition of EBITDA." EBITDA is not a recognized measure under IFRS and does not have a standardized meaning prescribed by IFRS. EBITDA may not be comparable to similar measures presented by other issuers.

Excluding the seasonal patterns of the business, revenue has decreased over the last eight quarters mainly due to the decrease in volume sold in Canada following softness in the envelope market and the strength of the Canadian dollar. The third quarter of 2012 loss is attributable to the recording of goodwill impairment of \$28.9 million considering the higher than expected future decline in North America's envelope industry.

## Selected Consolidated Financial Information

(In thousands of dollars, except for per share amounts)

	Three-month periods ended December 31,		Twelve-month periods ended December 31,	
	2012	2011	2012	2011
	\$	\$	\$	\$
<b>Revenue</b>	<b>33,737</b>	36,699	<b>131,875</b>	143,892
Operating expenses	<b>22,153</b>	24,069	<b>89,996</b>	96,209
Selling, general and administrative expenses	<b>4,351</b>	4,826	<b>16,788</b>	18,145
Restructuring expenses <sup>(1)</sup>	—	372	—	1,089
<b>EBITDA</b> <sup>(2)</sup>	<b>7,233</b>	7,432	<b>25,091</b>	28,449
Amortization of property, plant and equipment	<b>916</b>	853	<b>3,499</b>	4,398
Amortization of intangible assets	<b>1,541</b>	1,541	<b>6,164</b>	6,164
(Gain) loss on disposal of property, plant and equipment	—	86	<b>(18)</b>	400
Impairment of goodwill	—	—	<b>28,862</b>	—
<b>Operating (loss) earnings</b>	<b>4,776</b>	4,952	<b>(13,416)</b>	17,487
Financing charges	<b>563</b>	992	<b>2,362</b>	5,975
<b>Earnings (loss) before income taxes</b>	<b>4,213</b>	3,960	<b>(15,778)</b>	11,512
Income taxes expenses	<b>981</b>	1,010	<b>2,912</b>	3,197
<b>Net (loss) earnings</b>	<b>3,232</b>	2,950	<b>(18,690)</b>	8,315
Basic and diluted net (loss) earnings per share	<b>0.1111</b>	0.1007	<b>(0.6393)</b>	0.2838
Dividend declared per share	<b>0.0300</b>	0.0300	<b>0.1200</b>	0.0900
Total assets	<b>129,565</b>	166,841	<b>129,565</b>	166,841
Secured credit facilities	<b>50,000</b>	55,000	<b>50,000</b>	55,000

<sup>(1)</sup> Restructuring expenses are mainly related to the restructuring and improvement initiatives to reduce the Company's operating costs.

<sup>(2)</sup> See "Definition of EBITDA."

## Results of Operations

### *Three-month period ended December 31, 2012 compared with three-month period ended December 31, 2011*

#### *Revenue*

Revenue for the three-month period ended December 31, 2012 amounted to \$33.7 million compared with \$36.7 million for the three-month period ended December 31, 2011, a decrease of \$3.0 million or 8.1%. The decrease in revenue is mainly attributable to the lower number of units sold in Canada.

Revenue in Canada decreased by \$3.0 million or 8.8%, from \$33.9 million to \$30.9 million, and revenue in the United States remained stable at \$2.8 million.

The decrease in revenue in Canada was driven by a 9.5% decrease in the number of units sold partially offset by a 0.8% increase in the average selling price. The decrease in the number of units sold was spread in most of the accounts with bigger decline seen in the forms resellers and large corporations markets.

### *Operating expenses*

Operating expenses for the three-month period ended December 31, 2012 amounted to \$22.2 million compared with \$24.1 million for the same period in 2011, a decrease of \$1.9 million or 8.0%. The impact of the reduced volume and the cost reduction measures put in place mainly explains the decrease in operating expenses.

Gross profit decreased in 2012 compared with 2011. The margin erosion is mainly attributable to the reduced volume offset by various cost reduction measures put in place including the conversion, for future service, of its defined benefit plans into defined contribution plans.

### *Selling, general and administrative expenses*

Selling, general and administrative expenses totalled \$4.4 million for the three-month period ended December 31, 2012 compared with \$4.8 million for the same period in 2011, a decrease of \$0.4 million or 9.9%. The decrease is mainly attributable to decreased compensation.

### *EBITDA*

As a result of the changes described above, EBITDA was \$7.2 million for the three-month period ended December 31, 2012 compared with \$7.4 million for the same period in 2011, a decrease of \$0.2 million or 2.7%.

### *Amortization*

Aggregate amortization expense for the three-month period ended December 31, 2012 amounted to \$2.5 million compared with \$2.4 million for the comparable period in 2011 representing an increase of \$0.1 million or 2.7%, related to the 2012 acquisitions of property, plant and equipment.

### *Financing charges*

Financing charges for the three-month period ended December 31, 2012 amounted to \$0.6 million compared with \$1.0 million for the same period in 2011, representing a decrease of \$0.4 million or 43.3%, resulting from the lower amortization of deferred financing costs following the credit facilities renewal, the impact of the reduced level of debt, and the higher gain on valuation of derivative financial instrument.

### *Earnings before income taxes*

Due to the changes in revenue and expenses described herein, the earnings before income taxes totalled \$4.2 million for the three-month period ended December 31, 2012 compared with \$4.0 million for the same period in 2011, an increase of \$0.2 million or 6.4%.

### *Provision for income taxes*

During the three-month period ended December 31, 2012, the provision for income taxes remained stable at \$1.0 million.

### *Net earnings*

As a result of the changes described above, net earnings amounted to \$3.2 million for the three-month period ended December 31, 2012 compared with \$3.0 million for the same period in 2011, an increase of \$0.2 million or 9.5%.

### *Other comprehensive loss*

The higher than expected return on assets of the Company's defined benefit pension plan partially offset by the decrease of the discount rate for accrued plan benefit obligation has generated net actuarial gain of \$0.7 million. These variations impacted the Company's other comprehensive loss and deficit.

### ***Twelve-month period ended December 31, 2012 compared with twelve-month period ended December 31, 2011***

#### *Revenue*

Revenue for the twelve-month period ended December 31, 2012 amounted to \$131.9 million compared with \$143.9 million for the twelve-month period ended December 31, 2011, a decrease of \$12.0 million or 8.4%. The decrease in revenue is mainly attributable to the lower number of units sold in Canada.

Revenue in Canada decreased by \$12.0 million or 9.1%, from \$132.3 million to \$120.3 million, and revenue in the United States remained stable at \$11.6 million.

The decrease in revenue in Canada was mainly driven by a 9.4% decrease in the number of units sold offset by a 0.4% increase in average selling price. The decrease in the number of units sold was generally spread in all accounts with bigger decline seen in form resellers, large corporations and public markets.

#### *Operating expenses*

Operating expenses for the twelve-month period ended December 31, 2012 amounted to \$90.0 million compared with \$96.2 million for the same period in 2011, a decrease of \$6.2 million or 6.5%. The impact of the reduced volume and the cost reduction measures put in place mainly explains the decrease in operating expenses.

Gross profit decreased in 2012 compared with 2011. The margin erosion is attributable to the reduced volume and increase of raw material costs partially offset by various cost reduction measures put in place, including the conversion, for future service, of its defined benefit plans into defined contribution plans effective July 1, 2012.

#### *Selling, general and administrative expenses*

Selling, general and administrative expenses totalled \$16.8 million for the twelve-month period ended December 31, 2012 compared with \$18.1 million for the same period in 2011, a decrease of \$1.3 million or 7.5%. The decrease was mainly attributable to decreased compensation and bad debt expenses.

### *EBITDA*

As a result of the changes described above, EBITDA was \$25.1 million for the twelve-month period ended December 31, 2012 compared with \$28.4 million for the same period in 2011, a decrease of \$3.3 million or 11.8%.

### *Amortization*

Aggregate amortization expense for the twelve-month period ended December 31, 2012 amounted to \$9.7 million compared with \$10.6 million for the comparable period in 2011 representing a decrease of \$0.9 million or 8.5%. The decrease is mainly related to the review of the useful lives of some manufacturing equipment which have been extended since October 1, 2011.

### *Impairment of goodwill*

An impairment of goodwill charge has been recorded in the twelve-month period ended December 31, 2012 in the amount of \$28.9 million considering the higher than expected future decline in North America's envelope industry.

### *Financing charges*

Financing charges for the twelve-month period ended December 31, 2012 amounted to \$2.4 million compared with \$6.0 million for the same period in 2011, representing a decrease of \$3.6 million or 60.5%, resulting from the gain on valuation of derivative financial instruments in 2012 of \$0.5 million as compared to a loss on valuation of derivative financial instruments in 2011 of \$1.8 million, the lower amortization of deferred financing costs following the credit facilities renewal and the impact of the reduced level of debt.

### *(Loss) earnings before income taxes*

Due to the changes in revenue and expenses described herein, the loss before income taxes totalled \$15.8 million for the twelve-month period ended December 31, 2012 compared with earnings before income taxes of \$11.5 million for the same period in 2011.

### *Provision for income taxes*

During the twelve-month period ended December 31, 2012, the Company recorded a provision for income taxes of \$2.9 million compared with \$3.2 million for the twelve-month period ended December 31, 2011, a decrease of \$0.3 million or 8.9%. The decrease is mainly attributable to lower earnings before the portion of non-deductible goodwill impairment charge.

### *Net (loss) earnings*

As a result of the changes described above, net loss amounted to \$18.7 million for the twelve-month period ended December 31, 2012 compared with net earnings of \$8.3 million for the same period in 2011.

### *Other comprehensive loss*

The decrease of the discount rate for accrued benefit obligations of the Company's defined benefit pension plans partially offset by the higher than expected return on plan assets have generated net actuarial losses of \$4.1 million. These variations impacted the Company's other comprehensive loss and deficit.

### **Related Party Transactions**

During the year ended December 31, 2012, the Company has, in the normal course of business, received services in an amount of \$117,891 (2011 - \$34,674) from a major shareholder, Clarke Inc., and its subsidiaries.

### **Segmented Information**

The Company currently operates in one business segment: the manufacture and sale of envelopes. The Company's non-current assets amounted to \$95.0 million in Canada and \$0.8 million in the United States as at December 31, 2012 as compared to \$130.9 million and \$1.0 million as at December 31, 2011, respectively.

In Canada, the Company's revenue amounted to \$30.9 million and \$120.3 million for the three and twelve-month periods ended December 31, 2012 compared with \$33.9 million and \$132.3 million for the same periods in 2011, representing a decrease of \$3.0 million or 8.8% and \$12.0 million or 9.1%, respectively. In the United States, the Company's revenue remained stable at \$2.8 million and \$11.6 million for the three and twelve-month periods ended December 31, 2012.

### **Liquidity and Capital Resources**

#### *Operating activities*

Cash of \$13.7 million was generated from operating activities during the twelve-month period ended December 31, 2012 compared with \$19.0 million during the same period of 2011. The decrease in net cash flows from operating activities is primarily due to a decrease in net change in non-cash working capital balances and by lower earnings before non-cash items. The higher non-cash working capital level as at December 31, 2012 as compared to December 31, 2011, resulted mainly from the lower annual incentive programs accruals and the income taxes payable, partially offset by the decrease of accounts receivable.

#### *Investing activities*

Cash used in investing activities of \$2.2 million during the twelve-month period ended December 31, 2012 was mainly related to the acquisition of property, plant and equipment. In the prior-year period, cash of \$2.2 million was generated by the sale of the Markham facility partially offset by acquisition of property, plant and equipment.

#### *Financing activities*

In the twelve-month period ended December 31, 2012, cash of \$9.0 million was used in financing activities for the repayment of the credit facilities and the payment of dividends. Similarly, in prior-year period, \$18.7 million was used in financing activities for repayments on the credit facilities, payment of dividends and the payment of distributions on Fund units.



### *Liquidity and capital resources summary*

Our ability to generate cash flows from operations combined with our availability under our existing credit facilities are expected to provide sufficient liquidity to meet anticipated needs for existing and future projects.

### **Contractual Obligations**

The following chart outlines the Company's contractual obligations as at December 31, 2012.

*(in thousands of dollars)*

		<b>Payments due by fiscal year</b>		
	<b>Total</b>	<b>2013</b>	<b>2014</b>	<b>2015 and thereafter</b>
Secured credit facilities	<b>50,000,000</b>	5,000,000	5,000,000	40,000,000
Interest on secured credit facilities	<b>5,301,961</b>	1,984,834	1,851,789	1,465,338
Derivative financial liability	<b>700,435</b>	342,000	252,000	106,435
Operating leases	<b>7,377,099</b>	1,719,418	1,487,098	4,170,583
<b>Total</b>	<b>63,379,495</b>	9,046,252	8,590,887	45,742,356

### **Financing**

The Company's credit facilities consist of a \$20 million revolving facility, a \$45 million term credit facility (\$50 million as at December 31, 2011) and a \$25 million acquisition/capital expenditures facility (see "Recent Events"). As at December 31, 2012, Supremex had drawn \$5 million on the revolving credit facility and \$45 million on the term credit facility.

The revolving credit facility may be used to refinance existing credit facilities, finance working capital requirements and for other general corporate purposes. The acquisition/capital expenditures facility may be used to finance permitted acquisitions and permitted capital expenditures. The revolving and term credit facilities mature on November 4, 2015. The acquisition/capital expenditures credit facility matures on November 4, 2013 with the option to extend up to November 4, 2015. The term credit facility is repayable in quarterly principal instalments of \$1,250,000. In addition, 50% of the annual excess cash flow, as defined in the credit agreement, will be applied against the term credit facility if the debt to EBITDA ratio rises above 2.50, or 25% if the debt to EBITDA ratio falls between 2.50 and 2.00. No cash flow sweep are required if the debt to EBITDA ratio falls below 2.00 which was the case in 2012.

The facilities bear interest at a floating rate based on the Canadian prime rate or bankers' acceptance rate, plus an applicable margin on those rates. As at December 31, 2012, the interest rate on the revolving and term credit facilities was 3.54 %. The Company was in compliance with the covenants of its credit facilities as at December 31, 2012.

As at January 14, 2011, Supremex Inc. entered into an interest rate swap agreement for an amount of \$30 million at a fixed rate of 2.84% until January 14, 2016, excluding all applicable margins.

The credit facilities are collateralized by a hypothec and security interests covering all present and future assets of the Company and its subsidiaries.

### **Capitalization**

As at March 11, 2013, the Company had 28,960,867 common shares outstanding.

Pursuant to the normal course issuer bid, which began on December 5, 2011, the Company could have purchased for cancellation up to 1,500,000 shares until December 4, 2012. During the three and twelve month periods ended December 31, 2012, the Company purchased 260,900 and 336,900 shares for cancellation, respectively, at a price ranging from \$1.05 to \$1.62 per common share and thus completed its normal course issuer bid.

## Financial Instruments

### *Interest rate and foreign exchange risk*

The Company's credit facilities bear interest at a floating rate which give rise to the risk that its earnings and cash flows may be adversely impacted by fluctuations in interest rates. As at January 14, 2011, Supremex Inc. entered into an interest rate swap agreement for an amount of \$30 million at a fixed rate of 2.84% until January 14, 2016, excluding the applicable margin.

The Company operates in Canada and the United States, which gives rise to a risk that its earnings and cash flows may be adversely impacted by fluctuations in the exchange rate between the US and Canadian dollar. A portion of Supremex's revenue is earned in US dollars while a large portion of its expenses, including most of its paper and other raw materials costs as well as certain capital expenditures, are incurred in US dollars. Supremex also derives a portion of its revenue from Canadian dollar sales to certain customers for whom the selling price is sensitive to US competition. Net exposure to the US dollar decreased in 2012 due to lower US dollar purchases (see "Risk Factors"). Cash, accounts receivable and accounts payable and accrued liabilities include balances denominated in US dollars at the end of the year.

### *Fair value*

The fair value of the Company's financial instruments is indicated in note 20 to the Company's audited consolidated financial statements for the year ended December 31, 2012.

## Off-Balance Sheet Arrangements

The Company has no other off-balance sheet arrangements.

## Financial Position Highlights

*(In thousands of dollars except for ratio)*

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
	<b>\$</b>	<b>\$</b>
Working capital	<b>10,215</b>	5,825
Total assets	<b>129,565</b>	166,841
Total secured credit facilities	<b>49,356</b>	54,177
Equity	<b>37,907</b>	64,667

Supremex pays quarterly dividends to shareholders at the discretion of the Board of Directors. A dividend of \$869,876 or \$0.03 per share was declared and paid in the fourth quarter of 2012.

## **Disclosure Controls and Internal Controls over Financial Reporting**

In accordance with National Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*, the Company has filed certifications signed by the President and Chief Executive Officer, acting also as Chief Financial Officer (CFO), that, among other things, report on the design and effectiveness of disclosure controls and procedures, and the design and effectiveness of internal control over financial reporting.

Management has designed disclosure controls and procedures to provide reasonable assurance that material information relating to the Company is made known to the President and Chief Executive Officer and the Chief Financial Officer, particularly during the period in which annual filings are being prepared. The President and Chief Executive Officer, acting also as Chief Financial Officer (CFO), evaluated the effectiveness of the Company's disclosure controls and procedures and concluded, based on its evaluation, that such disclosure controls and procedures were effective as of December 31, 2012.

Management has also designed internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The President and Chief Executive Officer, acting also as Chief Financial Officer, evaluated the effectiveness of the Company's internal control over financial reporting and concluded, based on its evaluation, that such internal control over financial reporting was effective as of December 31, 2012. In making its evaluation, the President and Chief Executive Officer, also acting as Chief Financial Officer, used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework.

Finally, there has been no change in the Company's internal control over financial reporting during the year ended December 31, 2012 that materially affected, or is likely to materially affect, the Company's internal control over financial reporting.

## **Significant accounting policies and estimates**

The Company prepares its financial statements in conformity with IFRS, which requires management to make estimates, judgments and assumptions that management believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant areas requiring the use of management estimates relate to implied fair value of goodwill, determination of fair value of assets acquired and liabilities assumed in business combinations, determination of pension and other employee benefits, useful life of certain assets for amortization and evaluation of net recoverable amount, income taxes and determination of fair value of financial instruments. Management bases its estimates on historical experience and other assumptions, which it believes are reasonable under the circumstances. Management also assesses its estimates on an ongoing basis. The effect on the financial statements of changes in such estimates in future periods could be material and would be accounted for in the period a change occurs.

The significant accounting policies of the Company are described in note 2 to the Company's audited consolidated financial statements for the year ended December 31, 2012.

The policies the Company believes are most critical to assist in fully understanding and evaluating its reported results include the following:

### *Intangible assets and goodwill*

Intangible assets and goodwill arise out of business combinations for which the Company has applied the purchase method of accounting. The purchase method involves the allocation of the cost of an acquisition to the underlying net assets acquired based on their respective estimated fair value. As part of this allocation process, the Company must identify and attribute values and estimated lives to the intangible assets acquired. These determinations involve significant estimates and assumptions regarding cash flow projections, economic risk and weighted average cost of capital.

These estimates and assumptions determine the amount allocated to other identifiable intangible assets and goodwill as well as the amortization period for identifiable intangible assets with finite lives. If future events or results differ adversely from these estimates and assumptions, the Company could record increased amortization or impairment charges in the future.

Although the Company usually performed its goodwill impairment test annually as at December 31, during the third quarter of 2012, the Company has identified indications that its goodwill may be impaired. Consequently, as at September 30, 2012, the Company performed a goodwill impairment test using the discounted cash flows method based upon management's best estimates which reflect the Company's planned course of action in light of market conditions. The Company concluded that the recoverable value, determined on the basis of value in use, was less than its carrying value and recorded a goodwill impairment charge in the third quarter of 2012.

As at December 31, 2012, the Company has reviewed its goodwill impairment test and as no assumptions significantly changed since September 30, 2012, the Company concluded that there was no additional impairment needed in the carrying amount of its goodwill.

### *Valuation technique*

The Company uses the discounted cash flows ("DCF") method to determine the value in use of its cash-generating unit and has not made any changes to the valuation methodology used to assess goodwill impairment since the last annual impairment test.

### *Significant assumptions*

The income approach is predicated upon the value of the future cash flows that a business will generate going forward. The DCF method which was used as at September 30, 2012 and December 31, 2012 involves projecting cash flows and converting them into a present value equivalent through discounting. The discounting process uses a rate of return that is commensurate with the risk associated with the business or asset and the time value of money. This approach requires assumptions about revenue growth or decline rates, operating margins, tax rate and discount rate.

#### Growth or decline of revenue

The assumptions used were based on the Company's internal budget. The Company projected revenue, operating margins and cash flows for a period of four years that reflect lower demand and applied a perpetual long-term decline rate for the period thereafter. In arriving at its forecasts, the Company considered past experience, economic trends as well as industry and market trends.

#### Discount rate

The Company assumed a pre-tax discount rate to calculate the present value of its projected cash flows. The discount rate represented a weighted average cost of capital (“WACC”) for comparable companies operating in a similar industry. The WACC is an estimate of the overall required rate of return on an investment for both debt and equity owners and serves as the basis for developing an appropriate discount rate. Determination of the WACC requires separate analysis of the cost of equity and debt, and considers a risk premium based on an assessment of risks related to the projected cash flows.

The key assumptions used in performing the impairment test were as follows:

	<b>Assumptions</b>
Pre-tax discount rate	15.6%
Tax rate	25.8%
Perpetual decline rate	3.0%

#### *Sensitivity to changes in assumptions*

Management believes that an increase of 1% of the pre-tax discount rate or an increase of 1% of the perpetual decline rate, in isolation, would decrease the recoverable amount by approximately \$4.4 million.

#### ***Employee future benefits***

The Company sponsors defined benefit plans providing pension and other post-employment benefits to covered employees. The determination of expense and obligations associated with employee future benefits requires the use of assumptions such as the expected return on assets available to fund pension obligations, the discount rate to measure obligations, the expected mortality, the expected retirement age, the expected rate of future compensation increase and the expected healthcare cost trend rate. Because the determination of the cost and obligations associated with employee future benefits requires the use of various assumptions, there is measurement uncertainty inherent in the actuarial valuation. Actual results will differ from estimated results which are based on assumptions.

#### *Significant assumptions:*

Discount rate for accrued benefit obligation	3.90%
Discount rate for net pension cost	4.50%
Expected return on plan assets	6.00%
Rate of compensation increase	3.25%

#### Discount rate

As at December 31, 2012, we used the *Fiera Capital's CIA Method Accounting Discount Rate Curve* which follows the methodology suggested in the CIA Education Note on *Accounting Discount Rate Assumption for Pension and Post-employment Benefit Plans*. For the Company, a 0.25% increase or decrease in the discount rate would have decreased or increased the defined benefit obligation by approximately \$3.8 million as at December 31, 2012.

#### Expected rate or return

The expected rate of return on assets is based on the expected rate of return on each asset class category using a stochastic projecting tool that generates multiple expected-return scenarios over long periods of time for different asset classes. Expected fees payable by the plan are deducted from this expected rate of return. For the Company, a 0.25% increase or decrease in the expected rate of return would have decreased or increased pension expense by approximately \$0.2 million for the year 2012.

#### Rate of compensation

Future salary increases are based on expected future inflation rates.

#### Medical cost trend

The medical cost trend is based on our actuarial medical claims experience and future projections of medical costs. The average medical cost trend rate used was 6.7% for 2012, which is expected to decline to 2.5% in 2024. A one-percentage-point change in assumed health care cost trend rates would have no material impact.

#### ***Income taxes***

The Company computes an income tax provision in each of the jurisdictions in which it operates. However, the actual amount of the income tax expense becomes final only upon filing and acceptance of the tax return by the relevant authorities, which take place subsequent to the issuance of the financial statements. Additionally, estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions against future taxable income before they expire. The assessment is based upon existing tax laws and estimates of future taxable income. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period.

The Company is subject to taxation in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain during the normal course of business. The Company maintains provisions for uncertain tax positions that it believes appropriately reflect its risk with respect to tax matters under active discussion, audit, dispute or appeal with tax authorities, or which are otherwise considered to involve uncertainty. These provisions are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

The Company's 2012 effective tax rate was 26.1% of earnings before income tax. A 1% increase in the effective tax rate would have increased the 2012 income tax expense by approximately \$111,000.

### ***Impairment of long-lived assets***

Long-lived assets of the Company, including property, plant and equipment, are tested for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be fully recoverable. Impairment is assessed when the discounted expected future cash flows derived from an asset are less than its carrying amount. Impairment losses are recognized for the amount by which the carrying value of an asset exceeds its fair value. The Company periodically reviews the estimated useful lives of all long-lived assets and revises them if necessary.

### **New Accounting Policies**

#### ***Recent Accounting Pronouncements***

##### *IFRS 9, Financial Instruments*

In October 2010, the International Accounting Standards Board (“IASB”) issued IFRS 9, *Financial Instruments* (“IFRS 9”). IFRS 9, which replaces IAS 39, *Financial Instruments: Recognition and Measurement*, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity’s future cash flows.

##### *IFRS 10, Consolidated Financial Statements*

In May 2011, the IASB issued IFRS 10, *Consolidated Financial Statements* (“IFRS 10”). IFRS 10, which replaces SIC-12, *Consolidation – Special Purpose Entities* and part of IAS 27, *Consolidated and Separate Financial Statements*, provides additional guidance regarding the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.

##### *IFRS 12, Disclosure of Interests in Other Entities*

In May 2011, the IASB issued IFRS 12, *Disclosure of Interests in Other Entities* (“IFRS 12”). IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.

##### *IFRS 13, Fair Value Measurement*

In May 2011, the IASB issued IFRS 13 *Fair Value Measurement* (“IFRS 13”). IFRS 13 will improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS.

##### *IAS 1, Financial Statement Presentation*

In June 2011, the IASB issued amendments to IAS 1, *Financial Statement Presentation* (“IAS 1”). This amendment to IAS 1 will improve the presentation of the components of other comprehensive income.

##### *IAS 19, Employee Benefits*

In June 2011, the IASB issued amendments to IAS 19, *Employee Benefits* (“IAS 19”). This amendment to IAS 19 will improve the recognition and disclosure requirements for defined benefits plans.

These new standards are effective for the Company’s interim and annual consolidated financial statements commencing January 1, 2013. However, in December 2011, the IASB has postponed the mandatory application of IFRS 9, *Financial Instruments*, to January 1, 2015.

#### *IAS 32, Financial Instruments: Presentation*

In December 2011, the IASB issued amendments to IAS 32, *Financial Instruments: Presentation* (“IAS 32”) clarifying the requirements for offsetting financial assets and liabilities. The amendments shall be applied to annual periods beginning on or after January 1, 2014. The IASB also issued amendments to IFRS 7, *Financial Instruments: Disclosure* (“IFRS 7”) improving disclosure on offsetting of financial assets and liabilities. These amendments shall be applied to annual and interim periods beginning on or after January 1, 2013.

The Company is assessing the impact of these new standards on its consolidated financial statements.

#### **Recent Events**

On February 20, 2013, the Board of Directors has declared a quarterly dividend of \$0.03 per common share, payable on March 15, 2013 to shareholders of record at the close of business on March 4, 2013.

As permitted by the credit agreement, the Company requested on February 21, 2013 the cancellation of the \$25 million acquisition/capital expenditures credit facility effective February 22, 2013. No amount was drawn on this credit facility at that date.

#### **Risk Factors**

The results of operations, business prospects and financial condition of Supremex are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of Supremex’s management.

#### *Decline in Envelope Consumption*

Supremex’s envelope manufacturing business is highly dependent upon the demand for envelopes sent through the mail. Supremex may compete with product substitutes, which can impact demand for its products. Usage of the Internet and other electronic media continues to grow. Consumers use these media to purchase goods and services, and for other purposes such as paying utility and credit card bills. Advertisers use the Internet and electronic media for targeted campaigns directed at specific electronic user groups. Large and small businesses use electronic media to conduct business, send invoices and collect bills. The demand for envelopes and other printed materials for transactional purposes is expected to continue to decline in the future.

The North American envelope manufacturing and mailing industries are expected to continue to decline in the foreseeable future, due to a general progressive decline in the use of traditional paper-based products. The business depends on transactional mail and direct mail activities. Transactional mail volumes are thought to have declined in the last few years due in part to the increasing use of non-traditional means of communication and information transfer, such as facsimile machines, electronic mail and the Internet. While management believes that the significant decline experienced in the direct mail volume in the last few years was related to the economic conditions, we have no choice but to admit that many companies have reduced their marketing spend as well as redirected some of their overall marketing expenditures to other media channels. There is no assurance that the direct mail industry will regain. As a result, there can be no assurance that Supremex will be able to grow or even maintain historical sales levels.

To reduce this risk, the Company continually strives to improve operational efficiency and develop new products such as the RFID card protector.



### *Postal Services*

Because the majority of envelopes consumed in Canada and the United States are mailed, any strike or other work stoppage by unionized postal workers would result in a temporary suspension of the mail activities of most of Supremex's customers and could have a material adverse effect on Supremex. In the summer of 2011, there was a work stoppage at Canada Post that lasted about 3 weeks. During that period, envelope shipments to customers were slightly affected and some direct mail orders were cancelled. Adoption of e-billing also increased during that period. Many large corporations used the work stoppage at Canada Post to promote the advantages of e-billing. It is impossible to quantify the impact of the work stoppage due to its long-term potential effect.

In addition, postal rates are a significant factor affecting envelope usage and any increases in postal rates, relative to changes in the cost of alternative delivery means or advertising media, could result in reductions in the volume of mail sent. No assurance can be provided that future increases in postal rates will not have a negative effect on the level of mail sent or the volume of envelopes purchased.

Finally, there has been growing talk of "do-not-mail" legislation in the US with respect to the direct marketing industry. "Do-not-mail" legislation is instituted at the state level. In 2008, such legislation was introduced but not passed in some states. That being said, if such legislation were to be passed, it would have a negative impact on the Company's sales volume.

### *Relation with customers*

Supremex typically does not enter into long-term, written agreements with customers. As a result, there is a risk that customers may, without notice or penalty, terminate their relationship with Supremex at any time. In addition, even if customers decide to continue their relationship with Supremex, there can be no guarantee that they will purchase the same amount as in the past, or that purchases will be on similar terms. Supremex's customer base is solidly diversified with no single account representing more than 10% of sales, thus reducing dependence on any given single customer.

### *Competition*

Despite Supremex's leading market position in Canada, new entrants into the Canadian envelope market may have an impact on sales and margins. The strengthening of the Canadian dollar against the US dollar created an incentive for US-based competitors to increase market penetration in Canada in the last five years. The large US envelope manufacturers are using their excess capacity to penetrate the Canadian envelope market. As long as the US market stays relatively soft, there will be pricing pressure in the Canadian market. In the fall of 2008, the Canadian dollar weakened by almost 25% easing the pressure on the Canadian envelope market. Since then, the dollar has recovered most of its losses and has been trading close to parity with the US dollar, creating pressure on pricing in Canada. However, the costs of freight, coupled with the efficiency of delivery are barriers to servicing any significant customer volume from a distance.

In the current market, the Canadian envelope manufacturers are more aggressive on pricing in order to generate new sales to replace their lost sales. Given the Company's large market share in Canada, most of the gains of our smaller competitors in Canada are made in Supremex's accounts.

Nonetheless, to mitigate this risk, the Company continues to focus on continuous improvement programs, cost reduction initiatives and development of value-added services and products around its core businesses, and still believes in the value of having local service and representation in all the major Canadian markets.

### *Economic Cycles*

A significant risk that Supremex faces and over which it has no control is related to economic cycles. In a soft economy, the market most affected at Supremex is its direct mail market. There is a direct correlation between growth/decline in the gross domestic product and direct mail volume. Because of the economic conditions faced recently, we have experienced a significant direct mail volume decline. For Supremex, such impact is partially mitigated as direct mail represents approximately 20% of Supremex's total annual volume. For transactional mail, which represents about 50% of Supremex's annual volume, economic cycles had a lesser impact than on direct mail since businesses must still mail out bills to their customers, and the online billing penetration is fairly low in this segment. For many years, transactional volume has been declining.

### *Employee future benefits*

The Company maintains three registered defined benefit pension plans substantially covering all of its employees. Two of these plans are hybrid and included a defined contribution component. In the third quarter of 2012, the Company converted, for future services, its defined benefit pension plans into defined contributions plans. In the past, the Company has also provided post-retirement and post-employment benefits, including health care, dental care and life insurance, to a limited number of employees.

As at December 31, 2012, we estimated the solvency deficit at \$20.6 million.

The level of the contributions may vary depending on pension fund performance and the discount rate, which could affect the financial condition of Supremex.

### *Environment*

The Company operates in an industry which uses large quantities of paper in its day-to-day operations. With society's mounting concern over the protection of the environment and sustainable development, Supremex's products and services are under pressure to be more environmentally friendly. For instance, the growing concern over the environment could change the consumption habits of consumers and new regulations could force the Company to use more expensive environmentally friendly materials in its production process. To mitigate this risk, the Company tries to be at the forefront of its industry in terms of commitment to the environment and, in collaboration with its suppliers, seeks on an ongoing basis to reduce its impact on the environment. Supremex is also a leader in the Canadian envelope market in the marketing of environmental friendly products, such as 100% recycled paper.

### *Exchange Rate*

A portion of Supremex's revenue is earned in US dollars while a large portion of its expenses, including most of its paper and other raw materials costs as well as certain capital expenditures are incurred in US dollars. Supremex also derives a portion of its revenue from Canadian dollar sales to certain customers for whom selling price is sensitive to US competition.

Net exposure to the US dollar has decreased in 2012 due to lower US dollar purchases. Revenue generated in the United States represented 8.8% of consolidated revenue in fiscal 2012, up from 8.1% in fiscal 2011.

### *Availability of Capital*

In 2011, the Company completed the refinancing of its credit facilities totalling \$95 million consisting of a \$20 million revolving facility, a \$50 million term credit facility and a \$25 million acquisition/capital expenditures facility. The revolving and term credit facilities mature on November 4, 2015. The acquisition/capital expenditures facility matures on November 4, 2013 with the option to extend up to November 4, 2015 (see “Recent Events”). Although the Company carried out this refinancing successfully, there is no guarantee that additional funds will be available in the future, and if they are, that they will be provided in a timeframe and under conditions acceptable to the Company.

### *Raw Material Price Increases*

The primary raw materials the Company uses are paper, window material, glue and ink. Fluctuations in raw material and energy prices affect our operations.

First, the current tightening in the paper market, due to paper mill closures, has resulted in a decrease in the supply of paper which could in turn lead to paper price increases. While paper costs were generally a pass through in the past, an increase in the price of paper can negatively affect our operations if it changes the purchasing habits of our customers, especially in the current economic conditions. Moreover, an increase in the price of paper negatively affects Supremex’s profitability if the increases cannot be passed on to the customer. To mitigate this risk, the Company does not rely on any one supplier and is generally disciplined in passing on any raw material increases to its customers.

Fluctuations in the price of oil, a core ingredient in the composition of window material, glue and ink have a direct impact on their price. An increase in the price of oil can have a negative effect on our operations if it changes the purchasing habits of our customers.

### *Credit*

The Company is exposed to credit risk with respect to trade receivables. To mitigate this risk, the Company analyzes and reviews the financial health of its current customers on an ongoing basis. A specific credit limit is established for each customer and reviewed periodically by the Company. Supremex is protected against any concentration of credit risk through its clientele and geographic diversity. No single customer accounts for more than 10% of consolidated accounts receivable. Supremex’s customer base is solidly diversified and consists mainly of large national customers, such as large Canadian corporations, nationwide resellers and governmental bodies, as well as paper merchants and solution and process providers. Historically, the level of bad debt has been low given the nature of the customers. As at December 31, 2012, the maximum credit risk exposure for receivables corresponds to their carrying value.

### *Interest Rate*

The Company is exposed to market risks related to interest rate fluctuations. On January 14, 2011, a \$30 million interest swap was contracted. The Company’s policy is to fix a portion of its long-term debt. Under this swap, the fixed-rate portion represented 43% at the time it was entered into. Floating-rate debt bears interest rates based on bankers’ acceptances rate. This swap converts the variable interest rate, based on bankers’ acceptance rate, to an average fixed interest rate of 2.84% until January 14, 2016, excluding an applicable margin, which is 225 basis points as at December 31, 2012.

To mitigate this risk, the Company tries to maintain a good balance of fixed versus floating rate debt.

## *Litigation*

Supremex, like other manufacturing and sales organizations, is subject to potential liabilities connected with its business operations, including expenses associated with product defects, performance, reliability or delivery delays. Supremex is from time to time threatened with, or named as a defendant in, legal proceedings, including lawsuits based on product liability, personal injury, breach of contract and lost profits or other consequential damages claims, in the ordinary course of conducting its business. A significant judgment against Supremex or the imposition of a significant fine or penalty, as a result of a finding that Supremex failed to comply with laws or regulations, or being named as a defendant on multiple claims could have a material adverse effect on Supremex's business, financial condition, results of operations and cash available for distributions.

## **Forward-Looking Statements**

This MD&A contains "forward-looking statements" within the meaning of applicable Canadian securities laws, including (but not limited to) statements about the EBITDA projection, future performance of Supremex and similar statements concerning anticipated future results, circumstances, performance or expectations. A statement is forward-looking when it uses what Supremex knows and expects today to make a statement about the future. Forward-looking statements may include words such as anticipate, assumption, believe, could, expect, goal, guidance, intend, may, objective, outlook, plan, seek, should, strive, target and will. These statements relate to future events or future performance and reflect current assumptions, expectations and estimates of management regarding growth, results of operations, performance, business prospects and opportunities, Canadian economic environment and liability to attract and retain customers. Such forward-looking statements reflect current assumptions, expectations and estimates of management and are based on information currently available to Supremex as at the date of this MD&A.

Forward-looking statements are subject to certain risks and uncertainties, and should not be read as guarantees of future performance or results and actual results may differ materially from the conclusion, forecast or projection stated in such forward-looking statements. These risks, uncertainties and other factors include but are not limited to the following: economic cycles, availability of capital, decline in envelope consumption, increase of competition, exchange rate fluctuation, raw material increases, credits risks with respect to trade receivables, increase in funding of pension plans, postal services deficiencies, interest rates fluctuation and potential risk of litigation. Such assumptions, expectations, estimates, risks and uncertainties are discussed throughout our MD&A for fiscal 2012 and, in particular, in "Risk Factors". Consequently, we cannot guarantee that any forward-looking statements will materialize. Readers should not place any undue reliance on such forward-looking statements.

## **Definition of EBITDA and Non-IFRS Measures**

References to "EBITDA" are to earnings (loss) before financing charges, income tax expense, amortization of property, plant and equipment and of intangible assets, (gain) loss on disposal of property, plant and equipment and impairment of goodwill. Supremex believes that EBITDA is a measurement commonly used by readers of financial statements to evaluate a company's operational cash-generating capacity and ability to discharge its financial expenses.

EBITDA is not an earnings measure recognized under IFRS and does not have a standardized meaning prescribed by IFRS. Therefore, EBITDA may not be comparable to similar measures presented by other entities. Investors are cautioned that EBITDA should not be construed as an alternative to net earnings determined in accordance with IFRS as an indicator of the Company's performance.

**Additional Information**

Additional information relating to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

Consolidated Financial Statements

**Supremex Inc.**  
(Formerly Supremex Income Fund)

December 31, 2012 and 2011

All amounts expressed in Canadian dollars

## **INDEPENDENT AUDITORS' REPORT**

### **To the shareholders of Supremex Inc.**

We have audited the accompanying consolidated financial statements of Supremex Inc, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of (loss) earnings, comprehensive loss, changes in equity and cash flow for the years ended December 31, 2012 and 2011, and a summary of significant accounting policies and other explanatory information.

### **Management's responsibility for the consolidated financial statements**

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

### **Auditors' responsibility**

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Supremex Inc. as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years ended December 31, 2012 and 2011 in accordance with IFRS.

*Ernst & Young LLP<sup>1</sup>*

Montreal, Canada,  
March 11, 2013

<sup>1</sup> CPA auditor, CA, public accountancy permit no. A118111



**Supremex Inc.**

**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

As at December 31,	<i>Notes</i>	2012 \$	2011 \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash		5,093,876	2,606,332
Accounts receivable	5	15,071,817	18,740,499
Income tax receivable		11,115	—
Inventories	6	13,017,305	13,103,192
Prepaid expenses		605,258	512,584
<b>Total current assets</b>		<b>33,799,371</b>	<b>34,962,607</b>
Property, plant and equipment	7	28,264,702	29,528,673
Deferred income tax assets	8	176,426	—
Intangible assets	9	20,435,129	26,599,029
Goodwill	10	46,889,125	75,751,125
<b>Total assets</b>		<b>129,564,753</b>	<b>166,841,434</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	11	18,157,589	19,990,280
Provisions	12	426,311	656,567
Income tax payable		—	3,490,996
Current portion of secured credit facilities	13	5,000,000	5,000,000
<b>Total current liabilities</b>		<b>23,583,900</b>	<b>29,137,843</b>
Secured credit facilities	13	44,355,599	49,176,934
Deferred income tax liabilities	8	—	2,182,392
Accrued pension benefit liability	14	21,852,000	19,251,100
Other post-retirement benefit obligations	14	615,200	649,600
Derivative financial liability	13	1,251,154	1,776,293
<b>Equity</b>			
Share capital	15	9,885,008	10,000,000
Contributed surplus		280,108,017	280,423,746
Deficit		(252,002,146)	(225,680,313)
Foreign currency translation reserve		(83,979)	(76,161)
<b>Total equity</b>		<b>37,906,900</b>	<b>64,667,272</b>
<b>Total liabilities and equity</b>		<b>129,564,753</b>	<b>166,841,434</b>

Commitment, contingencies and guarantees [note 18]

Subsequent events [note 22]

See accompanying notes

On behalf of the Directors:

By: (Signed) Michael Rapps  
Director

By: (Signed) Gilles Cyr  
Director

**Supremex Inc.**

**CONSOLIDATED STATEMENTS OF (LOSS) EARNINGS**

Years ended December 31	Notes	2012 \$	2011 \$
<b>Revenue</b>		<b>131,874,631</b>	143,892,199
Operating expenses	6,17	89,996,324	96,209,379
Selling, general and administrative expenses	17	16,788,045	18,144,751
<b>Operating earnings before amortization, (gain) loss on disposal of property, plant and equipment, impairment of goodwill and restructuring expenses</b>		<b>25,090,262</b>	29,538,069
Amortization of property, plant and equipment	7	3,499,088	4,397,561
Amortization of intangible assets	9	6,163,900	6,163,900
(Gain) loss on disposal of property, plant and equipment		(17,517)	400,165
Impairment of goodwill	10	28,862,000	—
Restructuring expenses	12	—	1,089,401
<b>Operating (loss) earnings</b>		<b>(13,417,209)</b>	17,487,042
Financing charges	13	2,361,428	5,974,751
<b>(Loss) earnings before income taxes</b>		<b>(15,778,637)</b>	11,512,291
Income tax expense	8	2,912,035	3,197,417
<b>Net (loss) earnings</b>		<b>(18,690,672)</b>	8,314,874
<b>Basic and diluted net (loss) earnings per share</b>		<b>(0.6393)</b>	0.2838
<b>Weighted average number of shares outstanding</b>		<b>29,237,295</b>	29,297,767

*See accompanying notes*

**Supremex Inc.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

<b>Years ended December 31</b>	<b>Notes</b>	<b>2012</b>	<b>2011</b>
		<b>\$</b>	<b>\$</b>
<b>Net (loss) earnings</b>		<b>(18,690,672)</b>	8,314,874
<b>Other comprehensive loss</b>			
Recognized actuarial loss on defined benefit pension plans, net of income tax recovery of \$1,476,781 [2011 – \$4,091,882]	<b>14</b>	<b>(4,103,319)</b>	(11,818,418)
Recognized actuarial loss on other post-retirement benefit, net of income tax recovery of \$7,810 [2011 – \$9,944]	<b>14</b>	<b>(21,890)</b>	(28,656)
Foreign currency translation adjustments		<b>(7,818)</b>	7,518
<b>Other comprehensive loss</b>		<b>(4,133,027)</b>	(11,839,556)
<b>Total comprehensive loss</b>		<b>(22,823,699)</b>	(3,524,682)

*See accompanying notes*

## Supremex Inc.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Year ended December 31

	Share capital [notes 1 & 15] \$	Fund units [notes 1 & 15] \$	Contributed surplus [notes 1 & 15] \$	Deficit \$	Foreign currency translation reserve \$	Total equity \$
<b>As at December 31, 2011</b>	10,000,000	—	280,423,746	(225,680,313)	(76,161)	64,667,272
Net loss	—	—	—	(18,690,672)	—	(18,690,672)
Other comprehensive loss	—	—	—	(4,125,209)	(7,818)	(4,133,027)
Total comprehensive loss	—	—	—	(22,815,881)	(7,818)	(22,823,699)
Dividends declared [note 16]	—	—	—	(3,505,952)	—	(3,505,952)
Shares repurchased and cancelled [note 15]	(114,992)	—	(315,729)	—	—	(430,721)
<b>As at December 31, 2012</b>	<b>9,885,008</b>	—	<b>280,108,017</b>	<b>(252,002,146)</b>	<b>(83,979)</b>	<b>37,906,900</b>
<b>As at December 31, 2010</b>	—	282,798,322	7,625,424	(219,511,314)	(83,679)	70,828,753
Net earnings	—	—	—	8,314,874	—	8,314,874
Other comprehensive loss	—	—	—	(11,847,074)	7,518	(11,839,556)
Total comprehensive loss	—	—	—	(3,532,200)	7,518	(3,524,682)
Conversion into a corporation	282,798,322	(282,798,322)	—	—	—	—
Reduction of stated capital	(272,798,322)	—	272,798,322	—	—	—
Dividends declared	—	—	—	(2,636,799)	—	(2,636,799)
<b>As at December 31, 2011</b>	<b>10,000,000</b>	—	<b>280,423,746</b>	<b>(225,680,313)</b>	<b>(76,161)</b>	<b>64,667,272</b>

See accompanying notes

## Supremex Inc.

### CONSOLIDATED STATEMENTS OF CASH FLOW

Years ended December 31	Notes	2012 \$	2011 \$
<b>OPERATING ACTIVITIES</b>			
Net (loss) earnings		(18,690,672)	8,314,874
Non-cash adjustment to reconcile net earnings to net cash flows			
Amortization of property, plant and equipment	7	3,499,088	4,397,561
Amortization of intangible assets	9	6,163,900	6,163,900
Amortization of deferred financing costs	13	229,556	881,796
(Gain) loss on disposal of property, plant and equipment		(17,517)	400,165
Impairment of goodwill	10	28,862,000	—
(Gain) loss on valuation of derivative financial instruments	13	(525,139)	1,776,293
Deferred income tax recovery	8	(874,227)	(1,092,562)
Working capital adjustments			
Variation in accounts receivable		3,668,682	745,823
Variation in inventories		85,887	(1,163,472)
Variation in prepaid expenses		(92,674)	(87,391)
Variation in accounts payable and accrued liabilities		(1,832,691)	(121,532)
Variation in provisions		(230,256)	(274,730)
Variation in income tax receivable and payable		(3,502,111)	2,745,313
Change in accrued pension benefit liability		(2,979,200)	(3,643,500)
Change in other post-retirement benefit obligation		(64,100)	(37,300)
<b>Net cash flows from operating activities</b>		<b>13,700,526</b>	<b>19,005,238</b>
<b>INVESTING ACTIVITIES</b>			
Business acquisition		—	109,623
Acquisition of property, plant and equipment	7	(2,347,392)	(3,998,290)
Proceeds from sale of property, plant and equipment		107,417	336,611
Proceeds from sale of assets held for sale		—	5,727,170
<b>Net cash flows (used in) from investing activities</b>		<b>(2,239,975)</b>	<b>2,175,114</b>
<b>FINANCING ACTIVITIES</b>			
Repayment of term credit facility		(5,000,000)	(15,625,000)
Dividends paid	16	(3,505,952)	(2,636,799)
Financing cost incurred		(50,891)	(858,852)
Purchase of share capital for cancellation	15	(430,721)	—
Proceeds from revolving credit facility		—	709,114
Distributions paid on Fund units		—	(292,978)
<b>Net cash flows used in financing activities</b>		<b>(8,987,564)</b>	<b>(18,704,515)</b>
Net change in cash		2,472,987	2,475,837
Net foreign exchange difference		14,557	(18,379)
Cash, beginning of period		2,606,332	148,874
<b>Cash, ending of period</b>		<b>5,093,876</b>	<b>2,606,332</b>
<b>Supplemental information <sup>(1)</sup></b>			
Interest paid		2,660,394	3,135,932
Interest received		5,780	5,679
Income taxes paid		7,336,626	1,523,427
Income taxes received		167,409	29,370

<sup>(1)</sup> Amounts paid and received for interest and for income taxes were reflected as cash flows from operating activities in the consolidated statements of cash flows.

See accompanying notes

## Supremex Inc

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

#### 1. CORPORATE INFORMATION AND BASIS OF PREPARATION

Supremex Inc. (the “Company” or “Supremex”) was incorporated on March 31, 2006 under the *Canadian Business Corporation Act*. The common shares (“common share”) of the Company are listed on the Toronto Stock Exchange (“TSX”) under the symbol SXP. The registered office is located at 7213 Cordner Street in LaSalle, Quebec. The Company is the successor to Supremex Income Fund (the “Fund”) following the completion of the conversion of the Fund from an income trust to a corporation, on January 1, 2011 (the “Effective Date”).

On May 7, 2010, the unitholders of the Fund approved the plan of arrangement (the “Arrangement”) pursuant to which the Fund converted from an income trust structure to a public corporation named Supremex Inc. The final order of the Superior Court of Québec with respect to the Arrangement was obtained on May 10, 2010.

Under the Arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of Supremex.

The Arrangement has been accounted for as a continuity of interests of the Fund since Supremex continues to operate the business of the Fund and there are no ownership changes. Under the continuity of interest method of accounting, the transfer of the assets, liabilities and equity of the Fund to Supremex is recorded at the net book value as at the Effective Date of transaction. As a result, for accounting purposes, the transaction is required to be accounted for as though the Company was a continuation of the Fund but with its capital reflecting the exchange of Fund units for Supremex common shares. Therefore, certain terms such as shareholder/unitholder, dividend/distribution and share/unit may be used interchangeably throughout these consolidated financial statements. For the periods reported up to the Effective Date of the conversion, all payments to unitholders were in the form of fund unit distributions, and after that date all payments to shareholders were in the form of dividends.

Any references to the Fund for periods after January 1, 2011, shall mean Supremex Inc. as a successor of the Fund. References to “Company”, “share”, “dividends” and “shareholders” means “fund”, “unit”, “distributions” and “unitholders” for transactions that occurred before the conversion of the Fund into a corporation.

Pursuant to the Arrangement, the stated capital for the common shares was reduced to an amount of \$10 million as of the Effective Date.

The business of Supremex follows seasonal patterns with the highest revenue occurring from August to February due to seasonal advertising and mailing patterns of its customers since the highest number of mailings related to events including the return to school, fund-raising and the holiday and tax seasons take place during that period.

These consolidated financial statements were approved by the Company’s Board of Directors on March 11, 2013.

**Supremex Inc.**

## **NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

### **2. SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of preparation and statement of compliance**

These consolidated financial statements were prepared in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”). These consolidated financial statements were prepared on a going concern basis, under the historical cost convention, except for derivative financial instruments that have been measured at fair value.

#### **Principles of consolidation**

The consolidated financial statements comprise the financial statements of Supremex Inc. and its subsidiaries, Buffalo Envelope Inc., Montreal Envelope (2008) Inc. and Quebec Envelope (2008) Inc., as at December 31, 2012.

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intra-group balances, income and expenses, unrealized gains and losses and dividends resulting from intra-group transactions are eliminated in full.

#### **Business combinations and goodwill**

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at the fair value at the date of the acquisition. Acquisition costs incurred are expensed.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred over the Company’s net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

#### **Segment reporting**

The Company operates in one reporting segment: the manufacturing and sale of a broad range of stock and custom envelopes and related products.

#### **Foreign currency translation**

Supremex’s consolidated financial statements are presented in Canadian dollars, which is also its functional currency. Supremex and its subsidiaries each determine their own functional currency and items included in each of their financial statements are measured using that functional currency.

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

***Transactions and balances***

Transactions in foreign currencies are initially recorded by the entities at their respective functional currency rates prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the reporting date. All differences are taken to the consolidated statement of (loss) earnings.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

***Subsidiaries***

The assets and liabilities of foreign operations are translated into Canadian dollars at the rate of exchange prevailing at the reporting date and their statements of earnings are translated at exchange rates prevailing at the dates of the transactions. The exchange differences arising on translation are recognized in other comprehensive loss. On disposal of a foreign operation, the component of other comprehensive income relating to that particular foreign operation is recognized in the consolidated statement of (loss) earnings.

**Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable, net of estimated returns and discounts, and after eliminating intercompany sales.

Revenue from the sale of goods is recognized when the following criteria are met:

- The risks and rewards of ownership, including managerial involvement, have been transferred to the buyer;
- The amount of revenue can be measured reliably;
- The receipt of economic benefits is probable; and
- Costs incurred or to be incurred can be measured reliably.

In addition to the above general principles, the Company applies specific revenue recognition for bill and hold transactions. When customers request a bill and hold, revenue is recognized when the customer is invoiced for goods that have been produced, packaged and made ready for shipment. These goods are shipped within a specified period of time and are segregated from other inventory, the risk of ownership of the goods is assumed by the customer, and the terms and collection experience on the related billings are consistent with all other sales.

**Taxation**

Tax expense comprises current and deferred tax. Tax is recognized in the consolidated statement of (loss) earnings except to the extent it is related to items recognized in other comprehensive loss or directly in equity.



NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

*Current tax*

Current tax expense is based on the results for the year as adjusted for items that are not taxable or not deductible. Current tax is calculated using tax rates and laws that were enacted or substantively enacted at the end of the reporting period. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

*Deferred tax*

Deferred tax is recognized, using the liability method, on temporary differences at the reporting date arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated statement of financial position. Deferred tax is calculated using tax rates and laws that have been enacted or substantively enacted at the end of the reporting period, and which are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

*Deferred tax liabilities:*

- Are generally recognized for all taxable temporary differences;
- Are recognized for taxable temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and
- Are not recognized on temporary differences that arise from goodwill which is not deductible for tax purposes.

*Deferred tax assets:*

- Are recognized to the extent it is probable that taxable profits will be available against which the deductible temporary differences (carry-forward of unused tax credits and unused tax losses) can be utilized ; and
- Are reviewed at the end of the reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are not recognized in respect of temporary differences that arise on initial recognition of assets and liabilities acquired other than in a business combination. The transaction does not affect accounting profit or taxable profit upon completion. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

*Sales tax*

Revenues, expenses and assets are recognized net of the amount of sales tax, except:

- Where the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable;
- Accounts receivables and trade payables that are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of the accounts payable and accrued liabilities in the consolidated statement of financial position.

**Employee future benefits**

The Company maintains three defined benefit pension plans, two of which are hybrid as they also have a defined contribution component, covering substantially all of its employees. In the third quarter of 2012, the Company converted for future services its defined benefit pension plans into defined contribution plans. All defined benefit pension plans are funded. In the past, the acquired businesses have also provided post-retirement and post-employment benefits plans to a limited number of employees covering health care, dental care and life insurance. These benefits are unfunded.

For defined benefit pension plans and other post-employment benefits, the net periodic pension expense is actuarially determined on an annual basis by independent actuaries using the projected unit credit method. The determination of the net periodic pension expense requires assumptions such as the expected return on assets available to fund pension obligations, the discount rate to measure obligations, the expected mortality, the expected retirement age, the expected rate of future compensation increase and the expected healthcare cost trend rate. The assets are valued at fair value. Actual results will differ from estimated results which are based on assumptions. The vested portion of past service cost arising from plan amendments is recognized immediately in the consolidated statement of (loss) earnings. The unvested portion is amortized on a straight-line basis over the average remaining period until the benefits become vested.

The asset or liability recognized in the consolidated statement of financial position is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The present value of the defined benefit obligation for service accrued at calculation date is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating the terms of the related pension liability. All actuarial gains and losses that arise in calculating the present value of the defined benefit obligation and the fair value of plan assets are recognized immediately in other comprehensive loss. For funded plans, surpluses are recognized only to the extent that the surplus is considered recoverable taking into account future contributions for unfunded liability. Recoverability is primarily based on the extent to which the Company can unilaterally reduce future contributions to the plan.

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

Payments to defined contribution plans are expensed as incurred, i.e., as the related employee service is rendered.

**Share-based compensation plan**

The Company operates a cash-settled share-based compensation plan under which it receives services from employees as consideration. The cost of the cash-settled share-based plan is measured initially at fair value at grant date. This fair value is expensed over the period until the vesting date with recognition of a corresponding liability. The liability is re-measured to fair value at each reporting date up to and including the settlement date, with changes in fair value recognized in employee benefits expense.

**Termination benefits**

Termination benefits are generally payable when employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without realistic possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

**Basic and diluted net earnings per share**

The Company presents basic net earnings per share for its common shares, calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the year.

**Inventories**

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. The cost of finished goods and work-in-progress comprises raw materials, direct labour, other direct costs and related production overheads. Net realizable value is the estimated selling price in the normal course of business, less applicable variable selling expenses.

**Property, plant and equipment**

Property, plant and equipment are recorded at cost. Amortization is calculated using the straight-line method over the following estimated useful lives:

Buildings	10 to 40 years
Leasehold improvements	Lease term
Machinery and equipment	Seven to 15 years
Office equipment	Three to five years
Computer equipment	Three years

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

Residual values, method of amortization and useful lives are reviewed annually prior to year-end and adjusted if appropriate.

**Intangible assets**

Upon acquisition, identifiable intangible assets are recorded at fair value if they result from a business acquisition, if not, at cost and are carried at cost less accumulated amortization. Intangible assets acquired are comprised of customer relationships and non-compete agreements which are amortized on a straight-line basis over ten years.

**Impairment of non-financial assets**

Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use. Impairment losses, other than those relating to goodwill, are evaluated for potential reversals when events or changes in circumstances warrant such consideration.

The carrying values of all intangible assets and property, plant and equipment are reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. The Company bases its impairment calculation on detailed budgets and forecast calculations, which generally cover a period of four years.

**Impairment testing of goodwill**

Goodwill is tested for impairment annually as at December 31 or more often if events or changes in circumstances indicate that it might be impaired. The impairment test consists of a comparison of the recoverable amount of the cash-generating unit to which goodwill is assigned with its carrying amount. Any impairment loss in the carrying amount compared with the fair value is charged to earnings in the period in which the impairment occurs.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

### 2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

#### **Disposal of long-lived assets and discontinued operations**

Long-lived assets are classified as held for sale if the carrying amount will be recovered principally through a sale transaction rather than through continued use and such sale is considered highly probable with the asset available for immediate sale in its present condition. The criteria for classification as held for sale includes a firm decision by management or the board of directors to dispose of a business or a group of selected assets and the expectation that such disposal will be completed within a 12 month-period. Assets held for sale are measured at the lower of their carrying amounts or their fair value less costs to sell and are no longer amortized. Assets held for sale are classified as discontinued operations if the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes from the rest of the Company and they:

- Represent a separate major line of business or geographical area of operations;
- Are part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- Are a subsidiary acquired exclusively with a view to resale.

#### **Provisions**

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at the present value of the expected expenditures to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as financing charge.

#### ***Restructuring provisions***

Restructuring provisions are only recognized when general recognition criteria for provisions are fulfilled. Additionally, the Company needs to follow a detailed formal plan about the business or part of the business concerned, the location and number of employees affected, a detailed estimate of the associated costs and appropriate time-line. The people affected must also have a valid expectation that the restructuring is being carried out or the implementation has been initiated already.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as a financing charge.

#### **Leases**

Leases are classified as either operating or finance, based on the substance of the transaction at the inception of the lease. Classification is re-assessed if the terms of the lease are changed.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

*Operating lease*

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments under an operating lease are recognized in the consolidated statement of earnings on a straight-line basis over the period of the lease.

*Finance lease*

Leases in which substantially all the risks and rewards of ownership are transferred to the Company are classified as finance leases. Assets meeting finance lease criteria are capitalized at the lower of the present value of the related lease payments or the fair value of the leased asset at the inception of the lease. Minimum lease payments are apportioned between the finance charges and the liability. The finance charges are allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

**Financial instruments**

The Company classifies its financial assets in the following categories: at fair value through earnings or loans and receivables. The classification depends on the purpose for which the financial assets were acquired. The Company determines the classification of its financial assets at initial recognition.

*Fair value through earnings*

*Classification*

Financial assets are classified at fair value through earnings if acquired principally for the purpose of selling in the short-term, such as financial assets held for trading, or if so designated by the Company. Assets in this category principally include derivatives which do not qualify for hedge accounting and cash.

*Recognition and measurement*

Financial assets carried at fair value through earnings are initially recognized, and subsequently carried, at fair value, with changes recognized in the consolidated statement of (loss) earnings. Transaction costs are expensed.

*Loans and receivables*

*Classification*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Company's loans and receivables comprise accounts receivable in the consolidated statement of financial position.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]**

*Recognition and measurement*

Loans and receivables are initially recognized at fair value plus transaction costs and subsequently carried at amortized cost using the effective interest method.

*Impairment of financial assets*

At the end of each reporting period, the Company assesses whether there is objective evidence that a financial asset is impaired. Impairments are measured as the excess of the carrying amount over the fair value and are recognized in the consolidated statement of (loss) earnings.

*Financial liabilities*

Accounts payable and accrued liabilities, provisions and secured credit facilities are classified as financial liabilities. They are initially recognized at fair value and are subsequently carried at amortized cost using the effective interest method.

*Derivative financial instruments and hedging*

Derivatives are initially recognized at fair value on the date a contract is entered into and are subsequently re-measured at their fair value.

**3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS**

The preparation of the Company's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the end of the reporting period. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability affected in future periods.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

**Intangible assets and goodwill**

Intangible assets and goodwill arise out of business combinations for which the Company has applied the purchase method of accounting. The purchase method involves the allocation of the cost of an acquisition to the underlying net assets acquired based on their respective estimated fair value. As part of this allocation process, the Company must identify and attribute values and estimated lives to the intangible assets acquired. These determinations involve significant estimates and assumptions regarding cash flow projections, economic risk and weighted average cost of capital.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS [Cont'd]**

These estimates and assumptions determine the amount allocated to other identifiable intangible assets and goodwill as well as the amortization period for identifiable intangible assets with finite lives. If future events or results differ adversely from these estimates and assumptions, the Company could record increased amortization or impairment charges in the future [see note 10].

**Employee future benefits**

The Company sponsors defined benefit plans providing pension and other post-employment benefits to covered employees. The determination of expense and obligations associated with employee future benefits requires the use of assumptions such as the expected return on assets available to fund pension obligations, the discount rate to measure obligations, the expected mortality, the expected retirement age, the expected rate of future compensation increase and the expected healthcare cost trend rate. Because the determination of the cost and obligations associated with employee future benefits requires the use of various assumptions, there is measurement uncertainty inherent in the actuarial valuation process [see note 14]. Actual results will differ from estimated results which are based on assumptions.

**Income taxes**

The Company computes an income tax provision in each of the jurisdictions in which it operates. However, actual amounts of income tax expense only become final upon filing and acceptance of the tax return by the relevant authorities, which occur subsequent to the issuance of the financial statements. Additionally, estimation of income taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the ability to use the underlying future tax deductions against future taxable income before they expire. The assessment is based upon existing tax laws and estimates of future taxable income. To the extent estimates differ from the final tax return, earnings would be affected in a subsequent period.

The Company is subject to taxation in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain during the normal course of business. The Company maintains provision for uncertain tax positions that it believes appropriately reflect its risk with respect to tax matters under active discussion, audit, dispute or appeal with tax authorities, or which are otherwise considered to involve uncertainty. These provisions are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that, at some future date, an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

### 3. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS [Cont'd]

#### Impairment of long-lived assets

Long-lived assets of the Company, including property, plant and equipment, are tested for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be fully recoverable. Impairment is assessed when the discounted expected future cash flows derived from an asset are less than its carrying amount. Impairment losses are recognized for the amount by which the carrying value of an asset exceeds its fair value. The Company periodically reviews the estimated useful lives of all long-lived assets and revises them if necessary.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board ("IASB") or International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods beginning after January 1, 2013 or later periods. The standards impacted that are applicable to the Company are as follows:

- **IFRS 9, *Financial Instruments***  
In October 2010, the IASB issued IFRS 9, *Financial Instruments* ("IFRS 9"). IFRS 9, which replaces IAS 39, *Financial Instruments: Recognition and Measurement*, establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.
- **IFRS 10, *Consolidated Financial Statements***  
In May 2011, the IASB issued IFRS 10, *Consolidated Financial Statements* ("IFRS 10"). IFRS 10, which replaces SIC-12, *Consolidation – Special Purpose Entities* and part of IAS 27, *Consolidated and Separate Financial Statements*, provides additional guidance regarding the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company.
- **IFRS 12, *Disclosure of Interests in Other Entities***  
In May 2011, the IASB issued IFRS 12, *Disclosure of Interests in Other Entities* ("IFRS 12"). IFRS 12 is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles.
- **IFRS 13, *Fair Value Measurement***  
In May 2011, the IASB issued IFRS 13, *Fair Value Measurement* ("IFRS 13"). IFRS 13 will improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

4. RECENT ACCOUNTING PRONOUNCEMENTS [Cont'd]

- IAS 1, *Financial Statement Presentation*  
In June 2011, the IASB issued amendments to IAS 1, *Financial Statement Presentation* (“IAS 1”). This amendment to IAS 1 will improve the presentation of the components of other comprehensive income.
- IAS 19, *Employee Benefits*  
In June 2011, the IASB issued amendments to IAS 19, *Employee Benefits* (“IAS 19”). This amendment to IAS 19 will improve the recognition and disclosure requirements for defined benefits plans.

These new standards are effective for the Company’s interim and annual consolidated financial statements commencing January 1, 2013. However, in December 2011, the IASB has postponed the mandatory application of IFRS 9, *Financial Instruments*, to January 1, 2015.

- IAS 32, *Financial Instruments: Presentation*  
In December 2011, the IASB issued amendments to IAS 32, *Financial Instruments: Presentation* (“IAS 32”) clarifying the requirements for offsetting financial assets and liabilities. The amendments shall be applied to annual periods beginning on or after January 1, 2014. The IASB also issued amendments to IFRS 7, *Financial Instruments: Disclosure* (“IFRS 7”) improving disclosure on offsetting of financial assets and liabilities. These amendments shall be applied to annual and interim periods beginning on or after January 1, 2013.

The Company is assessing the impact of these new standards on its consolidated financial statements.

5. ACCOUNTS RECEIVABLE

	December 31, 2012	December 31, 2011
	\$	\$
Trade receivables	14,572,956	17,727,394
Less: Allowance for doubtful accounts	(108,514)	(237,360)
Trade receivables - net	14,464,442	17,490,034
Other receivables	607,375	1,250,465
	<b>15,071,817</b>	18,740,499

Trade receivables are non-interest bearing and are generally on 30-60 days terms.

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

5. ACCOUNTS RECEIVABLE [Cont'd]

The aging analysis of trade receivables at each reporting date was as follows:

	December 31, 2012 \$	December 31, 2011 \$
Current	9,627,835	11,990,422
31 – 60 days	3,768,323	4,411,804
61 – 90 days	955,385	910,264
91 – 120 days	126,620	203,123
Over 120 days	94,793	211,781
	<b>14,572,956</b>	<b>17,727,394</b>

Allowance for doubtful accounts

The changes in the allowance for doubtful accounts were as follows:

	December 31, 2012 \$	December 31, 2011 \$
Balance, beginning of year	237,360	62,714
Charge for the year	51,286	235,527
Utilized	(179,965)	(61,109)
Impact of foreign exchange (losses) gains	(167)	228
<b>Balance, end of year</b>	<b>108,514</b>	<b>237,360</b>

The Company is exposed to normal credit risk with respect to its accounts receivable and maintains provisions for potential credit losses. Potential for such losses is mitigated because there is no significant exposure to any single customer and because customer credit worthiness is evaluated before credit is extended.

6. INVENTORIES

	December 31, 2012 \$	December 31, 2011 \$
Raw materials	2,897,252	3,060,489
Work in progress	99,941	227,185
Finished goods	10,020,112	9,815,518
	<b>13,017,305</b>	<b>13,103,192</b>

The cost of inventories recognized as an expense and included in operating expenses, including the related amortization of property, plant and equipment allocated to inventories, during the year ended December 31, 2012 is \$93,283,795 [2011 - \$100,403,733].

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

7. PROPERTY, PLANT AND EQUIPMENT

	Land, buildings and leasehold improvements \$	Machinery and equipment \$	Office and computer equipment \$	Total \$
<b>Cost:</b>				
At December 31, 2010	13,781,844	33,434,176	1,331,843	48,547,863
Acquisition	1,743,492	2,104,479	150,319	3,998,290
Disposals	(343,129)	(1,337,413)	(28,831)	(1,709,373)
Transfer from assets held for sale	—	34,937	—	34,937
Translation adjustment	259	32,118	1,290	33,667
At December 31, 2011	15,182,466	34,268,297	1,454,621	50,905,384
Acquisition	61,074	2,111,666	174,652	2,347,392
Disposals	—	(448,965)	(5,823)	(454,788)
Translation adjustment	(255)	(28,209)	(1,451)	(29,915)
<b>At December 31, 2012</b>	<b>15,243,285</b>	<b>35,902,789</b>	<b>1,621,999</b>	<b>52,768,073</b>
<b>Amortization and impairment:</b>				
At December 31, 2010	1,903,043	15,203,247	991,628	18,097,918
Amortization	455,863	3,777,012	164,686	4,397,561
Disposals	(343,129)	(776,155)	(28,831)	(1,148,115)
Transfer from assets held for sale	—	21,577	—	21,577
Translation adjustment	267	6,017	1,486	7,770
At December 31, 2011	2,016,044	18,231,698	1,128,969	21,376,711
Amortization	444,908	2,884,910	169,270	3,499,088
Disposals	—	(359,065)	(5,823)	(364,888)
Translation adjustment	(255)	(5,834)	(1,451)	(7,540)
<b>At December 31, 2012</b>	<b>2,460,697</b>	<b>20,751,709</b>	<b>1,290,965</b>	<b>24,503,371</b>
<b>Net book value:</b>				
At December 31, 2011	13,166,422	16,036,599	325,652	29,528,673
<b>At December 31, 2012</b>	<b>12,782,588</b>	<b>15,151,080</b>	<b>331,034</b>	<b>28,264,702</b>

Effective October 1, 2011, the Company reviewed the useful lives of its main manufacturing equipment and determined that an adjustment was needed. The useful lives have been extended to at least five years considering their condition, which resulted in a decreased amortization charge of approximately \$0.4 million in 2011 and \$1.3 million in 2012. The expected impacts of this change in the upcoming years are a decrease in the amortization charge of approximately \$0.2 million in 2013 and a total increase of \$1.8 million for the years thereafter up to 2016.

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

8. INCOME TAXES

Income tax expense

The major components of income tax expense recognized in the consolidated statement of (loss) earnings were as follows:

	2012 \$	2011 \$
<b>Current income tax:</b>		
Current income tax expense	3,786,262	4,289,979
<b>Deferred income tax:</b>		
Reversal of temporary differences	(874,227)	(1,092,562)
<b>Income tax expense</b>	<b>2,912,035</b>	<b>3,197,417</b>

Income taxes on items recognized in other comprehensive loss were as follows:

	2012 \$	2011 \$
Deferred income tax related to items credited directly to equity during the year:		
Deferred tax benefit on recognized actuarial loss on defined benefit pension plans	(1,476,781)	(4,091,882)
Deferred tax benefit on recognized actuarial loss on other post-retirement benefit	(7,810)	(9,944)
<b>Income tax benefit charged to other comprehensive loss</b>	<b>(1,484,591)</b>	<b>(4,101,826)</b>

The income tax expense differs from the expense that would be obtained by applying the combined Canadian income tax (federal and provincial) as follows:

	2012 \$	2011 \$
(Loss) earnings before income taxes	(15,778,637)	11,512,291
Income tax (recovery) expense at combined federal and provincial statutory rate of 25.9% [2011 – 27.4%]	(4,085,089)	3,154,368
Impact of impairment of goodwill not deductible for tax purposes	6,969,268	—
Effect of change in enacted tax rates	43,331	88,245
Non-deductible expenses and other	(15,475)	(45,196)
<b>Income tax expense</b>	<b>2,912,035</b>	<b>3,197,417</b>

Changes in statutory rate mainly result from the reduction in the federal and Ontario corporation tax rate, as well as a change in the proportion of the Company's earnings in the two jurisdictions, which have different tax rates.

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

8. INCOME TAXES [Cont'd]

Deferred income tax

Deferred income tax relates to the following:

	Consolidated statement of financial position		Consolidated statement of (loss) earnings	
	December 31, 2012 \$	December 31, 2011 \$	2012 \$	2011 \$
<b>Deferred tax assets</b>				
Accrued pension benefit liability	5,657,000	4,950,263	770,044	932,089
Goodwill	1,932,948	1,625,168	(307,780)	214,665
Other	355,529	502,940	155,221	(3,419)
Derivative financial liability	323,898	456,759	132,861	(456,759)
Non-capital losses	31,684	162,123	130,439	11,621
Initial public offering expenses	—	—	—	211,362
	<b>8,301,059</b>	7,697,253	<b>880,785</b>	909,559
<b>Deferred tax liabilities</b>				
Intangible assets	4,422,905	5,891,375	1,468,470	1,471,686
Property, plant and equipment	3,310,146	3,448,338	138,192	370,900
Other	391,582	539,932	148,350	159,535
	<b>8,124,633</b>	9,879,645	<b>1,755,012</b>	2,002,121
<b>Deferred tax recovery</b>			<b>(874,227)</b>	(1,092,562)
<b>Net deferred income tax assets (liabilities)</b>	<b>176,426</b>	(2,182,392)		

*Reconciliation of net deferred tax assets (liabilities)*

	2012 \$	2011 \$
Balance – beginning of the year	(2,182,392)	(7,376,780)
Tax recovery during the year recognized in the consolidated statement of (loss) earnings	874,227	1,092,562
Tax benefit recognized in other comprehensive loss	1,484,591	4,101,826
<b>Balance – end of year</b>	<b>176,426</b>	(2,182,392)

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

9. INTANGIBLE ASSETS

	Customer relationships \$	Non-compete agreements \$	Total \$
<b>Cost</b>	<b>60,884,000</b>	<b>755,000</b>	<b>61,639,000</b>
<b>Accumulated amortization:</b>			
At December 31, 2010	28,517,239	358,832	28,876,071
Amortization	6,088,400	75,500	6,163,900
At December 31, 2011	34,605,639	434,332	35,039,971
Amortization	6,088,400	75,500	6,163,900
<b>At December 31, 2012</b>	<b>40,694,039</b>	<b>509,832</b>	<b>41,203,871</b>
<b>Net book value:</b>			
At December 31, 2011	26,278,361	320,668	26,599,029
<b>At December 31, 2012</b>	<b>20,189,961</b>	<b>245,168</b>	<b>20,435,129</b>

10. GOODWILL

	\$
Cost:	
At December 31, 2010	75,751,125
At December 31, 2011	75,751,125
Impairment of goodwill	(28,862,000)
<b>At December 31, 2012</b>	<b>46,889,125</b>

**Impairment test of goodwill**

During the third quarter of 2012, several new indicators have shown that the volume decrease in North America's envelope industry was higher than expected and that this decline is expected to continue in the upcoming years. This deterioration is particularly confirmed by the larger than expected decline in demand for uncoated fine paper; decline that has accelerated since June 2012. Negotiations and discussions with key customers in the third quarter have also shown to be a permanent reduction of their needs, some have even recently announced the abandonment of the use of envelopes for a portion of their activities.

Therefore, the Company has had to revise its financial projections and perform a goodwill impairment test as at September 30, 2012 instead of at December 31, 2012 which would be in accordance with its policy described in note 2. The recoverable value of the Company's only cash-generating unit, determined on the basis of value in use, was less than its carrying values. As a result, a goodwill impairment charge of \$28.9 million was recorded in the third quarter of 2012.

As at December 31, 2012, the Company has reviewed its goodwill impairment test and as no assumptions significantly changed since September 30, 2012, the Company concluded that there was no additional impairment needed in the carrying amount of its goodwill.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

10. GOODWILL [Cont'd]

*Valuation technique*

The Company uses the discounted cash flows (“DCF”) method to determine the value in use of its cash-generating unit and has not made any changes to the valuation methodology used to assess goodwill impairment since the last annual impairment test.

*Significant assumptions*

The income approach is predicated upon the value of the future cash flows that a business will generate going forward. The DCF method, which was used as at September 30, 2012 and as at December 31, 2012, involves projecting cash flows and converting them into a present value equivalent through discounting. The discounting process uses a rate of return that is commensurate with the risk associated with the business or asset and the time value of money. This approach requires assumptions about revenue growth or decline rates, operating margins, tax rate and discount rate.

*Growth or decline of revenue*

The assumptions used were based on the Company’s internal budget. The Company projected revenue, operating margins and cash flows for a period of four years that reflect lower demand and applied a perpetual long-term decline rate for the period thereafter. In arriving at its forecasts, the Company considered past experience, economic trends as well as industry and market trends.

*Discount rate*

The Company assumed a pre-tax discount rate in order to calculate the present value of its projected cash flows. The discount rate represented a weighted average cost of capital (“WACC”) for comparable companies operating in a similar industry. The WACC is an estimate of the overall required rate of return on an investment for both debt and equity owners and serves as the basis for developing an appropriate discount rate. Determination of the WACC requires separate analysis of the cost of equity and debt, and considers a risk premium based on an assessment of risks related to the projected cash flows.

The key assumptions used in performing the impairment test were as follows:

	<b>2012</b>	<b>2011</b>
Pre-tax discount rate	<b>15.6%</b>	15.8%
Tax rate	<b>25.8%</b>	25.7%
Perpetual decline rate	<b>3.0%</b>	0.0%

*Sensitivity to changes in assumptions*

Management believes that an increase of 1% of the pre-tax discount rate or an increase of 1% of the perpetual decline rate, in isolation, would decrease the recoverable amount by approximately \$4.4 million.



Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31, 2012 \$	December 31, 2011 \$
Trade payables	10,141,306	9,947,326
Accrued liabilities	8,016,283	10,042,954
	<b>18,157,589</b>	19,990,280

Trade payables are non-interest bearing and are normally settled on 20 to 60 day terms.

12. PROVISIONS

In connection with the acquisitions of NPG Envelope (“NPG”) in 2007, Montreal Envelope Inc. (“Montreal”) in 2008 and Pioneer Envelopes Ltd. (“Pioneer”) in 2010, the Company adopted a plan for the integration and restructuring of the acquired businesses. As a result, the Company recognized a provision for severance, relocation and exit costs relating to certain employees and facilities of the acquired businesses. As at December 31, 2012, the amount of the remaining accrued restructuring provision was \$0.4 million [\$0.5 million as at December 31, 2011]. This amount is related to deferred severance for employees on long-term disability and is payable on demand.

The Company incurred additional expenses during 2011 in the form of severances and other costs as a result of the restructuring to the Toronto and Montreal operations. The remaining balance, as at December 31, 2011, of \$0.2 million of these expenses were paid during the first quarter of 2012.

The following is a summary of amounts accrued and paid relating to restructuring expenses.

	December 31, 2012 \$	December 31, 2011 \$
Balance, beginning of year	656,567	931,297
Restructuring expenses charged against earnings	—	1,089,401
Cash payments	(230,256)	(1,364,131)
<b>Balance, end of year</b>	<b>426,311</b>	656,567

13. SECURED CREDIT FACILITIES

As at December 31, 2012, the Company has secured credit facilities consisting of a \$20 million revolving facility, a \$45 million term credit facility [\$50 million as at December 31, 2011] and a \$25 million acquisition/capital expenditures facility [see note 22]. The facilities bear interest at a floating rate based on the Canadian prime rate or bankers’ acceptance rates, plus an applicable margin on those rates.

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**13. SECURED CREDIT FACILITIES [Cont'd]**

The revolving credit facility may be used to refinance existing credit facilities, finance working capital requirements and for other general corporate purposes. The acquisition/capital expenditures facility may be used to finance permitted acquisitions and permitted capital expenditures.

The revolving and term credit facilities mature on November 4, 2015. The acquisition/capital expenditures credit facility matures on November 4, 2013 with the option to extend up to November 4, 2015. The term credit facility is repayable in quarterly principal instalments of \$1,250,000. In addition, 50% of the annual excess cash flow, as defined in the credit agreement, will be applied against the term credit facility if the debt to EBITDA ratio rises above 2.50, or 25% if the debt to EBITDA ratio falls between 2.50 and 2.00. No additional repayment is required if the debt to EBITDA ratio falls below 2.00, which was the case in 2011 and 2012.

Amounts owed under revolving and term credit facilities are as follows:

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
	<b>\$</b>	<b>\$</b>
Revolving credit facility	<b>5,000,000</b>	5,000,000
Term credit facility	<b>45,000,000</b>	50,000,000
Less: deferred financing costs, net	<b>(644,401)</b>	(823,066)
	<b>49,355,599</b>	54,176,934
Current portion	<b>(5,000,000)</b>	(5,000,000)
Long-term portion of secured credit facilities	<b>44,355,599</b>	49,176,934

Under the terms of the secured credit facilities, the Company is required, among other conditions, to meet certain covenants. The Company was in compliance with these covenants as at December 31, 2012. The secured credit facilities are collateralized by hypothec and security interests covering all present and future assets of the Company and its subsidiaries.

Minimum required payments on secured credit facilities are as follows:

	<b>\$</b>
2013	5,000,000
2014	5,000,000
2015	40,000,000

As at December 31, 2012, the effective interest rate on the revolving and term credit facilities was 3.54% (3.53% as at December 31, 2011). On January 14, 2011, the Company entered into an interest rate swap agreement for an amount of \$30 million at a fixed rate of 2.84% until January 14, 2016, excluding the applicable margin.

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**13. SECURED CREDIT FACILITIES [Cont'd]**

Financing charges are as follows:

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Interest on secured credit facilities	<b>2,629,629</b>	3,304,402
Other interest	<b>27,382</b>	12,260
Amortization of deferred financing costs	<b>229,556</b>	881,796
(Gain) loss on valuation of derivative financial instrument (interest rate swap)	<b>(525,139)</b>	1,776,293
	<b>2,361,428</b>	5,974,751

**14. EMPLOYEE DEFINED BENEFIT PLANS**

(a) Pension Plans

The Company maintains three defined benefit pension plans covering certain salaried and hourly employees. Two of these pension plans are hybrid because they also have a defined contribution component. All defined benefit pension plans are funded. During the third quarter of 2012, the Company converted, for future service, its defined benefit pension plans into defined contributions plans.

The defined benefit and defined contribution plans expenses included in operating, selling, general and administrative expenses are as follows:

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Defined benefit plans</b>		
Current service costs	<b>1,677,800</b>	2,399,700
Interest expense on benefit obligation	<b>4,058,600</b>	4,258,000
Expected return on plan assets	<b>(4,337,500)</b>	(4,613,000)
Defined benefit plans expense	<b>1,398,900</b>	2,044,700
Defined contribution plan expense	<b>938,700</b>	496,600
<b>Pension plans expense</b>	<b>2,337,600</b>	2,541,300

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

14. EMPLOYEE DEFINED BENEFIT PLANS [Cont'd]

The following table presents the changes in the accrued benefit obligation and the fair value of plan assets, as well as the funded status of the defined benefit plans.

	December 31, 2012 \$	December 31, 2011 \$
<b>Change in accrued benefit obligation</b>		
Benefit obligation, beginning of the year	91,597,100	78,380,400
Current service cost	1,677,800	2,399,700
Interest cost	4,058,600	4,258,000
Employees contribution	308,900	606,100
Actuarial losses on obligation	9,143,200	10,885,200
Benefits paid	(4,798,100)	(4,932,300)
<b>Benefit obligation, end of year</b>	<b>101,987,500</b>	<b>91,597,100</b>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of the year	72,346,000	73,126,800
Expected return on plan assets	4,337,500	4,613,000
Actuarial gains (losses)	3,563,100	(6,755,800)
Employees contribution	308,900	606,100
Employer contribution	4,378,100	5,688,200
Benefits paid	(4,798,100)	(4,932,300)
<b>Fair value of plan assets, end of year</b>	<b>80,135,500</b>	<b>72,346,000</b>
<b>Net amount recognized as accrued pension benefit liability</b>	<b>(21,852,000)</b>	<b>(19,251,100)</b>

The defined benefit plans amount recognized in other comprehensive loss, before taxation, is as follows:

	2012 \$	2011 \$
Actuarial losses	(5,580,100)	(17,641,000)
Asset limit and minimum funding adjustment	—	1,730,700
	<b>(5,580,100)</b>	<b>(15,910,300)</b>

The cumulative amount of actuarial losses recognized in the consolidated statement of comprehensive loss is \$23,410,000 as at December 31, 2012 [2011 - \$17,829,900].

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**14. EMPLOYEE DEFINED BENEFIT PLANS [Cont'd]**

The Company expects to contribute approximately \$3.4 million to its defined benefit and defined contribution pension plans in 2013.

The assumptions used in computing the net pension cost were as follows:

	<b>2012</b>	<b>2011</b>
	<b>%</b>	<b>%</b>
Discount rate for accrued benefit obligation	<b>3.90</b>	4.50
Discount rate for net pension cost	<b>4.50</b>	5.50
Expected return on plan assets	<b>6.00</b>	6.25
Rate of compensation increase	<b>3.25</b>	3.50

The expected rate of return on assets is based on the expected rate of return on each asset class category using a stochastic projection tool that generates multiple expected-return scenarios over long periods of time for different asset classes. Expected fees payable by the plan are deducted from this expected rate of return. The actual return on plan assets was a gain of \$7,900,600 for the year ended December 31, 2012 [2011 – loss of \$2,142,800].

The weighted average allocation of plan assets as at December 31 is as follows:

	<b>2012</b>	<b>2011</b>
	<b>%</b>	<b>%</b>
Equity securities	<b>67.9</b>	62.0
Debt	<b>29.0</b>	31.7
Cash and short-term securities	<b>3.1</b>	6.3
<b>Total</b>	<b>100.0</b>	100.0

The pension plans have an investment policy with the following target asset allocations: 57% equity securities, 42% debt securities and 1% short-term securities with a tolerable deviation of such allocation.

As of December 31, 2012 and 2011, there were no Supremex shares held in the Company's pension plans.

*Sensitivity analysis*

For the Company, a 0.25% increase or decrease in the discount rate would have decreased or increased the defined benefit obligation by approximately \$3.8 million as at December 31, 2012. A 0.25% increase or decrease in the expected rate of return would have decreased or increased the pension expense by approximately \$0.2 million for the year 2012.

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

14. EMPLOYEE DEFINED BENEFIT PLANS [Cont'd]

(b) Post-retirement benefits other than pension

The following tables provide a reconciliation of the change in the accrued benefit obligation of the plans.

	December 31, 2012 \$	December 31, 2011 \$
<b>Change in accrued benefit obligation</b>		
Benefit obligation, beginning of year	649,600	648,300
Interest cost	27,200	33,600
Benefits paid	(91,300)	(70,900)
Actuarial losses	29,700	38,600
<b>Benefit obligation, end of year</b>	<b>615,200</b>	<b>649,600</b>

Post-employment and other retirement benefits plans are not funded.

The other post-retirement benefit cost included in operating, selling, general and administrative expenses is composed of the interest cost on liability of \$27,200 for the year ended December 31, 2012 [2011 - \$33,600].

The other post-retirement benefits amount recognized in other comprehensive loss, before taxation, consists of actuarial losses of \$29,700 [2011 - \$38,600]. The cumulative amount of actuarial losses recognized in the consolidated statement of comprehensive loss is \$96,700 as at December 31, 2012 [2011 - \$67,000].

The assumptions used in the measurement of the Company's other post-retirement benefit cost were as follows:

	2012 %	2011 %
<b>Weighted-average assumptions</b>		
Discount rate for benefit obligation	3.90	4.50
Discount rate for net periodic benefit cost	4.50	5.50

As at December 31, 2012, the assumed health care trend rate for 2012 was 6.7%, progressively declining to 2.5% in 2024. A one-percentage-point change in assumed health care cost trend rates would have no material impact.

## Supremex Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

#### 15. SHARE CAPITAL

##### Share capital

An unlimited number of commons shares are issuable. Each common share represents a shareholder's proportionate undivided interest in the Company. Each common share confers to its holder the right to one vote at any meeting of shareholders and to participate equally and rateably in any dividends of the Company, if any, and, in the event of any required distribution of all of the property of the Company, in the net assets of the Company remaining after satisfaction of all liabilities.

##### Fund units

The Fund Declaration of Trust provided that an unlimited number of units may be issued. Each unit was transferable and represented an equal undivided beneficial interest in any distributions from the Fund and in the net assets of the Fund. All units were of the same class with equal rights and privileges. Each unit entitled the holder to participate equally in all allocations and distributions and to one vote at all meetings of unitholders for each whole unit held.

The Fund units were redeemable at any time at the option of the holder at the lesser of 90% of the weighted average price of the Fund unit during the last ten trading days of the units on an open market and the closing market price on the redemption date. All redemptions were subject to a maximum of \$50,000 in cash redemptions by the Fund in any particular month. Redemptions in excess of this amount would have been paid by way of a distribution *in specie* of the assets of the Fund.

The change in share capital and fund units was as follows:

	Supremex Income Fund		Supremex Inc.	
	Number of units	Fund units \$	Number of common shares	Share capital \$
Balance, as of December 31, 2010	29,297,767	282,798,322	—	—
Conversion into a corporation [note 1]	(29,297,767)	(282,798,322)	29,297,767	10,000,000
Balance, as of December 31, 2011	—	—	29,297,767	10,000,000
Purchase of share capital for cancellation	—	—	(336,900)	(114,992)
<b>Balance, as of December 31, 2012</b>	<b>—</b>	<b>—</b>	<b>28,960,867</b>	<b>9,885,008</b>

On January 1, 2011, all the outstanding units of the Fund were exchanged for common shares of Supremex on a one-for-one basis [see note 1].

Supremex Inc.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

15. SHARE CAPITAL / FUND UNITS [Cont'd]

Pursuant to the normal course issuer bid, which began on December 5, 2011, the Company could have purchased for cancellation up to 1,500,000 common shares until December 4, 2012. During the twelve month period ended December 31, 2012, the Company purchased for cancellation 336,900 common shares at a price ranging from \$1.05 to \$1.62 per common share and thus completed the normal course issuer bid. The excess of the cost of the common shares over their average book value of \$315,729 was accounted for as a reduction of contributed surplus.

16. DIVIDENDS

Dividends declared from January 1, 2012 to December 31, 2012 were as follows:

Declaration date	Record date	Payment date	Per share \$	Dividend \$
February 15, 2012	February 29, 2012	March 15, 2012	0.03	878,933
May 7, 2012	May 31, 2012	June 15, 2012	0.03	878,933
July 31, 2012	August 31, 2012	September 17, 2012	0.03	878,210
November 8, 2012	November 30, 2012	December 17, 2012	0.03	869,876
<b>Total</b>				<b>3,505,952</b>

Dividends declared from January 1, 2011 to December 31, 2011 were as follows:

Declaration date	Record date	Payment date	Per share \$	Dividend \$
March 18, 2011	March 31, 2011	April 15, 2011	0.03	878,933
June 17, 2011	June 30, 2011	July 15, 2011	0.03	878,933
November 8, 2011	November 30, 2011	December 15, 2011	0.03	878,933
<b>Total</b>				<b>2,636,799</b>

17. OPERATING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	2012 \$	2011 \$
Wages and salaries	33,513,477	35,870,921
Social security costs	4,999,024	5,424,341
Pension costs [see note 14]	2,337,600	2,541,300
Post-employment benefits other than pensions [see note 14]	27,200	33,600
Share-based program expense	(2,048)	18,257
Employee benefits expenses	40,875,253	43,888,419
Raw materials and other purchases	50,832,904	53,728,406
Other	15,076,212	16,737,305
	<b>106,784,369</b>	<b>114,354,130</b>



**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**18. COMMITMENTS, CONTINGENCIES AND GUARANTEES**

**Operating lease commitments**

The Company has entered into operating leases mainly for buildings.

Future minimum rentals payable under non-cancellable operating leases are as follows:

	<b>December 31, 2012</b>	<b>December 31, 2011</b>
	<b>\$</b>	<b>\$</b>
Within one year	<b>1,719,418</b>	1,682,755
After one year but not more than five years	<b>4,827,585</b>	4,418,416
More than five years	<b>830,096</b>	1,513,809
	<b>7,377,099</b>	7,614,980

**Legal claim**

In the normal course of its operations, the Company is exposed to various claims, disputes and legal proceedings. These disputes may involve numerous uncertainties and the outcome of individual cases is unpredictable. According to management, these disputes should not have a significant negative impact on the Company's financial position.

**Guarantees**

In the normal course of business, the Company has entered into agreements that contain features which meet the definition of a guarantee. These agreements may require the Company to compensate counterparties for costs and losses incurred as a result of various events including breaches of representations and warranties, loss of or damages to property, claims that may arise while providing services, and environmental liabilities. These agreements provide for indemnification and guarantees to counterparties as follows:

***Operating leases***

The Company has general indemnity clauses in many of its real estate leases whereby it, as lessee, indemnifies the lessor against liabilities related to the use of leased property. These leases mature at various dates through September 2019. The nature of the agreements varies based on individual contracts and this prevents the Company from estimating the total potential amount it would have to pay to lessors, if any. Historically, the Company has not made any significant payments under such agreements, has insurance coverage for certain of the obligations undertaken, and, as December 31, 2012, has not recorded any liability associated with these indemnifications.

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**19. RELATED PARTY TRANSACTIONS**

Compensation of key management personnel of Supremex is as follows:

	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Short-term employee benefits	<b>1,645,459</b>	1,933,249
Post-employment benefits	<b>77,409</b>	73,216
Share-based payment transactions	<b>(2,048)</b>	18,257
	<b>1,720,820</b>	2,024,722

The amounts disclosed in the table are the amounts recognized as an expense related to key management personnel during the reporting period.

During the year ended December 31, 2012, the Company has, in the normal course of business, received services in an amount of \$117,891 [2011 - \$34,674] from a major shareholder, Clarke Inc., and its subsidiaries.

**20. FINANCIAL INSTRUMENTS**

**Financial assets and liabilities**

Financial assets and liabilities in the statements of financial position were as follows:

<b>December 31, 2012</b>	<b>Loans and receivables</b>	<b>Assets at fair value through earnings</b>	<b>Derivatives</b>	<b>Other financial liabilities</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Cash	—	5,093,876	—	—	<b>5,093,876</b>
Accounts receivable	15,071,817	—	—	—	<b>15,071,817</b>
Accounts payable and accrued liabilities	—	—	—	(18,157,589)	<b>(18,157,589)</b>
Provisions	—	—	—	(426,311)	<b>(426,311)</b>
Secured credit facilities	—	—	—	(50,000,000)	<b>(50,000,000)</b>
Derivative financial liability	—	—	(1,251,154)	—	<b>(1,251,154)</b>
<b>Total</b>	<b>15,071,817</b>	<b>5,093,876</b>	<b>(1,251,154)</b>	<b>(68,583,900)</b>	<b>(49,669,361)</b>

**Supremex Inc.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****December 31, 2012 and 2011****20. FINANCIAL INSTRUMENTS [Cont'd]**

<b>December 31, 2011</b>	<b>Loans and receivables</b>	<b>Assets at fair value through earnings</b>	<b>Derivatives</b>	<b>Other financial liabilities</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Cash	—	2,606,332	—	—	2,606,332
Accounts receivable	18,740,499	—	—	—	18,740,499
Accounts payable and accrued liabilities	—	—	—	(19,990,280)	(19,990,280)
Provisions	—	—	—	(656,567)	(656,567)
Secured credit facilities	—	—	—	(55,000,000)	(55,000,000)
Derivative financial liability	—	—	(1,776,293)	—	(1,776,293)
<b>Total</b>	<b>18,740,499</b>	<b>2,606,332</b>	<b>(1,776,293)</b>	<b>(75,646,847)</b>	<b>(56,076,309)</b>

**Fair values**

The carrying value of financial assets designated as cash and accounts receivable and of financial liabilities designated as accounts payable and accrued liabilities, and provisions approximates their fair value since they are expected to be realized or settled in the short term.

The carrying amount of secured credit facilities approximates its fair value given its nature and floating interest rate.

The fair value of interest rate swap is measured using a generally accepted valuation technique, that is, the discounted value of the difference between the value of the swap based on variable interest rates (estimated using the yield curve for anticipated interest rates) and the value of the swap based on the swap's fixed interest rate. The Company's credit risk is also taken into consideration in determining fair value.

For the interest rate swap, the Company categorized the fair value measurement in Level 2, as it is primarily derived from observable market inputs, that is, interest rates.

**Management of risks arising from financial instruments**

In the normal course of business, the Company is exposed to a range of financial risks, which include credit risk, liquidity risk and market risk. To limit the effects of these risks on revenues, expenses and cash flows, the Company can avail itself of various derivative financial instruments. The Company's management is responsible for determining the acceptable level of risk and uses derivative financial instruments only to manage existing or anticipated risks, commitments or obligations based on past experience.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

## 20. FINANCIAL INSTRUMENTS [Cont'd]

**Credit risk**

Credit risk arises from cash and accounts receivables. In order to minimize the credit exposure, the Company's cash is placed with Canadian Schedule 1 banks.

Credit risk stems primarily from the potential inability of clients to discharge their obligations. Accounts receivable credit risk is mitigated through established monitoring activities, lack of customer concentration and the Company's diversified customer base. Historically, the Company has never made any significant write-off of accounts receivable. As at December 31, 2012 and 2011, total trade accounts receivable over 90 days past due amounted to less than 5% (see note 5). The Company does not hold collateral as security.

**Liquidity risk**

The Company is exposed to the risk of being unable to honour its financial commitments within the deadlines set out under the terms of such commitments and at a reasonable price. The Company manages liquidity risk by maintaining adequate cash balances and by appropriately using the Company's revolving credit facility. The Company continuously reviews both actual and forecasted cash flows to ensure that it has adequate credit facility capacity. The Company continuously reviews its exposure to interest rate fluctuations and has decided at this time to enter into a derivatives contract [see note 13].

The table below sets forth the contractual undiscounted cash flows of the non-derivative and derivative financial liabilities by maturity based on the remaining period from December 31, to the contractual maturity date.

<b>December 31, 2012</b>	<b>Less than 3 months \$</b>	<b>3 to 12 months \$</b>	<b>1 to 5 years \$</b>	<b>Total \$</b>
Accounts payable and accrued liabilities	18,157,589	—	—	18,157,589
Provisions	426,311	—	—	426,311
Secured credit facilities	1,250,000	3,750,000	45,000,000	50,000,000
Interest on secured credit facilities	520,864	1,463,970	3,317,127	5,301,961
Derivative financial liability	85,500	256,500	358,435	700,435
	<b>20,440,264</b>	<b>5,470,470</b>	<b>48,675,562</b>	<b>74,586,296</b>

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**20. FINANCIAL INSTRUMENTS [Cont'd]**

<b>December 31, 2011</b>	<b>Less than 3 months \$</b>	<b>3 to 12 months \$</b>	<b>1 to 5 years \$</b>	<b>Total \$</b>
Accounts payable and accrued liabilities	19,990,280	—	—	19,990,280
Provisions	656,567	—	—	656,567
Secured credit facilities	1,250,000	3,750,000	50,000,000	55,000,000
Interest on secured credit facilities	572,487	1,840,633	5,272,358	7,685,478
Derivative financial liability	104,250	312,750	696,000	1,113,000
	<b>22,573,584</b>	<b>5,903,383</b>	<b>55,968,358</b>	<b>84,445,325</b>

**Market risk**

Market risk is the risk that changes in market prices due to foreign exchange rates and interest rates will affect the value of the Company's financial instruments. The objective of market and risk management is to mitigate and control exposures within acceptable parameters while optimizing the return on risk.

*Interest rate risk*

The Company is exposed to interest rate fluctuations mainly on its secured credit facilities. The Company manages interest rate exposure by maintaining a balanced portfolio of fixed and variable loans and borrowings. Furthermore, interest rate fluctuations could have an impact on interest expense on its revolving and term credit facilities and on income the Company derives from cash. The Company invests its cash in highly liquid investment instruments to safeguard its capital while generating a reasonable return.

On December 31, 2012, a 25 basis-point rise or fall in interest rates, assuming all other variables remained unchanged, would have resulted, respectively, in a \$48,697 increase or decrease in the Company's net loss for the year ended December 31, 2012 [2011 - \$64,690].

*Foreign exchange risk*

The Company is exposed to fluctuations in US exchange rates because a portion of its activities are conducted in the United States and a portion of its purchases and capital expenditures are made in US dollars. The Company continuously reviews its exposure to fluctuations in the US exchange rate and has decided at this time not to enter into derivatives as the exposure is not significant.

As at December 31, 2012, net financial liabilities of the Company in Canadian dollars, denominated in US dollars, totalled \$2,690,690 [2011 - \$2,518,712].

## Supremex Inc.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2012 and 2011

#### 20. FINANCIAL INSTRUMENTS [Cont'd]

On December 31, 2012, a 5% rise or fall in the Canadian dollar against the US dollar, assuming all other variables remained unchanged, would have resulted, respectively, in a \$134,535 increase or decrease in the Company's net loss for the year then ended [2011 - \$125,936], whereas other comprehensive loss would have remained unchanged. However, the above change in net earnings may have been offset by adjustments in Canadian pricing required to remain competitive with imports from the United States, mainly in commodity products.

#### Capital management

The Company's capital consists of equity and secured credit facilities. The Company maintains a capital level that enables it to meet several objectives:

- Assure the longevity of its capital to support continued operations;
- Satisfy certain financial covenants under the secured credit facilities;
- Preserve its financial flexibility to benefit from potential opportunities as they arise; and
- Sustain growth in share value.

The Company continually assesses the adequacy of its capital structure and capacity and makes adjustments in view of the Company's strategy, economic conditions and the risk characteristics of the business to achieve the above objectives. The Company also monitors its capital to ensure full adherence to the "secured credit facilities/EBITDA" and "fixed charge covenant" ratios as defined in the credit facilities agreement.

The Company's capital structure is composed of equity, secured credit facilities, less cash. The capital structure of continuing operations is as follows:

	December 31, 2012	December 31, 2011
	\$	\$
Secured credit facilities	<b>50,000,000</b>	55,000,000
Cash	<b>(5,093,876)</b>	(2,606,332)
Net debt	<b>44,906,124</b>	52,393,668
Equity	<b>37,906,900</b>	64,667,272

The Company is not subject to any externally imposed capital requirements other than certain restrictions under the terms of its secured credit facilities, which relate mainly to permitted acquisitions.

#### 21. SEGMENTED INFORMATION

The Company currently operates in one reporting segment: the manufacturing and sale of envelopes. The Company's non-current assets amounted to \$94,919,075 in Canada and \$846,307 in the United States as at December 31, 2012 [\$130,876,557 and \$1,002,270, respectively, as at December 31, 2011]. The Company's revenue amounted to \$120,318,758 in Canada and \$11,555,873 in the United States for the year ended December 31, 2012 based on customer location [2011 - \$132,290,658 in Canada and \$11,601,541 in the United States, respectively].

**Supremex Inc.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**December 31, 2012 and 2011**

**22. SUBSEQUENT EVENTS**

On February 20, 2013, the Board of Directors has declared a quarterly dividend of \$0.03 per common share, payable on March 15, 2013 to shareholders of record at the close of business on March 4, 2013.

As permitted by the credit agreement, the Company requested on February 21, 2013 the cancellation of the \$25 million acquisition/capital expenditures credit facility effective February 22, 2013. No amount was drawn on this credit facility at that date.