



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
FOR THE THREE AND TWELVE-MONTH PERIODS ENDED DECEMBER 31, 2018**

*The following management's discussion and analysis of financial condition and results of operations ("MD&A"), dated February 20, 2019, of Supremex Inc. ("Supremex" or 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, 2018. 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, 2018.*

*The Company's shares are traded on the Toronto Stock Exchange under the symbol SXP. Additional information on Supremex may be found on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.supremex.com](http://www.supremex.com).*

*This MD&A contains forward-looking information. Please see "Forward-Looking Information" for a discussion of the risks, uncertainties and assumptions relating to these statements. This MD&A contains certain other non-IFRS financial measures. Terms by which non-IFRS financial measures are identified include EBITDA, "Adjusted EBITDA" and "Adjusted Net Earnings". 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 "Non IFRS measures: Definition of EBITDA, Adjusted EBITDA and Adjusted Net Earnings and "Reconciliation of Net Earnings to Adjusted EBITDA" and "Reconciliation of Net Earnings to Adjusted Net Earnings".*

## **Business Overview**

Supremex is a leading North American manufacturer and marketer of envelopes and a growing provider of paper-based packaging solutions. Supremex operates 12 facilities across seven provinces in Canada and three facilities in the United States employing approximately 810 people. Supremex' growing footprint allows it to efficiently manufacture and distribute paper and packaging solutions designed to the specifications of major national and multinational corporations, resellers, government entities, SMEs and solutions providers.

The Company manufactures a broad range of stock and custom envelopes in an array of styles, shapes and colours, which allows it to offer a high degree of flexibility and customization. It also manufactures and distributes a diverse range of packaging and specialty products, including corrugated boxes and high quality folding carton packaging. Other packaging and specialty products include the Conformer Products®, polyethylene bags for courier applications, bubble mailers, Enviro-logiX and Tyvek and other related products such as protective envelopes, X-ray envelopes, medical and file folders, repositionable notes, membership cards as well as labelling products.

## **Growth and Diversification Strategy**

To sustain long-term revenue and profitability growth, Supremex has been actively pursuing a three-pronged diversification strategy since 2014. First, the Company strengthened its market-leading position in the Canadian envelope market by leveraging its footprint through capacity allocation and acquiring Premier Envelope in 2015, a large supplier of envelopes in Western Canada. Second, by pursuing growth opportunities in the U.S. envelope market both organically and through the acquisition of Classic Envelope Inc. in the Northeast (in 2015), followed by the acquisition of Bowers Envelope Inc. in the Midwest (in 2016). Lastly, by building Supremex' packaging capabilities organically and through acquisitions, with the objective of significantly growing its revenues from this attractive growth market, specifically in the value-added folding carton and e-commerce markets.

The growth in e-commerce and changes in consumer behaviour have been significant growth drivers for the packaging, labels and specialty products markets. In 2016, the Company acquired Durabox Paper Inc. ("Durabox"), a manufacturer and distributor of corrugated paper boxes and, in 2017, acquired Stuart Packaging Inc. ("Stuart Packaging"), a manufacturer of specialty folding carton packaging solutions. In 2018, Supremex further expanded its specialty folding carton offering with the acquisition of Groupe Deux Printing Inc. ("G2 Printing") and Pharmaflex Labels Inc. ("Pharmaflex"). These three acquisitions in the paper packaging market represent an important building block of the Company's diversification strategy.

When Supremex first introduced this strategy in 2014 its revenues from the Canadian envelope market represented 81.4% of total revenues, the U.S. envelope market accounted for 11.2% of revenues and the packaging market, 7.4%. At the end of 2018, more than half of the Company's revenues came from a combination of the U.S. envelope market, which represents 22.2% of revenues, and the packaging market now reaching 29.2% of revenues compared with 19.3% at the end of 2017.

### **Fourth Quarter Financial Highlights and Recent Events**

- Revenue in Q4 2018 up by 9.7% year-over-year, to \$54.2 million from \$49.4 million.
- Revenue from packaging and specialty products accounted for 29.2% of sales, up from 26.2% in the fourth quarter of 2017.
- Adjusted EBITDA<sup>1</sup> stood at \$8.1 million, compared with \$8.0 million.
- Net Loss of \$12.4 million (or \$(0.44) per share) compared with Net Earnings of \$2.3 million (or \$0.08 per share) primarily as a result of a non-cash goodwill impairment charge of \$16.1 million related to the envelope operations.
- Adjusted Net Earnings<sup>1</sup> increased by 7.4% to \$4.7 million (or \$0.17 per share), compared with \$4.4 million (or \$0.16 per share).
- Announced and implemented a cost reduction plan to optimize envelope operations which resulted in an expense of \$1.2 million and is expected to generate cost savings of approximately \$2.7 million annually
- Approved a quarterly dividend of \$0.065 per share, equivalent to the same period of last year.

### **Fiscal Year Financial Performance Highlights**

- Revenue in 2018 up by 8.9% year-over-year, to \$195.1 million from \$179.1 million.
- Adjusted EBITDA<sup>1</sup> increased to \$26.8 million from \$26.5 million.
- Net Loss of \$4.8 million (or \$(0.17) per share) compared with Net Earnings of \$12.4 million (or \$0.43 per share) primarily as a result of a non-cash goodwill impairment charge of \$16.1 million related to the envelope operations.
- Adjusted Net Earnings<sup>1</sup> decreased by 4.2%, to \$14.1 million (or \$0.50 per share), compared with \$14.7 million (or \$0.52 per share)
- Declared a total of \$0.26 per share in dividends, an increase of 6.1% over the prior year.
- Purchased 125,000 common shares for cancellation under the Normal Course Issuer Bid ("NCIB") program, for total consideration of \$431,840.

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<sup>1</sup> Refer to the reconciliation of Net Earnings to Adjusted EBITDA and to the definition of Adjusted EBITDA and Adjusted Net Earnings in section Non-IFRS Measures.

## **Growing Focus on Packaging and Resource Allocation**

On December 7, 2018, the Company announced a plan to reduce operating expenses at its Canadian envelope operations to improve resource allocation and further support the Company's diversification strategy into the growing packaging market. Supremex announced it would reduce its Canadian envelope facilities headcount by a total of 41 employees, or approximately 8% of its Canadian envelope workforce. These measures will result in annual cost reductions of approximately \$2.7 million, before taxes, which will progressively materialize in the fourth quarter and will take full effect in 2019. A \$1.2 million restructuring charge was taken during the fourth quarter of 2018.

On May 1, 2018, the Company announced that it concluded the acquisition of Groupe Deux Printing Inc. ("G2 Printing") and its related company Pharmaflex Labels Inc. ("Pharmaflex") of Laval, QC, a leading manufacturer of premium quality folding carton packaging and labels primarily for the pharmaceutical industry. The transaction was concluded for a total cash consideration of \$11.6 million on a cash-free and debt-free basis. It employs approximately 60 people at two state-of-the-art facilities located in Laval, Quebec. Its customers include some of the largest multinational companies operating in the pharmaceutical and cosmetics industries. G2 Printing is known for its in-house pre-press operations and leading-edge manufacturing and printing technology.

During 2018, Supremex moved its Durabox operations and acquired new equipment to grow its corrugated sheet manufacturing capacity. The move to the new facility was completed in the fourth quarter.

On January 22, 2018, the Company closed its Printer Gateway Inc. ("Printer Gateway") operations. After a challenging post-acquisition transition in 2017, it was determined that this business required disproportionate management attention and resources to achieve acceptable profitability. The Company provisioned, in the fourth quarter of 2017, a total of \$0.2 million of non-recurring expenses related to the shutdown of this operation. Additionally, an impairment loss totaling \$2.0 million was also recorded in the fourth quarter of 2017 in connection with the write-down of the carrying amounts of goodwill, customer relations, intangibles and property, plant and equipment. No corresponding expenses were recorded in the year ended December 31, 2018 in connection with this shutdown.

For more information on the various business acquisitions of 2018 and 2017 and the detailed purchase price allocations, the reader should refer to note 5 to the audited consolidated financial statements for the year ended December 31, 2018.

## **Corporate Developments**

Islem Yezza joined the Company on March 1, 2018 and was appointed Vice-President and General Manager of Folding Carton operations during the third quarter of 2018. Mr. Yezza has over 10 years of progressive experience in the paper and packaging business and holds a degree in Chemical Engineering and a Ph.D. in Bioprocess Engineering.

On March 28, 2018, The Company appointed Guy Prenevost, CPA, CMA as Chief Financial Officer and Corporate Secretary effective April 16, 2018. Mr. Prenevost is a highly accomplished financial executive with more than 20 years of diversified experience in finance, sales and operations.

On May 9, 2018, the Company appointed two new independent Directors to join the Board, Nicole Boivin and Steven P. Richardson.

## Credit Facility

On July 3, 2018, the Company amended its committed senior secured revolving facility agreement maturing on October 6, 2020 to increase the amount of the facility to \$75 million.

## Declaration of Dividend

On February 20, 2019, the Board of Directors declared a quarterly dividend of \$0.065 per common share, payable on April 12, 2019, to the shareholders of record at the close of business on March 29, 2019. This dividend is designated as an “eligible” dividend for the purpose of the Income Tax Act (Canada) and any similar provincial legislation.

## Renewal of the Normal Course Issuer Bid (“NCIB”)

On August 3, 2018, the Company announced that it had received approval from the TSX to purchase by way of a NCIB, for cancellation, up to 500,000 of its common shares, representing approximately 1.77% of its 28,305,469 issued and outstanding common shares as of July 31, 2018. Purchases under the NCIB will be made through the facilities of the TSX or alternative trading facilities in Canada, if eligible, in accordance with applicable securities laws and regulations, over a maximum period of 12 months beginning on August 8, 2018 and ending on August 7, 2019.

## Summary of Financial Information and Non-IFRS Measures

### 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	
	2018	2017	2018	2017
<b>Revenue</b>	<b>54,150</b>	49,350	<b>195,087</b>	179,072
Operating expenses	<b>40,785</b>	36,115	<b>146,294</b>	130,325
Selling, general and administrative expenses	<b>5,397</b>	5,805	<b>24,708</b>	22,920
<b>Operating earnings before depreciation, amortization and other items</b>	<b>7,968</b>	7,430	<b>24,085</b>	25,827
Depreciation of property, plant and equipment	<b>1,286</b>	1,025	<b>4,295</b>	3,713
Amortization of intangible assets	<b>588</b>	497	<b>2,088</b>	1,682
Loss (gain) on disposal of property, plant and equipment	—	40	<b>(777)</b>	115
Goodwill impairment	<b>16,137</b>	—	<b>16,137</b>	—
Restructuring expenses	<b>1,219</b>	—	<b>1,219</b>	—
Shutdown of non-core operations of Printer Gateway	—	2,192	—	2,192
<b>Operating (loss) earnings</b>	<b>(11,262)</b>	3,676	<b>1,123</b>	18,125
Financing charges, net	<b>557</b>	399	<b>1,841</b>	1,078
<b>(Loss) earnings before income taxes</b>	<b>(11,819)</b>	3,277	<b>(718)</b>	17,047
Income tax expense	<b>607</b>	1,015	<b>4,075</b>	4,656
<b>Net (loss) earnings</b>	<b>(12,426)</b>	2,262	<b>(4,793)</b>	12,391
Basic and diluted net (loss) earnings per share	<b>(0.44)</b>	0.08	<b>(0.17)</b>	0.43
Dividend declared per share	<b>0.065</b>	0.065	<b>0.26</b>	0.245

## Revenue Information

(In millions of dollars)

	Three-month periods ended December 31		Twelve-month periods ended December 31	
	2018	2017	2018	2017
<b>Canadian Envelope</b>	<b>\$25.8</b>	\$25.5	<b>\$94.8</b>	\$102.1
Volume variation	-7.4%	-11.3%	-10.9%	-7.7%
Average selling price variation	9.2%	2.5%	4.2%	0.6%
Total variation	1.1%	-9.1%	-7.2%	-7.2%
<b>U.S. Envelope</b>	<b>\$12.6</b>	\$11.0	<b>\$43.4</b>	\$42.4
Volume variation	3.5%	5.4%	-4.0%	12.6%
Average selling price variation (in CAD)	11.2%	-6.5%	6.8%	-1.9%
Total variation	15.1%	-1.5%	2.5%	10.4%
<b>Packaging &amp; Specialty Products</b>				
Canada & U.S.	<b>\$15.8</b>	\$12.9	<b>\$56.9</b>	\$34.6
Total variation	22.2%	204.1%	64.4%	184.0%
<b>Total Revenue</b>	<b>\$54.2</b>	\$49.4	<b>\$195.1</b>	\$179.1
Revenue variation	9.7%	13.8%	8.9%	11.5%

## Reconciliation of Net (Loss) Earnings to Adjusted EBITDA

(In thousands of dollars)

	Three-month periods ended December 31		Twelve-month periods ended December 31	
	2018	2017	2018	2017
<b>Net (Loss) Earnings</b>	<b>(12,426)</b>	2,262	<b>(4,793)</b>	12,391
Income tax expense	607	1,015	4,075	4,656
Financing charges, net	557	399	1,841	1,078
Depreciation of property, plant and equipment	1,286	1,025	4,295	3,713
Amortization of intangible assets	588	497	2,088	1,682
<b>EBITDA<sup>(1)</sup></b>	<b>(9,388)</b>	5,198	<b>7,506</b>	23,520
Goodwill impairment	16,137	—	16,137	—
Restructuring expenses	1,219	—	1,219	—
Expense for contingent remuneration related to business combinations	—	577	1,623	827
New Durabox facility start-up costs	180	—	333	—
Shutdown of non-core operations of Printer Gateway	—	2,192	—	2,192
<b>Adjusted EBITDA<sup>(1)</sup></b>	<b>8,148</b>	7,967	<b>26,818</b>	26,539

<sup>(1)</sup> Refer to "Definition of EBITDA and Adjusted EBITDA in section Non-IFRS measures"

## Reconciliation of Net (Loss) Earnings to Adjusted Net Earnings

(In thousands of dollars)

	Three-month periods ended December 31		Twelve-month periods ended December 31	
	2018	2017	2018	2017
<b>Net (Loss) Earnings</b>	<b>(12,426)</b>	2,262	<b>(4,793)</b>	12,391
Adjustments, net of income taxes				
Goodwill impairment	16,137	—	16,137	—
Restructuring expenses	902	—	902	—
Expense for contingent remuneration related to business combinations	—	538	1,623	722
New Durabox facility start-up costs	133	—	246	—
Shutdown of non-core operations of Printer Gateway	—	1,620	—	1,620
<b>Adjusted Net Earnings</b> <sup>(1)</sup>	<b>4,746</b>	4,420	<b>14,115</b>	14,733

(1) Refer to "Definition of Adjusted Net Earnings in section Non-IFRS measures"

## Results of Operations

### *Three-month period ended December 31, 2018, compared with the three-month period ended December 31, 2017*

#### Revenue

Revenue for the three-month period ended December 31, 2018 increased by 9.7% or \$4.8 million, reaching \$54.2 million compared to \$49.4 million during the three-month period ended December 31, 2017. Revenue growth was experienced across all offerings, primarily from packaging and specialty products, which now represents 29.2% of the Company's revenues in the quarter, and from U.S. envelope sales.

Revenue from the Canadian envelope market grew to \$25.8 million, an increase of 1.1% or \$0.3 million from \$25.5 million recorded during the fourth quarter of 2017. Volume declined by 7.4%, primarily as a result of the combined effects of industry-wide secular decline, customer and contract movement and the impact of Canada Post labour friction and eventual strike action. Average selling prices increased by 9.2% following price increases to reflect input cost inflation. For reference, Canada Post Transactional Mail volumes were down 4.6% in their third quarter ended September 29, 2018<sup>2</sup>.

Revenue from the U.S. envelope market grew to \$12.6 million, an increase of 15.1% or \$1.6 million from revenue of \$11.0 million in the fourth quarter of 2017. The volume of units sold increased by 3.5% and average selling prices increased by 11.2% as a result of a combination of a more favorable product mix, increased customer prices implemented to mitigate rising input costs and from a favorable foreign exchange translation effect from a weaker Canadian dollar. For reference, the U.S. Postal Service First Class Mail volumes were down 3.6% during their fiscal year ended September 30, 2018<sup>3</sup>.

Revenue from packaging products stood at \$15.8 million, an increase of 22.2% or \$2.9 million from \$12.9 million in the equivalent quarter of the prior year, primarily from the acquisition of G2 Printing and Pharmaflex, concluded on April 30, 2018, and from organic growth in folding carton.

<sup>2</sup> Canada Post 2018 Third Quarter MD&A

<sup>3</sup> USPS 2018 Fiscal Results 10-K

### *Operating Expenses*

Operating expenses for the three-month period ended December 31, 2018, stood at \$40.8 million compared with \$36.1 million for the same period in 2017, an increase of \$4.7 million or 12.9%. The increase is in large part attributable to the acquisitions of G2 Printing and Pharmaflex and inflationary pressure on input costs, mainly paper and transportation and modest duplicate costs associated with the move and start-up of the Durabox project.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses totalled \$5.4 million for the three-month period ended December 31, 2018, compared with \$5.8 million for the same period in 2017, representing a decrease of \$0.4 million or 7.0%. Excluding the \$0.6 million provision for contingent remuneration in 2017, SG&A expenses were comparable to the equivalent quarter of 2017.

### *Adjusted EBITDA and Adjusted EBITDA Margins*

Adjusted EBITDA stood at \$8.1 million, an increase of \$0.2 million or 2.3% compared to the fourth quarter of 2017. Solid growth in the U.S. envelope business in the fourth quarter of 2018 and selling price increases in the Canadian envelope market mitigated some of the effects of the inflationary pressures on input costs, mainly paper and transportation. Fourth quarter 2018 Adjusted EBITDA margins stood at 15.1% of revenues compared with 16.1% in the equivalent quarter of 2017.

### *Depreciation and Amortization*

Depreciation and amortization expenses for the three-month period ended December 31, 2018, amounted to \$1.9 million, compared with \$1.5 million in the fourth quarter of 2017. The higher depreciation of property, plant and equipment and amortization of intangible assets are related to the Durabox project and to the acquisitions of G2 Printing and Pharmaflex.

### *Financing Charges*

Financing charges for the three-month period ended December 31, 2018, were \$0.6 million, compared to \$0.4 million during the equivalent quarter of the prior year, primarily from the higher debt used to finance the packaging acquisitions.

### *(Loss) Earnings Before Income Taxes*

As a result of the fluctuation in revenue and expenses described above, and from the \$16.1 million non-cash goodwill impairment charge related to the envelope operations, the loss before income taxes amounted to \$11.8 million during the three-month period ended December 31, 2018, compared with earnings before income taxes of \$3.3 million during the equivalent period of 2017.

### *Income Tax Expense*

Income taxes amounted to \$0.6 million during the three-month period ended December 31, 2018, compared with \$1.0 million in the equivalent quarter of last year, resulting from lower earnings before income taxes and the non-deductible effect of the goodwill impairment charge.

### *Net (Loss) Earnings and Adjusted Net Earnings*

Net loss of \$12.4 million (or \$(0.44) per share) for the three-month period ended December 31, 2018, compared with net earnings of \$2.3 million (or \$0.08 per share) for the equivalent period in 2017. Adjusted net earnings increased to \$4.7 million (or \$0.17 per share) for the three-month period ended December 31, 2018, compared with \$4.4 million (or \$0.16 per share) for the equivalent period in 2017.

### *Other Comprehensive Income*

The discount rate used to calculate the accrued plan benefit obligations decreased to 3.8% as at December 31, 2018, from 3.9% as at September 30, 2018. This decrease combined with a lower than expected return on assets generated a net actuarial loss of \$4.9 million during the fourth quarter ended December 31, 2018.

### ***Twelve-month period ended December 31, 2018, compared with the twelve-month period ended December 31, 2017***

#### *Revenue*

Revenue for the twelve-month period ended December 31, 2018, increased by 8.9% or \$16.0 million, reaching \$195.1 million compared to \$179.1 million during the twelve-month period ended December 31, 2017. Revenue growth comes mainly from packaging and specialty products, and to a lesser extent, from U.S. envelope sales.

Revenue from the Canadian envelope market was \$94.8 million, a decrease of 7.2% or \$7.3 million from \$102.1 million during the twelve-month period of 2017. This variance comes from a reduction of 10.9% in units sold primarily from the combined effects of industry-wide secular decline, contract and customer movement and the impact of Canada Post labour friction and eventual strike action. Average selling prices increased by 4.2% reflecting inflation cost passthrough. For reference, Canada Post Transactional Mail volumes were down 4.9% during the first three quarters of 2018<sup>4</sup>.

Revenue from the U.S. envelope market stood at \$43.4 million, an increase of 2.5% or \$1.0 million from revenue of \$42.4 million recorded during the equivalent twelve-month period of 2017. The volume of units sold decreased by 4.0%, primarily from the Company's strategic decision not to renew an underpriced contract earlier in 2018 and the expiration of a strategic production alliance with a long-standing commercial partner. Average selling prices increased by 6.8%, reflecting input cost inflation pass through and the impact of the aforementioned expiration of the strategic production alliance.

Revenue from packaging products stood at \$56.9 million, an increase of 64.4% or \$22.3 million compared to the prior year, primarily resulting from the acquisitions of Stuart Packaging on a full year effect, G2 Printing and Pharmaflex during the year, and from organic growth in packaging offerings.

#### *Operating Expenses*

Operating expenses for the twelve-month period ended December 31, 2018, stood at \$146.3 million compared with \$130.3 million for the same period in 2017, an increase of \$16.0 million or 12.3%. The increase is mainly attributable to the acquisitions of Stuart Packaging on a full year basis, G2 Printing and Pharmaflex, and inflationary pressures on input costs, mainly paper and transportation. Printer-Gateway's non-core operations, shutdown on January 22, 2018, represented \$2.7 million of additional operating expenses in the equivalent period of 2017.

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<sup>4</sup> Canada Post 2018 Third Quarter MD&A



### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses totaled \$24.7 million for the twelve-month period ended December 31, 2018, compared with \$22.9 million for the same period in 2017, an increase of \$1.8 million or 7.8% primarily due to the above-mentioned acquisitions, and to the \$1.6 million expense in connection with the contingent remuneration (or “earn-out”) related to the acquisition of Stuart Packaging, compared with \$0.8 million in contingent remuneration expensed for the year ended December 31, 2017.

### *Adjusted EBITDA and Adjusted EBITDA Margins*

Adjusted EBITDA stood at \$26.8 million for the twelve-month period ended December 31, 2018, compared with \$26.5 million for the equivalent period in 2017, representing an increase of 1.1%. The positive EBITDA contribution from the Company’s packaging operations was mitigated by the loss of envelope volume in Canada combined with inflationary pressures on input costs, mainly paper and transportation. Adjusted EBITDA margins stood at 13.8% compared with 14.8% in the equivalent period of last year.

### *Depreciation and Amortization*

Depreciation and amortization expenses for the twelve-month period ended December 31, 2018, amounted to \$6.4 million, compared with \$5.4 million in the comparable period of 2017. The higher depreciation of property, plant and equipment and amortization of intangible assets are related to the acquisitions of Stuart Packaging, G2 Printing and Pharmaflex.

### *Gain on Disposal of Property, Plant and Equipment*

The Company recognized a gain of \$0.8 million on the disposal of property, plant and equipment mainly from the sale of equipment to a commercial partner upon the end of a strategic production alliance in the U.S. envelope market during the second quarter of 2018 and from the disposal of a building in Mississauga, Ontario and Printer Gateway’s manufacturing equipment during the third quarter of 2018.

### *Financing Charges*

Financing charges for the twelve-month period ended December 31, 2018, stood at \$1.8 million, compared to \$1.1 million during the equivalent period of the prior year, primarily from the higher debt used to finance the acquisitions of G2 Printing and Pharmaflex.

### *(Loss) Earnings Before Income Taxes*

As a result of the fluctuation in revenue and expenses described above and from the \$16.1 million non-cash goodwill impairment charge related to the Company’s envelope operations in the fourth quarter of 2018, earnings before income taxes decreased to \$(0.7) million during the twelve-month period ended December 31, 2018, compared with \$17.0 million during the equivalent period of 2017.

### *Income Tax Expense*

Income taxes amounted to \$4.1 million during the twelve-month period ended December 31, 2018 compared with \$4.7 million in the equivalent twelve-month period of last year.

### Net (Loss) Earnings and Adjusted Net Earnings

Net loss stood at \$4.8 million (or \$(0.17) per share) for the twelve-month period ended December 31, 2018, compared with net earnings of \$12.4 million (or \$0.43 per share) for the equivalent period in 2017. Adjusted net earnings stood at \$14.1 million (or \$0.50 per share) for the twelve-month period ended December 31, 2018, compared with \$14.7 million (or \$0.52 per share) for the equivalent period in 2017.

### Other Comprehensive Income

The discount rate used to calculate the accrued plan benefit obligations increased to 3.9% as at December 31, 2018, from 3.4% as at December 31, 2017. This increase offset the lower than expected return on assets resulting of a net actuarial gain of \$0.5 million.

### Segment Information

The Company currently operates in one reporting segment: the manufacturing and sale of envelopes, packaging and specialty products. The Company's non-current assets amounted to \$94.5 million and \$11.9 million in the United States as at December 31, 2018, compared with \$99.7 million and \$11.1 million respectively as at December 31, 2017.

For the three-month period ended December 31, 2018, the Company's revenue in Canada was \$36.8 million, up 11.1% compared with \$33.1 million in the equivalent period of 2017 and was at \$17.4 million in the United States, an increase of 7.0% from \$16.3 million in the equivalent period of 2017.

For the twelve-month period ended December 31, 2018, the Company's revenue in Canada was \$130.0 million, an increase of 4.2% from \$124.8 million in the equivalent period of 2017 and was \$65.1 million in the United States, an increase of 19.9% from \$54.3 million in the equivalent period of 2017.

For the three-month period ended December 31, 2018, the Company's revenue from envelopes was \$38.3 million, an increase of 5.3% from \$36.4 million in the equivalent period of 2017. Revenue from packaging and specialty products was \$15.8 million, an increase of 22.2% from \$12.9 million in the equivalent period of 2017.

For the Twelve-month period ended December 31, 2018, the Company's revenue from envelopes was \$138.2 million, a decrease of 4.3% from \$144.5 million in the equivalent period of 2017. Revenue from packaging and specialty products was \$56.9 million, an increase of 64.4% from \$34.6 million in the equivalent period of 2017.

### Summary of Quarterly Operating Results from January 1, 2017 to December 31, 2018

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

	Dec. 31 2018	Sep. 30 2018	June 30 2018	Mar. 31 2018	Dec. 31 2017	Sep. 30 2017	June 30 2017	Mar. 31 2017
Revenue	54,150	45,158	46,845	48,933	49,350	43,424	41,147	45,151
Adjusted EBITDA <sup>(1)</sup>	8,148	5,328	6,727	6,614	7,967	6,279	5,398	6,895
Earnings before income taxes	(11,819)	1,995	4,527	4,579	3,277	4,238	4,017	5,514
Net (loss) earnings	(12,426)	1,153	3,135	3,345	2,262	3,214	2,833	4,081
Net (loss) earnings per share	(0.44)	0.04	0.11	0.12	0.08	0.11	0.10	0.14
Adjusted net earnings	4,746	2,264	3,391	3,601	4,420	3,399	2,833	4,081
Adjusted net earnings per share	0.17	0.08	0.12	0.13	0.16	0.12	0.10	0.14

<sup>(1)</sup> Refer to "Definition Adjusted EBITDA, Adjusted Net Earnings in section non-IFRS measures"

## Seasonality

Supremex' revenue is subject to the seasonal advertising and mailing patterns of its customers. The number of envelopes 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, the holidays and tax seasons. The number of envelopes sold by Supremex is generally lower during spring and summer in anticipation of a slowdown in mailing activities of businesses during the summer.

Revenues from packaging and specialty products are subject to a mix of linear (i.e. specialty folding cartons for large multinational customers) and seasonal patterns related to the holidays and sporting events (i.e. innovative protective packaging solutions for e-commerce or corrugated boxes for food delivery) which the contribution is currently less significant. As such, there is currently little to no seasonal effect on Supremex' total revenues.

As a result, Supremex' 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 uses warehouse capabilities to stock envelopes as required and thereby counter predictable seasonal variations in sales volume.

## Financial Position and Capital Resources

### Financial Position Highlights

*(In thousands of dollars)*

	December 31, 2018	December 31, 2017
Working capital	30,620	25,020
Total assets	159,703	157,924
Secured credit facility	53,894	42,831
Total equity	75,661	86,519

The increase in working capital, total assets and secured credit facility balances at December 31, 2018 when compared to December 31, 2017 is mainly driven by the business acquisitions of G2 Printing and Pharmaflex. The decrease in total equity results from the \$16.1 million goodwill impairment related to the envelope cash generating unit.

### Summary of Cash Flows

*(In thousands of dollars)*

	Three-month periods ended December 31		Twelve-month periods ended December 31	
	2018	2017	2018	2017
Operating activities	2,907	5,739	11,937	15,932
Investing activities	(1,822)	(332)	(16,051)	(25,000)
Financing activities	(1,253)	(5,821)	3,379	8,085
Net foreign exchange difference	239	24	338	(275)
Net change in cash	71	(390)	(397)	(1,258)

#### *Cash Flows from Operating Activities*

Net cash flows from operating activities stood at \$11.9 million during the twelve-month period ended December 31, 2018, compared with \$15.9 million in the equivalent period of 2017. This variation results mainly from lower net earnings and from inventory build-up related to the Company's decision to invest in increasing Durabox' production capacity, and the increase in input costs.

### *Cash Flows used in Investing Activities*

Net cash flows used in investing activities amounted to \$16.1 million during the twelve-month period ended December 31, 2018, compared with \$25.0 million used in the equivalent period of 2017, mainly resulting from lower cash used in business combinations and from higher proceeds from the sale of property, plant and equipment in the current year.

### *Cash Flows from Financing Activities*

Net cash flows from financing activities stood at \$3.4 million during the twelve-month period ended December 31, 2018, compared with \$8.1 million in the equivalent period of 2017 and results mainly from the decrease in the use of the secured credit facility to fund business acquisitions.

### *Financial Position and Capital Resources Summary*

The Company's ability to generate cash flows from operations combined with its availability under existing credit facilities are expected to provide sufficient liquidity to meet anticipated needs for existing and future projects.

### **Contractual Obligations and Off-Balance Sheet Arrangements**

The following chart outlines the Company's contractual obligations as at December 31, 2018.

(in thousands of dollars)

	Payments due by fiscal year			2021 and thereafter
	Total	2019	2020	
Secured credit facility	54,014	—	54,014	—
Operating leases	25,298	4,946	4,330	16,022
Total	79,312	4,946	58,344	16,022

The Company has no other off-balance sheet arrangements.

### **Financing**

On July 3, 2018, the Company amended its committed senior secured revolving facility agreement maturing on October 6, 2020 to increase the amount of the facility to \$75 million. No principal repayments are required prior to maturity. This facility bears interest at a floating rate based on the Canadian prime rate plus an applicable margin that ranges between 0% and 0.50% or bankers' acceptance rates, plus an applicable margin that ranges between 1.50% and 2.00%.

The secured credit facility is used for working capital, capital expenditure and other general corporate purposes. It is collateralized by hypothec and security interests covering all assets of the Company and its subsidiaries and is subject to certain covenants, which the Company is required, among other conditions, to meet. The Company was in compliance with these covenants in 2018 and as at December 31, 2018.

As at December 31, 2018 and 2017, the Company had outstanding letter of credit for a total of \$10,000.

### **Capitalization**

As at February 20, 2019, the Company had 28,280,469 common shares outstanding, representing a reduction of 125,000 when compared to the 28,405,469 shares outstanding as at December 31, 2017.

## **Execution of Normal Course Issuer Bid (“NCIB”)**

The Company purchased 125,000 common shares for cancellation under its NCIB program for a total consideration of \$431,840 since January 1, 2018.

## **Financial Instruments**

### *Interest rate and foreign exchange risk*

The Company’s credit facility bear interest at a floating rate which gives rise to the risk that its earnings and cash flows may be adversely affected by fluctuations in interest rates.

The Company operates in Canada and the United States, which exposes its earnings and cash flows to fluctuations in the exchange rate between the U.S. and Canadian dollar. A portion of Supremex’ revenue is earned in U.S. 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 U.S. dollars. Supremex also derives a portion of its revenue from Canadian dollar sales to certain customers for whom the selling price is sensitive to U.S. competition (see “Risk Factors”). Cash, accounts receivable, accounts payable and accrued liabilities include balances denominated in U.S. dollars at the end of the year.

### *Fair value*

The fair value of the Company’s financial instruments is indicated in note 22 to the Company’s audited consolidated financial statements for the year ended December 31, 2018.

## **Disclosure Controls and procedures (“DC&P”) and Internal Controls over Financial Reporting (“ICFR”)**

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 and the Chief Financial Officer, 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 and the Chief Financial Officer, 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, 2018.

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 and the 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, 2018. In making its evaluation, the President and Chief Executive Officer and the 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, 2018, that materially affected, or is likely to materially affect, the Company’s internal control over financial reporting.

While the Company's certification now includes its previous business acquisition of Stuart Packaging, the Company expects that its 2018 business acquisitions will be covered by its certification of ICFR under National Instrument 52-109 by the second quarter of 2019.

### **Significant accounting policies and estimates**

The Company prepares its financial statements in conformity with IFRS, which requires management to make estimates and assumptions that management believes are reasonable based upon the information available. These estimates 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 intangible assets and goodwill, employee future benefits and income taxes. 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, 2018.

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 acquisition method of accounting. The acquisition 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 ("WACC").

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.

#### **Impairment test of goodwill**

As at December 31, 2018, the Company performed a goodwill impairment test for both of its cash generating units ("CGU"), the Envelope and the Packaging CGUs, 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 a non-cash goodwill impairment charge was required for its Envelope CGU.

Several indicators have shown that the volume decrease in North America's envelope industry is expected to continue in the upcoming years. Furthermore, the Company volume has decreased at a higher than expected rate in 2018 leading the Company to revise its financial projections in the fourth quarter of fiscal 2018. Following its goodwill impairment test, the recoverable value of the Company's envelopes cash-generating unit, determined on the basis of a value in use, fell below its carrying value. As a result, the Company recorded a non-cash goodwill impairment charge of \$16.1 million.

The Company's Packaging CGU's recoverable amount exceeded its carrying amount. Therefore, there was no impairment 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 December 31, 2018, 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 rates.

### *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 for each CGU. Specific assumptions are used for each CGU. Forecasts for Envelope CGU considered a lower demand in the Canadian and U.S. envelope markets and applied a perpetual long-term decline rate for the period thereafter. Forecasts for Packaging CGU considered a perpetual long-term growth for this value-added market. In arriving at its forecasts, the Company considered past experience, recent acquisitions, 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 the Company’s estimated weighted average cost of capital (“WACC”). 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:

	2018		2017	
	Envelopes	Packaging	Envelopes	Packaging
Pre-tax discount rate	16.8%	16.9%	16.7%	16.8%
Tax rate	26.0%	26.5%	26.1%	26.5%
Perpetual (decline) growth rate	(3.0%)	2.5%	(3.0%)	2.0%

### *Sensitivity*

Envelope CGU - Management believes that an increase of 1% of the pre-tax discount rate would have decreased the recoverable amount by approximately \$3.7 million or an increase of 1% of the perpetual decline rate, would have decreased the recoverable amount by approximately \$3.3 million for the Envelopes CGU.

Packaging CGU - In the most recent impairment test performed for the Packaging CGU, if the pre-tax discount rate had increased to 18.8% or the perpetual growth rate had decreased to 0.5%, the recoverable amount of the Packaging cash generating unit would have then equaled the carrying amount as at December 31, 2018.

## Employee future benefits

The Company sponsors defined benefit plans to provide 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 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	3.80%
Discount rate for net pension costs	3.40%
Rate of compensation increase	2.50%
Mortality assumption	CPM Private

### *Discount rate*

As at December 31, 2018, 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*.

### *Sensitivity analysis*

For the Company, a 0.25% increase or decrease in the discount rate would have decreased or increased the defined benefit liability by approximately \$3.0 million as at December 31, 2018. A 0.25% increase or decrease in the rate of compensation would have increased or decreased the pension benefit liability by approximately \$0.3 million as at December 31, 2018. An increase of one year in the life expectancy of plan members as at December 31, 2018 results in an increase of \$2.9 million in total projected defined benefit obligation of pension plans. The sensitivity analysis has been determined based on a method that determines the impact on the defined benefit liability of a 0.25% change in the key assumptions. There have been no changes in the methods and assumptions used to determine the sensitivity analysis from the comparative year.

### *Rate of compensation*

Future salary increases are based on expected future inflation rates.

## 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 multiple 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 reflects 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 2018 effective tax rate was 26.1% of earnings before income tax.

### **New Accounting Standards adopted in 2018**

The Company adopted the following new accounting standards effective January 1, 2018.

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

IFRS 9, Financial Instruments ("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 9 includes revised guidance on the classification and measurement of financial instruments, new guidance for measuring impairment on financial assets, and new hedge accounting guidance. Effective January 1, 2018, the Company adopted IFRS 9 and this adoption did not have a material impact on the Company's consolidated financial statements.

As at January 1, 2018, the measurement category of the Company's financial instruments comparing IAS 39 to IFRS 9 are as follows, with no transitional adjustment required:

<b>Financial Instrument</b>	<b>IAS 39 Measurement</b>	<b>IFRS 9 Measurement</b>
Cash	FVTPL	Amortized cost
Accounts receivable	Amortized cost (loans and receivables)	Amortized cost
Accounts payable and accrued liabilities	Amortized cost (other liabilities)	Amortized cost
Dividend payable	Amortized cost (other liabilities)	Amortized cost
Provisions	Amortized cost (other liabilities)	Amortized cost
Secured credit facility	Amortized cost (other liabilities)	Amortized cost

#### ***IFRS 15, Revenue from Contracts with Customers***

IFRS 15, Revenue from contracts with customers supersedes previous accounting standards for revenue, including IAS 11, Construction Contracts, and IAS 18, Revenue, and all existing IFRS revenue interpretations. IFRS 15 introduced a single model for recognizing revenue from contracts with customers. This standard applies to all contracts with customers (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services.

Effective January 1, 2018, the Company adopted IFRS 15 using the full retrospective method and this adoption did not have a material impact on the Company's consolidated financial statements and the timing of revenue recognition policies. Consequently, the Company's revenue continues to be recognized at a point in time when performance obligations under the customers' contracts are fulfilled, generally upon delivery of goods.

## **Future Changes of Accounting Policies**

The IASB has issued IFRS 16, Leases, which is required to be applied retrospectively for annual periods beginning on or after January 1, 2019. IFRS 16 replaces IAS 17 Leases and related interpretation. Under this new standard, which provides a single model for leases abolishing the current distinction between finance leases and operating leases, most leases will be recognized in the statement of financial position. Certain exemptions will apply for short-term leases of low-value assets.

The Company is currently still assessing the financial impact of this new standard on its consolidated financial statements. The Company plans to adopt the modified retrospective approach on January 1, 2019 and measure the right-of-use asset at its carrying amount as if IFRS 16 had been applied since the adoption date. The Company will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms end within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value.

The Company anticipates that the adoption of IFRS 16 will have a material impact on its statement of financial position and its statement of earnings as nearly all operating leases will be capitalized with a corresponding liability, while the rent expense will be replaced by the amortization of the right to use the related assets, and interest accretion expense from the liabilities will be recorded.

## **Recent Event**

On February 20, 2019, the Board of Directors declared a quarterly dividend of \$0.065 per common share, payable on April 12, 2019, to shareholders of record at the close of business on March 29, 2019.

## **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' management.

### *Decline in Envelope Consumption*

Supremex' envelope manufacturing business is highly dependent upon the demand for envelopes sent through the mail. 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 invoices. 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 receive payments.

The North American envelope manufacturing and mailing industries are expected to continue to decline in the foreseeable future, due to a general progressive reduction in the use of traditional paper-based products. The business depends on transactional mail and direct mail activities. Transactional and direct mail volumes 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 electronic mail and the Internet. 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 and acquire new products such as the packaging directed toward e-commerce fulfillment and other applications.

The majority of envelopes consumed in Canada and the United States are mailed and as a result, any strike or other work stoppage by unionized postal workers would result in a temporary suspension of the mail activities of most of Supremex' customers and could have a material adverse effect on Supremex. In the autumn of 2018, there was a work stoppage at Canada Post that lasted a few weeks. However, the federal government legislated

an end to job action by postal workers on November 22, 2018 and subsequent work disruptions were averted. During that period, envelope shipments to customers were affected and some direct mail orders were cancelled. It can be reasonably assumed that the adoption of e-billing alternatives also increased during that period since many large corporations used the interruption 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, from time to time, there has been talk of “do-not-mail” legislation in the U.S. with respect to the direct mail industry, primarily around the distribution of non-targeted advertising mail and the environment. “Do-not-mail” legislation is instituted at the state level. While such activities have generally not been successful, if such legislation were to be passed, it would have a negative impact on the Company’s sales volume.

#### *Customer relationships*

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 they did in the past, or that purchases will be on similar terms.

#### *Competition*

Despite Supremex’ leading market position in Canada in the envelope business, new competitors could enter the Canadian envelope market impacting sales and margins. A strengthening of the Canadian dollar against the U.S. dollar could create an incentive for U.S.-based competitors to increase market penetration in Canada. Also, as long as the U.S. market stays oversupplied, there will be pricing pressure in the Canadian market. However, the costs of freight, coupled with delivery inefficiencies 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 sales lost to secular decline. Given the Company’s large market share in Canada, most of the gains by smaller competitors in Canada are made at the expense of Supremex’ accounts.

#### *Competition in the Packaging Industry*

The packaging industry is highly competitive and Supremex’ diversification in packaging is relatively recent. Some of Supremex’s competitors are larger and have more fully integrated operations. If Supremex fails to further penetrate the packaging industry, the growth in its sales, could be negatively impacted. Supremex cannot assure that its efforts to increase market penetration in its existing markets and to expend into the packaging market will be successful. Failure to do so could have a material adverse effect on Supremex’s operating results.

#### *Growth by Acquisitions*

The Company plans to grow both organically and through acquisitions. In the recent years, the Company has grown through acquisitions and has relied in large part on new acquisitions to pursue its growth. The ability to properly evaluate the fair value of the businesses being acquired, to properly devote the time and human resources required to successfully integrate their activities with those of the Company as well as the capability to

realize synergies, improvements and the expected profit and to achieve anticipated returns constitute inherent risks related to acquisitions. The Company may also be subject to potential liabilities from past acquisitions that it may not discover in its due diligence process. One or more of these factors could impact the Company's ability to successfully integrate or leverage an acquisition and could negatively affect the Company's results of operations.

#### *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. Therefore, soft economic conditions can have significant impact on direct mail volume. Although direct mail represents less than 15% of Supremex' total annual envelope volume, a decline would put pressure on the overall market. For transactional mail, which represents about 50% of Supremex' annual envelope volume, economic cycles have a lesser impact than on direct mail since businesses must still mail out invoices to their customers, although the online billing penetration is growing in this segment. In the long term, transactional mail volume has been declining.

#### *Reliance on Key Personnel*

Supremex' senior executives and employees have extensive experience in the industry and with the business, suppliers, products and customers. The loss of management knowledge, expertise and technical proficiency as a result of the loss of one or more members of the core management team could result in a diversion of management resources or a temporary executive gap, and negatively affect the Company's ability to develop and pursue other business strategies, which could materially adversely affect its business and financial results. Also, the expertise pertaining to envelope manufacturing is rare and the loss of key executives heading those functions could have a material adverse effect on the Company's ability to continue to offer a compelling product offering to its customers, which in turn would materially adversely affect its business and financial results.

#### *Raw Material*

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

Paper costs represent a significant portion of Supremex's material cost and they have been subject to volatility due to supply and demand in the marketplace. While paper costs were generally a pass through in the past, an increase in the price of paper can negatively affect operations if it changes the purchasing habits of customers. Moreover, an increase in the price of paper negatively affects Supremex' 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 has generally been disciplined in passing on raw material increases to its customers. The availability of suitable quality recycled board within a reasonable distance of the Company's packaging divisions is also a risk. Finally, fluctuations in the price of oil, a core ingredient in the composition of window material, glue and ink has a direct impact on their price. An increase in the price of oil can have a negative effect on operations if it changes the purchasing habits of customers.

#### *Exchange Rate*

A portion of Supremex' revenue is earned in U.S. 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 U.S. dollars. Supremex also derives a portion of its revenue from Canadian dollar sales to certain customers for whom selling price is sensitive to U.S. competition.

Net exposure to the U.S. dollar continues to decrease as the Company's growing revenues in the U.S. envelope market, compensates for the volume of raw materials it currently purchases in USD. Revenue generated from customers in the United States represented 33.4% of consolidated revenue in fiscal 2018, up from 30.3% in fiscal 2017.

### *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' 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. There is no assurance that any of such increased costs could be passed on to Supremex' customers. 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 environmentally friendly products, such as 100% recycled paper. If price of raw materials were to increase for environmental reasons, it could negatively affect Supremex' profitability if such increase cannot be passed on to the customer.

### *Availability of Capital*

In 2015, the Company entered into a Five-Year Committed \$50 million Senior Secured Revolving Facility Agreement with Bank of Montreal maturing on October 6, 2020. This facility was increased to \$75 million in 2018. Although the Company carried out this modification to its line of credit 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.

### *Credit*

The Company is exposed to credit risk with respect to trade receivables. A specific credit limit is established for each customer and periodically reviewed by the Company. No single customer accounts for more than 10% of consolidated accounts receivable. Supremex' customer base is well 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, 2018, 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. Floating-rate debt bears interest based on Canadian prime rate, plus an applicable margin that ranges between 0% and 0.50% or bankers' acceptance rates, plus an applicable margin, which ranges from 1.50% to 2.00%.

### *Litigation*

Supremex, like other manufacturing and sales organizations, is subject to potential liabilities in connection with its business operations, including expenses associated with product defects, performance, and 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' business, financial condition, results of operations and cash available for distributions.

#### *Employee Future Benefits*

The Company maintains four registered defined benefit pension plans substantially covering all of its employees. Three of these plans are hybrids 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-contribution 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.

The level of the contributions may vary depending on the realized return on the pension fund asset and the discount rate of the future liabilities, which could affect the financial condition of Supremex.

#### *Cyber security and data protection*

In the normal course of its operations, the Company relies on the continuous and uninterrupted operation of its systems, data hosting centers, cloud computing systems and computer hardware. In addition, it receives processes and transfers sensitive data, including confidential information about Supremex, its customers, its suppliers, as well as personal information regarding its employees.

If the Company were to experience cyber threats, breaches, unauthorized accesses, viruses other security breaches, human errors, sabotage or other similar events, it could have a material adverse impact on its activities, including system disruptions or breakdowns. This could also negatively impact Supremex's results, cause considerable damage to the Company's reputation and potentially result in legal actions against it.

Cyberattacks attempts occur more and more frequently and their nature continuously evolves and become more refined, which increases the risk that the Company's operations be disrupted and that the Company's data be compromised. In addition, it is possible that such a cyber breach or event might not be detected quickly enough to limit the scope of the information that could be stolen or compromised.

#### *No guaranty to pay cash dividends*

The Board of Directors has, for some years, declared a cash dividend on a quarterly regular basis. Decisions regarding dividends are within the discretion of the Board of Directors, and will be influenced by a number of factors, including general business and economic conditions, Supremex's financial condition, operating results and restrictions imposed by its debt agreements, the emergence of acquisition opportunities, changes in business strategy and other factors. Changes in, or the elimination of dividends could have an adverse effect on the price of Supremex's common shares.

#### *Cash payments*

Supremex depends on its relationships with its existing customers and on the development of its growing clientele. Some of Supremex's customers have been paying for Supremex's products in cash. The Corporation took measures to ensure that appropriate procedures were followed in connection with such payments. Given the number of rules applicable to the handling of cash amounts and the risk associated with this practice, it has been decided to cease accepting large cash payments.

## **Forward-Looking Information**

This MD&A contains “forward-looking information” within the meaning of applicable Canadian securities laws, including (but not limited to) statements about the EBITDA, Adjusted EBITDA and future performance of Supremex and similar statements or information concerning anticipated future results, circumstances, performance or expectations. Forward-looking information may include words such as anticipate, assumption, believe, could, expect, goal, guidance, intend, may, objective, outlook, plan, seek, should, strive, target and will. Such information relates to future events or future performance and reflects 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 information reflects current assumptions, expectations and estimates of management and is based on information currently available to Supremex as at the date of this MD&A. Such assumptions, expectations and estimates are discussed throughout the MD&A for the year ended December 31, 2018.

Forward-looking information is subject to certain risks and uncertainties, and should not be read as a guarantee of future performance or results and actual results may differ materially from the conclusion, forecast or projection stated in such forward-looking information. These risks and uncertainties include but are not limited to the following: economic cycles, availability of capital, decline in envelope consumption, increase of competition, exchange rate fluctuations, raw material increases, credit risks with respect to trade receivables, interest rates fluctuations and potential risk of litigation. Such risks and uncertainties are discussed throughout this MD&A for the year ended December 31, 2018, and, in particular, in “Risk Factors”. Consequently, we cannot guarantee that any forward-looking information will materialize. Readers should not place any undue reliance on such forward-looking information unless otherwise required by applicable securities legislation. The Company expressly disclaims any intention and assumes no obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise

## **Non-IFRS measures: Definition of EBITDA, Adjusted EBITDA and Adjusted Net Earnings**

References to “EBITDA” are to earnings before financing charges, income tax expense, depreciation of property, plant and equipment and amortization of intangible assets. References to “Adjusted EBITDA” are to EBITDA adjusted to remove special non-recurring items. These special items include, but are not limited to, charges for impairment of assets, restructuring expenses, contingent remuneration expenses in connection with business combinations and new facility start-up costs. Supremex believes that EBITDA or Adjusted 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 obligations. Adjusted EBITDA allows readers to appreciate the Company’s earnings without effect of non-recurring items making it valuable to assess ongoing operations.

References to “Adjusted Net Earnings” are to net earnings adjusted to remove the special non-recurring items as mentioned above, net of income taxes.

EBITDA, Adjusted EBITDA or Adjusted Net Earnings are not recognized earnings measures under IFRS and do not have a standardized meaning prescribed by IFRS. Therefore, EBITDA, Adjusted EBITDA or Adjusted Net Earnings may not be comparable to similar measures presented by other entities. Investors are cautioned that EBITDA, Adjusted EBITDA and Adjusted Net Earnings 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, including the Company’s annual information form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).

Consolidated Financial Statements

Supremex Inc.

December 31, 2018 and 2017

All amounts expressed in Canadian dollars



# Independent auditor's report

To the Shareholders of **Supremex Inc.**

## Opinion

We have audited the consolidated financial statements of **Supremex Inc.** and its subsidiaries (the Group), which comprise the consolidated statements of financial position as at December 31, 2018 and 2017, the consolidated statements of (loss) earnings, the consolidated statements of comprehensive (loss) income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2018 and 2017, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

## Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Other information included

Management is responsible for the other information. The other information comprises:

- Management's discussion and analysis

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information, and in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

We obtained Management's Discussion & Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with 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.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.



### **Auditor's responsibilities for the audit of the consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure, and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Wajih Chemali.

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

Montréal, Canada  
February 20, 2019

<sup>1</sup> CPA auditor, CA, public accountancy permit no. A121006



Supremex Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

As at December 31	Notes	2018 \$	2017 \$
<b>ASSETS</b>	15		
Current assets			
Cash		308,941	706,190
Accounts receivable	6	26,518,240	25,977,010
Income tax receivable		1,248,918	524,520
Inventories	7	23,561,672	18,917,859
Prepaid expenses and others		1,656,993	1,026,896
<b>Total current assets</b>		<b>53,294,764</b>	<b>47,152,475</b>
Property, plant and equipment	8	36,965,022	34,329,207
Accrued pension benefit asset	9	4,427,607	3,876,907
Intangible assets	11	18,133,648	14,796,056
Goodwill	12	46,390,779	57,769,363
Other long-term asset		490,802	—
<b>Total assets</b>		<b>159,702,622</b>	<b>157,924,008</b>
<b>LIABILITIES AND EQUITY</b>			
Current liabilities			
Accounts payable and accrued liabilities	13	19,807,079	19,994,984
Dividend payable	19	1,838,230	1,846,355
Provisions	14	1,029,173	290,864
<b>Total current liabilities</b>		<b>22,674,482</b>	<b>22,132,203</b>
Secured credit facility	15	53,894,196	42,830,886
Deferred income tax liabilities	16	7,273,250	5,808,186
Other long-term liability	5	—	427,000
Other post-retirement benefit obligations	9	199,400	206,600
<b>Total liabilities</b>		<b>84,041,328</b>	<b>71,404,875</b>
Equity			
Share capital	17	9,652,774	9,695,439
Contributed surplus	17	277,722,233	278,111,408
Deficit		(212,589,405)	(200,939,855)
Foreign currency translation reserve		875,692	(347,859)
<b>Total equity</b>		<b>75,661,294</b>	<b>86,519,133</b>
<b>Total liabilities and equity</b>		<b>159,702,622</b>	<b>157,924,008</b>

Commitments, contingencies and guarantees [note 20]

Subsequent event [note 25]

See accompanying notes

On behalf of the Directors:

By: signed (Robert B. Johnston) \_\_\_\_\_  
Director

By: signed (Steven P. Richardson) \_\_\_\_\_  
Director

Supremex Inc.

CONSOLIDATED STATEMENTS OF (LOSS) EARNINGS

Years ended December 31	Notes	2018 \$	2017 \$
Revenue		195,087,280	179,072,759
Operating expenses	7, 9, 18	146,294,758	130,325,375
Selling, general and administrative expenses	9, 18	24,707,600	22,920,182
Operating earnings before, depreciation, amortization and other items		24,084,922	25,827,202
Depreciation of property, plant and equipment	8	4,295,024	3,713,196
Amortization of intangible assets	11	2,088,659	1,682,702
(Gain) loss on disposal of property, plant and equipment		(777,740)	114,533
Goodwill impairment	12	16,137,000	—
Restructuring expenses	14	1,218,945	—
Shutdown of non-core operations of Printer Gateway	10	—	2,191,765
Operating earnings		1,123,034	18,125,006
Financing charges, net	15	1,841,635	1,078,191
(Loss) earnings before income taxes		(718,601)	17,046,815
Income tax expense	16	4,074,509	4,655,987
Net (loss) earnings		(4,793,110)	12,390,828
Basic and diluted net (loss) earnings per share		(0.1691)	0.4348
Weighted average number of shares outstanding		28,345,948	28,495,406

See accompanying notes

Supremex Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

Years ended December 31	Notes	2018 \$	2017 \$
Net (loss) earnings		(4,793,110)	12,390,828
Other comprehensive income (loss)			
Other comprehensive income (loss) to be reclassified to earnings in subsequent periods			
Foreign currency translation adjustments		1,223,551	(983,214)
Net other comprehensive income (loss) to be reclassified to earnings in subsequent periods		1,223,551	(983,214)
Items not to be reclassified to earnings in subsequent periods			
Recognized actuarial gain on defined benefit pension plans, net of income tax expense of \$176,247 [2017 – \$244,822]			
	9	501,053	692,878
Recognized actuarial gain (loss) on other post-retirement benefit, net of income tax expense of \$1,822 [2017 – recovery of \$1,775]			
	9	5,178	(5,025)
Net other comprehensive income not being reclassified to earnings in subsequent periods		506,231	687,853
Other comprehensive income (loss)		1,729,782	(295,361)
Total comprehensive (loss) income		(3,063,328)	12,095,467

See accompanying notes

Supremex Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Years ended December 31

	Share capital \$	Contributed surplus \$	Deficit \$	Foreign currency translation reserve \$	Total equity \$
As at December 31, 2016	9,765,711	278,979,895	(207,043,901)	635,355	82,337,060
Net earnings	—	—	12,390,828	—	12,390,828
Other comprehensive income (loss)	—	—	687,853	(983,214)	(295,361)
Total comprehensive income	—	—	13,078,681	(983,214)	12,095,467
Dividends declared [note 19]	—	—	(6,974,635)	—	(6,974,635)
Shares repurchased and cancelled [note 17]	(70,272)	(868,487)	—	—	(938,759)
As at December 31, 2017	9,695,439	278,111,408	(200,939,855)	(347,859)	86,519,133
Net loss	—	—	(4,793,110)	—	(4,793,110)
Other comprehensive income	—	—	506,231	1,223,551	1,729,782
Total comprehensive (loss) income	—	—	(4,286,879)	1,223,551	(3,063,328)
Dividends declared [note 19]	—	—	(7,362,671)	—	(7,362,671)
Shares repurchased and cancelled [note 17]	(42,665)	(389,175)	—	—	(431,840)
As at December 31, 2018	9,652,774	277,722,233	(212,589,405)	875,692	75,661,294

See accompanying notes

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31	Notes	2018 \$	2017 \$
<b>OPERATING ACTIVITIES</b>			
Net (loss) earnings		(4,793,110)	12,390,828
Non-cash adjustment to reconcile net earnings to net cash flows			
Depreciation of property, plant and equipment	8	4,295,024	3,713,196
Amortization of intangible assets	11	2,088,659	1,682,702
Amortization of deferred financing costs	15	68,628	68,628
(Gain) loss on disposal of property, plant and equipment		(777,740)	114,533
Goodwill impairment	12	16,137,000	—
Shutdown of non-core operations of Printer Gateway	10	—	2,191,765
Deferred income tax recovery	16	(628,695)	(629,423)
Change in employee benefits		101,000	19,700
		16,490,766	19,551,929
Working capital adjustments			
Variation in accounts receivable		1,325,036	(1,855,105)
Variation in income tax receivable		(668,433)	(114,786)
Variation in inventories		(3,743,354)	(1,107,192)
Variation in prepaid expenses		(266,103)	(222,221)
Variation in accounts payable and accrued liabilities		(1,537,765)	(61,565)
Variation in provisions	14	738,309	(33,372)
Change in other long-term liability	5	(427,000)	427,000
Change in employee benefits		25,400	(653,000)
Net cash flows from operating activities		11,936,856	15,931,688
<b>INVESTING ACTIVITIES</b>			
Business combination, net of cash acquired	5	(11,696,509)	(17,930,008)
Adjustments to consideration paid for previous business combinations		—	463,533
Acquisition of property, plant and equipment	8	(8,216,739)	(8,062,692)
Acquisition of intangible assets	11	(343,699)	(373,835)
Proceeds from the disposal of property, plant and equipment		4,205,836	903,127
Net cash flows used in investing activities		(16,051,111)	(24,999,875)
<b>FINANCING ACTIVITIES</b>			
Increase of secured credit facility		10,994,682	15,868,344
Dividends paid	19	(7,370,796)	(6,844,961)
Purchase of share capital for cancellation	17	(431,840)	(938,759)
Change in other long-term asset		187,026	—
Net cash flows from financing activities		3,379,072	8,084,624
Net change in cash		(735,183)	(983,563)
Net foreign exchange difference		337,934	(275,194)
Cash, beginning of period		706,190	1,964,947
Cash, ending of period		308,941	706,190
Supplemental information <sup>(1)</sup>			
Interest paid		2,141,906	1,149,003
Interest received		13,381	12,670
Income taxes paid		5,884,285	5,593,141
Income taxes received		622,678	388,038

<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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

### 1. CORPORATE INFORMATION

Supremex Inc. (the "Company" or "Supremex") was incorporated on March 31, 2006 under the Canadian Business Corporation Act. The common shares of the Company are listed on the Toronto Stock Exchange ("TSX") under the symbol SXP. The Company's registered office is located at 7213 Cordner Street in LaSalle, Quebec.

Supremex is a leading North American manufacturer and marketer of envelopes and a growing provider of paper-based packaging solutions and specialty products. Supremex' revenue is subject to the seasonal advertising and mailing patterns of its customers. The number of envelopes 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, the holidays and tax seasons. The number of envelopes sold by Supremex is generally lower during spring and summer in anticipation of a slowdown in mailing activities of businesses during the summer.

Revenues from packaging and specialty products are subject to a mix of linear (i.e. specialty folding cartons for large multinational customers) and seasonal patterns related to the holidays and sporting events (i.e. innovative protective packaging solutions for e-commerce or corrugated boxes for food delivery) which the contribution is currently less significant. As such, there is currently little to no seasonal effect on Supremex' total revenues.

These consolidated financial statements were approved by the Company's Board of Directors on February 20, 2019.

### 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"). These consolidated financial statements were prepared on a going concern basis, under the historical cost convention.

#### Principles of consolidation

The consolidated financial statements comprise the financial statements of Supremex Inc. and its wholly-owned subsidiaries, Stuart Packaging Inc., Supremex Midwest Inc., SXP Packaging Inc., Groupe Deux Printing Inc., Pharmaflex Labels Inc., Buffalo Envelope Inc. and Classic Envelope Inc.

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.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

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

#### 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 and included in administrative expenses.

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.

Goodwill is allocated as at the date of a business combination to a cash-generating unit ("CGU") for purpose of impairment testing [See note 2 (Impairment testing of goodwill)]. The allocation is made to the CGU or group of CGUs expected to benefit from the synergies of the business acquisitions.

#### Segment reporting

The Company operates in one reporting segment: the manufacturing and sale of a broad range of standard and custom envelopes, packaging and specialty products.

#### Foreign currency translation

Supremex' 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.

#### 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 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 average exchange rates of the period. The exchange differences arising on translation are recognized in other comprehensive income (loss). On disposal of a foreign operation, the component of other comprehensive income (loss) relating to that particular foreign operation is recognized in the consolidated statement of (loss) earnings.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

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

#### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, net of estimated discounts, and after eliminating intercompany sales. Discounts are estimated based on the most likely amount method and using contractual terms with customers.

Revenue from the sale of goods is recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services.

This is achieved by applying the following five steps:

1. Identify the contract with a customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract; and
5. Recognize revenue when (or as) the entity satisfies a performance obligation, which is generally achieved upon the delivery of the products.

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 control is transferred to 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 earnings except to the extent it is related to items recognized in other comprehensive loss or directly in equity.

#### 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

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 and 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.

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;
- For 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 four defined benefit pension plans, three 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 its defined benefit pension plans into defined contribution plans for future services. All defined benefit pension plans are funded.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

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 past service cost is recognized in the consolidated statement of (loss) earnings on the earlier of the date of the plan amendment or curtailment, and the date the Company recognizes pension plan restructuring related costs.

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 and the effect of the ceiling, if any. The present value of the defined benefit obligation for service accrued at year-end 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, the effect of the asset ceiling and the return on plan assets, excluding net interest, are recognized immediately in other comprehensive income (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. The interest expense of defined benefit obligation is calculated by applying the prior year's discount rate to the beginning balance of the accrued pension benefit liability and to the year's cash inflows. It is recognized in the financing charges of the consolidated statements of (loss) earnings. All the other administrative defined benefit plan expense components are recognized in the selling, general and administrative expenses of the consolidated statement of (loss) earnings.

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

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

2. SIGNIFICANT ACCOUNTING POLICIES [Cont'd]

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

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 mainly customer relationships and non-compete agreements which are amortized on a straight-line basis over ten years. Software is amortized on a straight line basis over seven to 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 inflows. 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, 2018 and 2017

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

#### 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 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.

#### 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.

#### Financial instruments

##### (i) Classification and subsequent measurement categories

- A financial asset is classified as subsequently measured at amortized cost; fair value through other comprehensive income ("FVTOCI"); or fair value through profit and loss ("FVTPL"). The classification is based on two criteria: the Company's business model for managing the assets; and whether the instruments' contractual cash flows represent 'solely payments of principal and interest' on the principal amount outstanding (the "SPPI criterion"). The Company's financial assets are held within a business model with the objective to hold the financial assets in order to collect contractual cash flows that meet the SPPI criterion are classified and subsequently measured at amortized cost. They consist of cash, accounts receivable and other long-term asset.
- A financial liability is classified as subsequently measured at amortized cost or FVTPL. The Company's financial liabilities measured at amortized cost consist of accounts payable and accrued liabilities, dividend payable, provisions and secured credit facility and are classified as other financial liabilities. They are initially recognized at fair value, net of directly attributable transaction costs, and are subsequently carried at amortized cost using the effective interest method.

##### (ii) Impairment of financial assets measured at amortized cost

- The Company applies the simplified approach to measuring expected credit losses ("ECL") which uses a lifetime expected loss allowance for all trade receivables.
- To measure the ECL, accounts receivables have been grouped based on shared risk characteristics and the days past due. As at December 31, 2018 and 2017, ECL was not significant.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

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

- Trade receivables are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the debtor enters bankruptcy, is in significant financial difficulty or has failed to make contractual payments for a period greater than 120 days, unless the Company has reasonable and supportable information to demonstrate that a more lagging criterion is more appropriate.

#### (iii) Derecognition of financial assets and liabilities

- Financial assets are derecognized when the rights to receive cash flows from the assets have expired or when substantially all the risks and rewards of ownership and cash flows have been transferred. A financial liability is derecognized when the obligation under the liability is discharged, canceled or expired. Gains and losses on derecognition are recognized within finance income and finance expenses, respectively.

### 3. SIGNIFICANT ACCOUNTING ESTIMATES

The preparation of the Company's consolidated financial statements requires management to make 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 acquisition method of accounting. The acquisition 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 ("WACC").

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 5]. The Company used also other estimates and assumptions related to the impairment test of goodwill [see note 12].

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

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

#### 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 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 9]. 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 multiple jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain during the normal course of business. The Company maintains a 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.

### 4. RECENT ACCOUNTING PRONOUNCEMENTS

#### New Accounting Standards adopted in 2018

The Company adopted the following new accounting standards effective January 1, 2018.

#### IFRS 9, Financial Instruments

IFRS 9, Financial Instruments ("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 9 includes revised guidance on the classification and measurement of financial instruments, new guidance for measuring impairment on financial assets, and new hedge accounting guidance. Effective January 1, 2018, the Company adopted IFRS 9 and this adoption did not have a material impact on the Company's consolidated financial statements.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 4. RECENT ACCOUNTING PRONOUNCEMENTS [Cont'd]

As at January 1, 2018, the measurement category of the Company's financial instruments comparing IAS 39 to IFRS 9 are as follows, with no transitional adjustment required:

Financial Instrument	IAS 39 Measurement	IFRS 9 Measurement
Cash	FVTPL	Amortized cost
Accounts receivable	Amortized cost (loans and receivables)	Amortized cost
Accounts payable and accrued liabilities	Amortized cost (other liabilities)	Amortized cost
Dividend payable	Amortized cost (other liabilities)	Amortized cost
Provisions	Amortized cost (other liabilities)	Amortized cost
Secured credit facility	Amortized cost (other liabilities)	Amortized cost

## IFRS 15, Revenue from Contracts with Customers

IFRS 15, Revenue from contracts with customers supersedes previous accounting standards for revenue, including IAS 11, Construction Contracts, and IAS 18, Revenue, and all existing IFRS revenue interpretations. IFRS 15 introduced a single model for recognizing revenue from contracts with customers. This standard applies to all contracts with customers (with limited exceptions), regardless of the type of revenue transaction or the industry. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services.

Effective January 1, 2018, the Company adopted IFRS 15 using the full retrospective method and this adoption did not have a material impact on the Company's consolidated financial statements and the timing of revenue recognition policies. Consequently, the Company's revenue continues to be recognized at a point in time when performance obligations under the customers' contracts are fulfilled, generally upon delivery of goods.

## Future Changes of Accounting Policies

The IASB has issued IFRS 16, Leases, which is required to be applied retrospectively for annual periods beginning on or after January 1, 2019. IFRS 16 replaces IAS 17 Leases and related interpretation. Under this new standard, which provides a single model for leases abolishing the current distinction between finance leases and operating leases, most leases will be recognized in the statement of financial position. Certain exemptions will apply for short-term leases of low-value assets.

The Company is currently still assessing the financial impact of this new standard on its consolidated financial statements. The Company plans to adopt the modified retrospective approach on January 1, 2019 and measure the right-of-use asset at its carrying amount as if IFRS 16 had been applied since the adoption date. The Company will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms end within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value.

The Company anticipates that the adoption of IFRS 16 will have a material impact on its statement of financial position and its statement of earnings as nearly all operating leases will be capitalized with a corresponding liability, while the rent expense will be replaced by the amortization of the right to use the related assets, and interest accretion expense from the liabilities will be recorded.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 5. BUSINESS COMBINATIONS

On April 30, 2018, the Company acquired all of the outstanding shares of Groupe Deux Printing Inc. ("G2 Printing") and Pharmaflex Labels Inc. ("Pharmaflex"), for a cash consideration of \$12,367,794. G2 Printing is a leading manufacturer of premium quality folding carton packaging and labels for the pharmaceutical industry based in Laval, Quebec.

This acquisition aligns with the Company's long-term strategy to extend its core products in key markets.

On December 13, 2018, the Company purchased the principal net assets of The Filing Store Inc. and Filing Specialties Systems Products Co. Ltd ("Filing Store") for a cash consideration of \$127,959.

The following table presents a summary of the fair value of assets acquired and liabilities assumed at the acquisition date that occurred during the year ended December 31, 2018:

	G2 Printing and Pharmaflex \$	Filing Store \$	Total \$
Net assets acquired			
Cash	799,244	—	799,244
Accounts receivable	1,962,413	—	1,962,413
Income tax receivable	55,965	—	55,965
Inventories	803,040	97,419	900,459
Prepaid expenses and others	49,327	—	49,327
Total current assets	3,669,989	97,419	3,767,408
Property and equipment	2,725,119	5,540	2,730,659
Customer relationships	4,900,000	25,000	4,925,000
Goodwill	4,267,993	—	4,267,993
Total assets	15,563,101	127,959	15,691,060
Accounts payable and accrued liabilities	1,349,860	—	1,349,860
Deferred income tax liabilities	1,845,447	—	1,845,447
Net assets acquired	12,367,794	127,959	12,495,753
Cash consideration, net of cash acquired	11,568,550	127,959	11,696,509
Acquisition-related costs recognized as an expense	54,322	—	54,322

The Company's consolidated statement of earnings for the period ended December 31, 2018 included the G2 Printing revenue of \$5,935,509 since the acquisition date. The fair value of the receivables acquired of \$1,962,413 of which no amount was considered uncollectible at the acquisition date is included in the current asset in the accounting of the business acquisition.

If the acquisition had occurred on January 1, 2018, revenue for the full year from G2 Printing would have been approximately \$10,000,000.

There is no goodwill deductible for tax purposes. The goodwill related to the acquisition is composed of expected growth and operation synergies.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 5. BUSINESS COMBINATIONS [Cont'd]

2017 Business Combination

On July 20, 2017, the Company acquired all of the outstanding shares of Stuart Packaging Inc. ("Stuart Packaging") for a cash consideration of \$18,639,950. Stuart Packaging is a leading provider of premium quality folding carton packaging for the consumer based in Montreal, Quebec. In addition to the consideration paid, the Company had a contingent consideration payable to the previous owner on the realization of certain future financial targets during his employment period. The Company's expenses include an amount of \$1,623,000 during the year ended December 31, 2018 [2017 - \$427,000] as a result of the payment of such contingent consideration which was considered as a compensation expense.

The following table presents a summary of the fair value of assets acquired and liabilities assumed at the acquisition date that occurred during the year ended December 31, 2017:

	Stuart Packaging \$	Adjustments \$	Total \$
<hr/>			
Net assets acquired			
Cash	709,942	—	709,942
Accounts receivable	2,948,043	(96,147)	2,851,896
Inventories	1,851,164	—	1,851,164
Prepaid expenses	163,648	—	163,648
Total current assets	5,672,797	(96,147)	5,576,650
Property, plant and equipment	4,411,294	—	4,411,294
Customer relationships	7,600,000	—	7,600,000
Goodwill	6,002,328	96,147	6,098,475
Total assets	23,686,419	—	23,686,419
Accounts payable and accrued liabilities	2,022,678	—	2,022,678
Income tax payable	63,152	—	63,152
Deferred income tax liabilities	2,960,639	—	2,960,639
Net assets acquired	18,639,950	—	18,639,950
<hr/>			
Cash consideration, net of cash acquired	17,930,008	—	17,930,008
<hr/>			
Acquisition-related costs recognized as an expense	83,877	—	83,877
<hr/>			

The Company's consolidated statement of earnings for the period ended December 31, 2017 includes the Stuart Packaging's revenue of \$7,721,717 since the acquisition date. The fair value of the receivables acquired of \$2,851,896 of which no amount was considered uncollectible at the acquisition date, is included in the current asset in the accounting of the business acquisition.

If the acquisition had occurred on January 1, 2017 revenue for the full year from Stuart Packaging would have been approximately \$18,000,000.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 5. BUSINESS COMBINATIONS [Cont'd]

There is no goodwill deductible for tax purposes. The goodwill related to the acquisition is composed of expected growth and operational synergies.

During fiscal 2018, the Company completed its final assessment of the fair value of assets acquired or liabilities assumed of Stuart Packaging Inc.

## 6. ACCOUNTS RECEIVABLE

	December 31, 2018 \$	December 31, 2017 \$
Trade receivables	25,803,562	24,796,841
Less: Allowance for doubtful accounts	(157,475)	(230,835)
Trade receivables - net	25,646,087	24,566,006
Other receivables	872,153	1,411,004
	<u>26,518,240</u>	<u>25,977,010</u>

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

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

	December 31, 2018 \$	December 31, 2017 \$
Current	15,463,514	13,560,351
31 – 60 days	8,086,623	7,532,980
61 – 90 days	1,540,845	2,769,781
91 – 120 days	439,908	593,914
Over 120 days	272,672	339,815
	<u>25,803,562</u>	<u>24,796,841</u>

## Allowance for doubtful accounts

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

	December 31, 2018 \$	December 31, 2017 \$
Balance, beginning of year	230,835	185,693
Business combinations	5,000	66,125
Charge (recovery) for the year	18,851	(530)
Utilized	(100,364)	(20,778)
Impact of foreign exchange losses	3,153	325
Balance, end of year	<u>157,475</u>	<u>230,835</u>

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. Historically, the estimated credit losses from trade receivables have been not significant.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 7. INVENTORIES

	December 31, 2018 \$	December 31, 2017 \$
Raw materials	8,987,542	5,895,409
Work in progress	978,561	696,612
Finished goods	13,595,569	12,325,838
	<u>23,561,672</u>	<u>18,917,859</u>

The cost of inventories recognized as an expense and included in operating expenses, including the related depreciation of property, plant and equipment allocated to cost of inventories, during the year ended December 31, 2018 is \$143,935,112 [2017 - \$127,792,308].

## 8. PROPERTY, PLANT AND EQUIPMENT

	Lands, buildings and leasehold improvements \$	Machinery and equipment \$	Office and computer equipment \$	Total \$
Cost:				
At December 31, 2016	15,614,528	48,949,323	2,312,653	66,876,504
Acquisition	3,818,631	4,128,540	115,521	8,062,692
Business combinations [note 5]	282,892	3,788,024	340,378	4,411,294
Adjustments for previous year's business combinations	—	(323,666)	—	(323,666)
Disposals	(19,662)	(1,793,029)	(250,356)	(2,063,047)
Translation adjustment	(8,143)	(497,553)	(7,705)	(513,401)
At December 31, 2017	<u>19,688,246</u>	<u>54,251,639</u>	<u>2,510,491</u>	<u>76,450,376</u>
Acquisition	179,816	7,875,139	161,784	8,216,739
Business combinations [note 5]	—	2,653,339	77,320	2,730,659
Disposals	(3,725,567)	(3,079,964)	(69,256)	(6,874,787)
Translation adjustment	17,562	596,605	10,034	624,201
At December 31, 2018	<u>16,160,057</u>	<u>62,296,758</u>	<u>2,690,373</u>	<u>81,147,188</u>
Depreciation:				
At December 31, 2016	4,131,732	33,589,666	1,751,080	39,472,478
Depreciation	509,421	2,952,903	250,872	3,713,196
Impairment from shutdown of Printer Gateway [note 10]	—	113,733	25,388	139,121
Disposals	(19,662)	(779,601)	(246,124)	(1,045,387)
Translation adjustment	(1,641)	(150,422)	(6,176)	(158,239)
At December 31, 2017	<u>4,619,850</u>	<u>35,726,279</u>	<u>1,775,040</u>	<u>42,121,169</u>
Depreciation	539,483	3,464,007	291,534	4,295,024
Disposals	(92,596)	(2,313,889)	(55,530)	(2,462,015)
Translation adjustment	3,403	215,922	8,663	227,988
At December 31, 2018	<u>5,070,140</u>	<u>37,092,319</u>	<u>2,019,707</u>	<u>44,182,166</u>
Net book value:				
At December 31, 2017	15,068,396	18,525,360	735,451	34,329,207
At December 31, 2018	<u>11,089,917</u>	<u>25,204,439</u>	<u>670,666</u>	<u>36,965,022</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 9. EMPLOYEE DEFINED BENEFIT PLANS

## (a) Pension Plans

The Company maintains four defined benefit pension plans covering substantially all of salaried and hourly employees. Three of these pension plans are hybrid because they also have a defined contribution component. All defined benefit pension plans are funded. Two of these plans are governed by the Pension Benefits Act of Ontario. The benefits of one of these plans are based on the average earnings of the best three years and on the final average earnings of the five consecutive years for the other plan. The other two plans are governed under the Supplemental Pension Plans Act of the Régie des rentes du Québec. The benefits of one of these plans are based on the average earning of the best three years where the maximum salary was reached and on the average earnings of the best five consecutive years for the other plan. During the third quarter of 2012, the Company converted, for future service, its defined benefit pension plans into defined contributions plans.

The key risks pension plans are exposed to include interest rate risks, investment risks and change in the life expectancy for pensioners.

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

	2018	2017
	\$	\$
Defined benefit plans		
Administration expenses	267,000	195,200
Past service gains	(43,000)	(88,100)
Defined benefit plans expense	224,000	107,100
Defined contribution plan expense	1,251,000	1,320,200
Pension plans expense [note 18]	1,475,000	1,427,300

Interest income on pension defined benefit plan obligation of \$129,900 [2017 – \$94,800] is included in the financing charges in the consolidated statement of (loss) earnings [note 15].

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 9. 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, 2018 \$	December 31, 2017 \$
<b>Change in accrued benefit obligation</b>		
Benefit obligation, beginning of the year	98,367,200	93,391,800
Interest cost	3,263,200	3,463,800
Employees contribution	43,000	88,100
Actuarial loss from change in demographic assumptions	2,592,900	—
Actuarial (gain) loss from change in financial assumptions	(4,884,200)	5,311,900
Actuarial (gain) loss from experience	(2,771,700)	680,600
Benefits paid	(4,781,600)	(4,480,900)
Past service gains	(43,000)	(88,100)
<b>Benefit obligation, end of year</b>	<b>91,785,800</b>	<b>98,367,200</b>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of the year	102,244,107	95,696,907
Interest income on plan assets	3,393,100	3,558,600
Actuarial (losses) gains	(4,385,700)	6,930,200
Employer contribution	163,100	646,400
Employees contribution	43,000	88,100
Use of surplus to pay for employer defined contributions	(195,600)	—
Benefits paid	(4,781,600)	(4,480,900)
Plan administration expenses	(267,000)	(195,200)
<b>Fair value of plan assets, end of year</b>	<b>96,213,407</b>	<b>102,244,107</b>
<b>Net amount recognized as accrued pension benefit asset</b>	<b>4,427,607</b>	<b>3,876,907</b>

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

	2018 \$	2017 \$
<b>Total actuarial gains</b>	<b>677,300</b>	<b>937,700</b>
	<b>677,300</b>	<b>937,700</b>

The cumulative amount of actuarial losses recognized in the consolidated statement of comprehensive (loss) income is \$1,059,000 as at December 31, 2018 [2017 – \$1,736,300].

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 9. EMPLOYEE DEFINED BENEFIT PLANS [Cont'd]

The key assumptions used in computing the benefit obligation and net pension cost were as follows:

	2018 %	2017 %
Discount rate for accrued benefit obligation	3.80	3.40
Discount rate for net pension cost	3.40	3.80
Rate of compensation increase	2.50	2.50
Mortality assumption <sup>1</sup>	CPM Private	CPM Private

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

	2018 %	2017 %
Equity securities		
Canadian	23.9	29.9
Oil & Gas	—	1.6
Financial services	1.9	5.9
Communications & media	0.1	1.1
Industrial products	1.9	2.5
Other	5.9	8.9
Pooled Equity Funds	10.5	—
Preferred Shares Funds	3.6	9.9
Foreign Global Equity Funds	33.4	31.2
	57.3	61.1
Fixed income funds		
Canadian	41.4	37.6
Cash and short-term securities		
Canadian	1.3	1.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>

All financial equity instruments and investment funds are classified as Level 1 fair value hierarchy (quoted prices in active markets).

Three of the pension plans have an investment policy with the following target asset allocation: 75% in equity securities and 25% in fixed income securities (2017 – 60% in equity securities and 40% in fixed income securities). The other pension plan has an investment policy with the following target asset allocation: 52% in equity securities and 48% in fixed income securities (2017 – 60% in equity securities and 40% in fixed income securities). As at December 2018 and 2017, the pension plans were in compliance with their investment policy allocations.

As of December 31, 2018 and 2017, there were no Supremex shares held in the Company's pension plans.

<sup>1</sup> CPM 2014 Private Sector Mortality table projected generationally using improvement scale MI-2017 (2017 – CPM improvement scale B with no size adjustment)



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 9. EMPLOYEE DEFINED BENEFIT PLANS [Cont'd]

The average duration of the defined benefit plan obligation is 13.0 years as at December 31, 2018 [2017 – 14.0 years].

## Sensitivity analysis

For the Company, a 0.25% increase or decrease in the discount rate would have decreased or increased the defined benefit liability by approximately \$3.0 million as at December 31, 2018. A 0.25% increase or decrease in the rate of compensation would have increased or decreased the pension benefit liability by approximately \$0.3 million as at December 31, 2018. An increase of one year in the life expectancy of plan members as at December 31, 2018 results in an increase of \$2.9 million in total projected defined benefit obligation of pension plans. The sensitivity analysis has been determined based on a method that determines the impact on the defined benefit liability of a 0.25% change in the key assumptions. There have been no changes in the methods and assumptions used to determine the sensitivity analysis from the comparative year.

## (b) Post-retirement benefits other than pension

The following table provides a reconciliation of the change in the accrued benefit obligation of the plans.

	December 31, 2018 \$	December 31, 2017 \$
Change in accrued benefit obligation		
Benefit obligation, beginning of year	206,600	199,000
Interest cost [note 15]	6,900	7,400
Actuarial (gain) loss from change in financial assumption	(7,000)	6,800
Benefits paid	(7,100)	(6,600)
<b>Benefit obligation, end of year</b>	<b>199,400</b>	<b>206,600</b>

Post retirement benefits other than pension are not funded.

The post-retirement benefits amount recognized in other comprehensive income (loss), before taxation, consists of an actuarial gain of \$7,000 [2017 – loss of \$6,800]. The cumulative amount of actuarial losses recognized in the consolidated statement of comprehensive (loss) income is \$321,100 as at December 31, 2018 [2017 - \$328,100].

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

	2018 %	2017 %
Weighted-average assumptions		
Discount rate for benefit obligation	3.80	3.40
Discount rate for net periodic benefit cost	3.40	3.80

As at December 31, 2018, no coverage is provided to retirees for healthcare and dental. The average duration of the post-retirement benefits' obligation is 8.0 years as at December 31, 2018 [2017 – 7.0 years].

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 10. SHUTDOWN OF NON-CORE OPERATIONS OF PRINTER GATEWAY

On January 22, 2018, the Company closed its Printer Gateway operation to concentrate on its core diversification strategy. The Company provisioned, in the fourth quarter of 2017, a total of \$0.2 million of non-recurring expenses related to the shutdown of this operation. Additionally, an impairment loss totaling \$2.0 million was also recorded in the fourth quarter of 2017 in connection with the write-down of the carrying amounts of goodwill, customer relations, intangibles and property, plant and equipment. No corresponding expenses were recorded in the year ended December 31, 2018, in connection with this shutdown.

## 11. INTANGIBLE ASSETS

	Customer relationships \$	Non- compete agreements \$	Software \$	Total \$
<b>Cost</b>				
At December 31, 2016	67,727,408	755,000	2,555,649	71,038,057
Additions	—	—	373,835	373,835
Business combinations [note 5]	7,600,000	—	—	7,600,000
Adjustments for previous year's business combinations	113,000	—	—	113,000
Translation adjustment	(167,474)	—	—	(167,474)
At December 31, 2017	75,272,934	755,000	2,929,484	78,957,418
Additions	—	—	343,699	343,699
Business combinations [note 5]	4,925,000	—	—	4,925,000
Disposals	(403,000)	—	(556,207)	(959,207)
Translation adjustment	210,185	—	—	210,185
At December 31, 2018	80,005,119	755,000	2,716,976	83,477,095
<b>Accumulated amortization:</b>				
At December 31, 2016	60,825,094	755,000	80,942	61,661,036
Amortization	1,385,084	—	297,618	1,682,702
Impairment from shutdown of Printer Gateway [note 10]	362,700	—	478,177	840,877
Translation adjustment	(23,253)	—	—	(23,253)
At December 31, 2017	62,549,625	755,000	856,737	64,161,362
Amortization	1,837,983	—	250,676	2,088,659
Disposals	(403,000)	—	(556,207)	(959,207)
Translation adjustment	52,633	—	—	52,633
At December 31, 2018	64,037,241	755,000	551,206	65,343,447
<b>Net book value:</b>				
At December 31, 2017	12,723,309	—	2,072,747	14,796,056
At December 31, 2018	15,967,878	—	2,165,770	18,133,648

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 12. GOODWILL

Cost	
At December 31, 2016	53,088,016
Business combinations [note 5]	6,002,328
Adjustments for previous year's business combinations	(4,959)
Impairment from shutdown of Printer Gateway [note 10]	(999,020)
Translation adjustment	(317,002)
At December 31, 2017	57,769,363
Business combinations [note 5]	4,267,993
Adjustments for previous year's business combinations [note 5]	96,147
Impairment	(16,137,000)
Translation adjustment	394,276
At December 31, 2018	46,390,779

The net carrying amount of goodwill as of December 31, 2018 was allocated to the following significant CGU groups:

	\$
CGU groups	
Envelopes <sup>1</sup>	35,853,004
Packaging	10,537,775
Total	46,390,779

<sup>1</sup> Includes the packaging and specialty products from legacy envelope businesses.

The packaging CGU was created in 2017 following the acquisitions of Stuart Packaging, acquired on July 20, 2017, Durabox Paper acquired on November 28, 2016 and Groupe Deux Printing Inc. and Pharmaflex Labels Inc., acquired on April 30, 2018.

## Impairment test of goodwill

The Company conducted its annual goodwill impairment test as at December 31, 2018, in accordance with its policy described in note 2.

Several indicators have shown that the volume decrease in North America's envelope industry is expected to continue in the upcoming years. Furthermore, the Company volume has decreased at a higher than expected rate in 2018 leading the Company to revise its financial projections in the fourth quarter of fiscal 2018. Following its goodwill impairment test, the recoverable value of the Company's envelopes cash-generating unit, determined on the basis of a value in use, fell below its carrying value. As a result, the Company recorded a non-cash goodwill impairment charge of \$16,137,000.

The Company's Packaging CGU's recoverable amount exceeded its carrying amount. Therefore, there was no impairment 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 each of its cash-generating units and has not made any changes to the valuation methodology used to assess goodwill impairment since the last annual impairment test.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 12. GOODWILL [Cont'd]

## 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 December 31, 2018, 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 for each CGU. Specific assumptions are used for each CGU. Forecasts for Envelopes CGU considered a lower demand in the Canadian and U.S. envelope markets and a perpetual long-term decline rate for the periods thereafter. Forecasts for Packaging CGU considered a perpetual long-term growth for this value-added market. In arriving at its forecasts, the Company considered past experience, recent acquisitions, 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 the Company's estimated weighted average cost of capital ("WACC"). 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:

	2018		2017	
	Envelopes	Packaging	Envelopes	Packaging
Pre-tax discount rate	16.8%	16.9%	16.7%	16.8%
Tax rate	26.0%	26.5%	26.1%	26.5%
Perpetual (decline) growth rate	(3.0%)	2.5%	(3.0%)	2.0%

## Sensitivity

Envelope CGU - Management believes that an increase of 1% of the pre-tax discount rate would have decreased the recoverable amount by approximately \$3.7 million, while an increase of 1% of the perpetual decline rate, would have decreased the recoverable amount by approximately \$3.3 million.

Packaging CGU - In the most recent impairment test performed for the Packaging CGU, if the pre-tax discount rate had increased to 18.8% or the perpetual growth rate had decreased to 0.5%, the recoverable amount of the Packaging cash generating unit would have then equaled the carrying amount as at December 31, 2018.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 13. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31, 2018 \$	December 31, 2017 \$
Trade payables	10,945,666	10,033,787
Accrued rebates liabilities	1,649,258	1,496,883
Other accrued liabilities	7,212,155	8,464,314
	<u>19,807,079</u>	<u>19,994,984</u>

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

## 14. PROVISIONS

In 2018, the Company adopted a plan to optimize costs at its envelope CGU. As a result, the Company recognized a provision for severance relating to certain terminated employees. As at December 31, 2018, the amount of the remaining accrued restructuring provision was \$1.0 million. The accrued restructuring provision in connection with the previous years' restructuring plans was settled during 2018.

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

	December 31, 2018 \$	December 31, 2017 \$
Balance, beginning of year	290,864	324,236
Settlement	(290,864)	—
Current year restructuring provision	1,218,945	—
Cash payments	(189,772)	(33,372)
Balance, end of year	<u>1,029,173</u>	<u>290,864</u>

## 15. SECURED CREDIT FACILITY

As at December 31, 2018, the Company had a committed \$75 million senior secured revolving facility agreement maturing on October 6, 2020. No principal repayments are required prior to maturity. This facility bears interest at a floating rate based on the Canadian prime rate, plus an applicable margin that ranges between 0% and 0.50% or bankers' acceptance rates, plus an applicable margin that ranges between 1.50% and 2.00%.

The secured credit facility is used for working capital, capital expenditure and other general corporate purpose. It is collateralized by hypothec and security interests covering all assets of the Company and its subsidiaries and is subject to certain covenants, which the Company is required, among other conditions, to meet. The Company was in compliance with these covenants during 2018 and as at December 31, 2018.

Amounts owed under secured credit facility are as follows:

	December 31, 2018 \$	December 31, 2017 \$
Revolving credit facility	54,014,291	43,019,609
Less: deferred financing costs, net	(120,095)	(188,723)
Long-term portion of secured credit facility	<u>53,894,196</u>	<u>42,830,886</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 15. SECURED CREDIT FACILITY [Cont'd]

The Company had outstanding letters of credit for a total of \$10,000 as at December 31, 2018, [2017 – \$10,000].

The effective interest rate on the secured credit facility was 4.01% as at December 31, 2018 [3.09% as at December 31, 2017].

Financing charges are as follows:

	2018	2017
	\$	\$
Interest on secured credit facility	1,901,148	1,100,922
Interest income on defined benefit plan obligation [note 9]	(129,900)	(94,800)
Interest on post-retirement benefits [note 9]	6,900	7,400
Other interest income	(5,141)	(3,959)
Amortization of deferred financing costs	68,628	68,628
	<u>1,841,635</u>	<u>1,078,191</u>

## 16. INCOME TAXES

Income tax expense

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

	2018	2017
	\$	\$
Current income tax:		
Current income tax expense	4,703,204	5,285,410
Deferred income tax:		
Reversal of temporary differences	(628,695)	(629,423)
Income tax expense	<u>4,074,509</u>	<u>4,655,987</u>

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

	2018	2017
	\$	\$
Deferred income tax related to items imputed directly to equity during the year:		
Deferred tax expense on recognized actuarial gain on defined benefit pension plans	176,247	244,822
Deferred tax expense (benefit) on recognized actuarial gain (loss) on other post-retirement benefit	1,822	(1,775)
Income tax expense charged to other comprehensive income	<u>178,069</u>	<u>243,047</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 16. INCOME TAXES [Cont'd]

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

	2018 \$	2017 \$
(Loss) earnings before income taxes	(718,601)	17,046,815
Income tax expense at combined federal and provincial statutory rate of 26.1% [2017 – 26.1%]	(187,410)	4,442,908
Effect of change in enacted tax rates	(55,240)	(588,716)
Impact of goodwill impairment not deductible for tax purposes	4,208,505	—
Income tax rate differential for subsidiaries	19,865	40,007
Non-deductible expenses and other	88,789	761,788
Income tax expense	4,074,509	4,655,987

Deferred income tax

Deferred income tax relates to the following:

	Consolidated statement of financial position		Consolidated statement of earnings	
	December 31, 2018 \$	December 31, 2017 \$	December 31, 2018 \$	December 31, 2017 \$
Deferred tax assets				
Goodwill	850,569	1,025,638	179,304	332,358
Other	390,126	219,036	(165,714)	(64,295)
Non-capital losses	1,133,511	189,845	(889,694)	(13,806)
	2,374,206	1,434,519	(876,104)	254,257
Deferred tax liabilities				
Accrued pension benefit asset	1,152,151	1,012,213	36,309	(166,344)
Property, plant and equipment	4,972,787	3,693,997	(632,205)	726,720
Intangible assets	3,291,783	2,324,635	349,239	325,777
Other	230,735	211,860	(752)	(2,473)
	9,647,456	7,242,705	(247,409)	883,680
Deferred tax recovery			(628,695)	(629,423)
Net deferred income tax liabilities	(7,273,250)	(5,808,186)		

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 16. INCOME TAXES [Cont'd]

## Reconciliation of net deferred tax liabilities

	2018 \$	2017 \$
Balance – beginning of the year	(5,808,186)	(3,186,717)
Tax recovery during the year recognized in the consolidated statement of earnings	628,695	629,423
Tax benefit recognized in other comprehensive loss	(178,069)	(243,047)
Net deferred tax from business combinations [note 5]	(1,845,447)	(2,960,639)
Net deferred tax from adjustments for previous year's business combinations	—	(155,571)
Translation adjustment on net deferred tax	(70,243)	108,365
Balance – end of year	<u>(7,273,250)</u>	<u>(5,808,186)</u>

## 17. SHARE CAPITAL

An unlimited number of common 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.

The change in share capital was as follows:

	Number of common Shares	Share capital \$
Balance, as of December 31, 2016	28,611,351	9,765,711
Purchase of share capital for cancellation	(205,882)	(70,272)
Balance, as of December 31, 2017	28,405,469	9,695,439
Purchase of share capital for cancellation	(125,000)	(42,665)
Balance, as of December 31, 2018	<u>28,280,469</u>	<u>9,652,774</u>

During the year ended December 31, 2018, the Company repurchased 125,000 (2017 – 205,882) common shares for cancellation through a normal course issuer bid for a consideration of \$431,840 (2017 – \$938,759). The excess of the purchase price over the carrying value in the amount of \$389,175 (2017 – \$868,487) was recorded as a reduction of contributed surplus.

On August 2, 2018, Supremex received approval from the TSX to renew the Company's NCIB program to repurchase up to 500,000 common shares for cancellation during a period of 12 months beginning August 8, 2018 and ending August 7, 2019.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 17. SHARE CAPITAL [Cont'd]

## Deferred Share Unit Plan (DSU)

On December 15, 2015 the Company adopted a Deferred Share Unit ("DSU") Plan for its members of the Board of Directors. The DSU Plan enables its participants to receive compensation in cash at the termination date, as a member of the Board of Directors, equal to the market price of the Corporation's common share for each DSU.

Each participant in the DSU Plan may elect, each fiscal year, to receive up to 100% of their director's annual retainer fees in DSUs. Such DSUs are expensed on an earned basis and their costs are determined using a valuation model and all issued and outstanding DSUs are measured at each reporting period.

The financial liability resulting from the plan of \$305,647 [2017 - \$309,251] is presented under "Accounts payable and accrued liabilities".

The compensation income for the DSUs during the twelve-month period ended December 31, 2018 amounted to \$3,604 [2017 - expense of \$125,451] and is recognized under selling, general and administrative expenses.

## 18. OPERATING, SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	2018	2017
	\$	\$
Wages and salaries	49,855,038	45,662,043
Social security costs	7,727,919	6,840,664
Pension plans expense [note 9]	1,475,000	1,427,300
Employee benefits expenses	59,057,957	53,930,007
Raw materials and other purchases	86,030,590	73,748,958
Other	25,913,811	25,566,592
	171,002,358	153,245,557

## 19. DIVIDENDS

Dividends declared from January 1, 2018 to December 31, 2018 were as follows:

Declaration date	Record date	Payment date	Per share	Dividend
			\$	\$
February 20, 2018	March 29, 2018	April 13, 2018	0.065	1,846,355
May 8, 2018	June 29, 2018	July 17, 2018	0.065	1,839,856
August 2, 2018	September 28, 2018	October 12, 2018	0.065	1,838,230
November 8, 2018	December 31, 2018	January 16, 2019	0.065	1,838,230
Total				7,362,671

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 19. DIVIDENDS [Cont'd]

Dividends declared from January 1, 2017 to December 31, 2017 were as follows:

Declaration date	Record date	Payment date	Per share \$	Dividend \$
February 15, 2017	March 31, 2017	April 14, 2017	0.06	1,714,995
May 4, 2017	June 30, 2017	July 14, 2017	0.06	1,708,957
July 31, 2017	September 30, 2017	October 13, 2017	0.06	1,704,328
November 9, 2017	December 31, 2017	January 16, 2018	0.065	1,846,355
Total				6,974,635

## 20. 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:

	December 31, 2018 \$
Within one year	4,946,378
After one year but not more than five years	13,880,532
More than five years	6,471,199
	25,298,109

## 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. The Company does believe 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:

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 20. COMMITMENTS, CONTINGENCIES AND GUARANTEES [Cont'd]

## 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 July 2028 with renewal option for some leases. The nature of these indemnification agreements prevents the Company from estimating the total potential amount it would have to pay to lessors, since these events have not occurred yet. Historically, the Company has not made any significant payments under such agreements, has insurance coverage for certain of the obligations undertaken and, as at December 31, 2018, has not recorded any liability associated with these indemnifications.

## 21. RELATED PARTY TRANSACTIONS

Compensation of key management personnel, including members of the Board of directors of Supremex recognized as an expense is as follows:

	2018	2017
	\$	\$
Short-term employee benefits	1,549,767	1,560,223
Post-employment benefits	77,487	74,363
	<u>1,627,254</u>	<u>1,634,586</u>

## 22. FINANCIAL INSTRUMENTS

## Financial assets and liabilities

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

December 31, 2018	Assets at amortized cost \$	Liabilities at amortized cost \$	Total \$
Cash	308,941	—	308,941
Accounts receivable	26,518,240	—	26,518,240
Other assets	828,979	—	828,979
Accounts payable and accrued liabilities excluding sales tax payable	—	(19,060,879)	(19,060,879)
Dividend payable	—	(1,838,230)	(1,838,230)
Provisions	—	(1,029,173)	(1,029,173)
Secured credit facility	—	(54,014,291)	(54,014,291)
<u>Total</u>	<u>27,656,160</u>	<u>(75,942,573)</u>	<u>(48,286,413)</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 22. FINANCIAL INSTRUMENTS [Cont'd]

December 31, 2017	Loans and receivables \$	Assets at fair value through earnings \$	Other financial liabilities \$	Total \$
Cash	—	706,190	—	706,190
Accounts receivable	25,977,010	—	—	25,977,010
Accounts payable and accrued liabilities excluding sales tax payable	—	—	(18,773,105)	(18,773,105)
Dividend payable	—	—	(1,846,355)	(1,846,355)
Provisions	—	—	(290,864)	(290,864)
Secured credit facility	—	—	(43,019,609)	(43,019,609)
Other long-term liability	—	—	(427,000)	(427,000)
<b>Total</b>	<b>25,977,010</b>	<b>706,190</b>	<b>(64,356,933)</b>	<b>(37,673,733)</b>

## Fair values

The carrying amount of secured credit facility approximates its fair value given it carries a floating interest rate.

For the secured credit facility, the Company categorized the fair value measurement as 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.

## Credit risk

Credit risk arises from cash and accounts receivable. In order to minimize the credit exposure, the Company's cash is placed with major Canadian banks and their U.S subsidiaries.

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, 2018 and 2017, total trade accounts receivable over 90 days past due amounted to less than 5% [see note 6] of total trade receivables. The Company does not hold collateral as a security.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 22. FINANCIAL INSTRUMENTS [Cont'd]

## 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 secured credit facility. The Company continuously reviews both actual and forecasted cash flows to ensure that it has adequate credit facility capacity and reviews its exposure to interest rate fluctuations.

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

December 31, 2018	Less than 3 months \$	1 to 5 years \$	Total \$
Accounts payable and accrued liabilities excluding			
sales tax payable	19,060,879	—	19,060,879
Dividend payable	1,838,230	—	1,838,230
Provisions	1,029,173	—	1,029,173
Secured credit facility	—	54,014,291	54,014,291
	21,928,282	54,014,291	75,942,573
December 31, 2017	Less than 3 months \$	1 to 5 years \$	Total \$
Accounts payable and accrued liabilities excluding			
sales tax payable	18,773,105	—	18,773,105
Dividend payable	1,846,355	—	1,846,355
Provisions	290,864	—	290,864
Secured credit facility	—	43,019,609	43,019,609
Other long-term liability	—	427,000	427,000
	20,910,324	43,446,609	64,356,933

## 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 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 facility. The Company manages interest rate exposure by maintaining a balanced portfolio of fixed and variable loans and borrowings depending on the level of the Company's exposure. Furthermore, interest rate fluctuations could have an impact on interest expense on its credit facility and on income the Company derives from cash. The Company invests, when applicable, its cash in highly liquid investment instruments to safeguard its capital while generating a reasonable return.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018 and 2017

## 22. FINANCIAL INSTRUMENTS [Cont'd]

On December 31, 2018, a 25 basis-point rise or fall in interest rates, assuming all other variables remained unchanged, would have resulted, respectively, in a \$206,464 increase or decrease in the Company's net earnings for the year ended December 31, 2018 [2017 - \$193,685].

## Foreign exchange risk

The Company is exposed to fluctuations in U.S. 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 U.S. dollars. The Company continuously reviews its exposure to fluctuations in the U.S. exchange rate and has decided at this time not to enter into derivatives as the net exposure is not significant.

As at December 31, 2018, net financial assets of the Company in Canadian dollars, denominated in U.S. dollars, totalled \$4,848,743 [2017 - \$4,793,913].

On December 31, 2018, a 5% rise or fall in the Canadian dollar against the U.S. dollar on financial instruments held at that date, assuming all other variables remained unchanged, would have resulted, respectively, in a \$242,437 increase or decrease in the Company's net earnings for the year then ended [2017- \$239,696], whereas other comprehensive (loss) income would have increased or decreased by \$376,169 [2017 - \$304,434].

## 23. CAPITAL MANAGEMENT

The Company's capital consists of equity and secured credit facility. 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 facility;
- 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 facility / EBITDA" and "fixed charge coverage" ratios as defined in the credit facility agreement.

The Company's capital structure is composed of equity and secured credit facility less cash. The capital structure is as follows:

	December 31, 2018 \$	December 31, 2017 \$
Secured credit facility	53,894,196	42,830,886
Cash	(308,941)	(706,190)
Net debt	53,585,255	42,124,696
Equity	75,661,294	86,519,133

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December 31, 2018 and 2017

23. CAPITAL MANAGEMENT [Cont'd]

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

24. SEGMENTED INFORMATION

The Company currently operates in one reporting segment: the manufacturing and sale of envelopes, packaging and specialty products. The Company's non-current assets amounted to \$94,532,165 in Canada and \$11,875,693 in the United States as at December 31, 2018 [\$99,656,332 and \$11,115,201, respectively, as at December 31, 2017]. The Company's revenue amounted to \$130,005,492 in Canada and \$65,081,788 in the United States for the year ended December 31, 2018 based on customers' locations [2017 - \$124,771,855 in Canada and \$54,300,904 in the United States]. The Company's revenue amounted to \$138,200,941 from envelopes and \$56,886,339 from packaging and specialty products for the year ended December 31, 2018 based on product classification [2017 - \$144,472,369 from envelopes and \$34,600,390 from packaging and specialty products].

25. SUBSEQUENT EVENT

On February 20, 2019, the Board of Directors declared a quarterly dividend of \$0.065 per common share, payable on April 12, 2019 to shareholders of record at the close of business on March 29, 2019.