



**Canadian Dairy
Commission**

**Commission
canadienne du lait**

Quarterly Financial Report

First quarter

August to October 2012

DM233423

Canada 



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Quarterly Financial Report

First quarter

August to October 2012

Management Discussion and Analysis

The following discussion and analysis of the operating results and financial position of the Canadian Dairy Commission (CDC) for the quarter ending October 31, 2012 should be read in conjunction with the financial statements enclosed herein and the 2011-2012 Annual Report.

1. Basis of Preparation

This discussion was prepared in accordance with the Treasury Board Standard on Quarterly Financial Reports for Crown Corporations (Treasury Board Standard). This narrative discussion is not intended to be a full Management Discussion and Analysis (MD&A). Disclosures and information in the Canadian Dairy Commission's July 31, 2012 annual report are assumed to apply to the current quarter unless otherwise updated below.

The financial statements are unaudited and have been prepared in Canadian dollars in accordance with International Accounting Standard 34, *Interim Financial Reporting* (IAS 34) and the Treasury Board Standard. This narrative discussion and the accompanying financial statements were reviewed and approved by CDC's Audit Committee.

2. Financial Results

Domestic Activities

(in thousands)	Q1 ending October 31st		
	2012	2011	\$ change
Domestic sales revenues	\$ 83,623	\$ 72,230	\$ 11,393
Cost of goods sold	\$ 79,171	\$ 64,526	\$ 14,645
Transport and carrying charges	\$ 1,426	\$ 1,258	\$ 168
Finance Costs	\$ 328	\$ 133	\$ 195
Gross profit on domestic sales	\$ 2,698	\$ 6,313	\$ (3,615)

Domestic sales revenues for the three month period ending October 31, 2012 increased by \$11.39 million or 15.7% compared to the quarter ending October 31, 2011. This is mainly due to higher volume in sales for domestic butter and 4(m) skim milk powder (SMP). Although revenues increased, the gross profit on domestic sales decreased by \$3.62 million compared the previous year's result due to an increase in the cost of goods sold. This is mainly due to the cost of 4(m) SMP that was more in line with the expected sales revenues at the time of purchase. Transport and carrying charges were slightly



higher in 2012-2013 due to higher inventories and higher volume of sales. Similarly, the higher finance costs are due to higher inventories.

Export Activities

(in thousands)	Q1 ending October 31st		
	2012	2011	\$ change
Export sales revenues	\$ 5,674	\$ 2,209	\$ 3,465
Cost of goods sold	\$ 5,204	\$ 1,793	\$ 3,411
Transport and carrying charges	\$ 118	\$ 193	\$ (75)
Finance costs	\$ 3	\$ -	\$ 3
Gross profit on export sales	\$ 349	\$ 223	\$ 126

The gross profit on export sales for the first quarter of 2012-2013 amounted to \$0.35 million, a slight increase from the previous year's result. A larger volume of skim milk powder was exported during the first three months of 2012-2013 which explains the differences in revenues and cost of sales compared to the previous year.

The CDC purchases surplus dairy products destined for export at prices that reflect the prevailing world market conditions at the time, with the intent of breaking even over the course of each dairy year. As these markets are difficult to predict, this activity may generate gains or losses throughout the year, but should break even by year-end.

Other Revenues

(in thousands)	Q1 ending October 31st		
	2012	2011	\$ change
Pooling contributions	\$ 1,644	\$ 1,459	\$ 185
Funding from the Government of Canada	\$ 1,026	\$ 1,517	\$ (491)
Audit Services	\$ -	\$ -	\$ -
Total Other Revenues	\$ 2,670	\$ 2,976	\$ (306)

The pooling contributions represent the revenues obtained from producers and the marketplace to finance a portion of the Commission's administrative expenses, the cost of production study as well as the carrying charges associated with the CDC butter stocks. The 2012-2013 Q1 results are slightly higher as a result of an increase in the carrying charges associated with the CDC butter stocks.

Parliamentary appropriations for operating expenditures are recognized in the Statement of Operations and Comprehensive Income based on government-funded administrative expenses. On a year-to-date basis, there was a decrease of \$0.49 million compared to the same period last year. This decrease is mainly due to the reimbursement by the government to the CDC for severance benefits paid to employees which was part of the previous year's Q1 result and not for this year. An agreement was



reached with a major Public Service union representing more than half of the CDC employees, to terminate the accumulation of severance benefits. Employees were given the option to cash out immediately, or at time of retirement, any accumulated severance pay. The majority of employees opted to cash out their accumulated severance benefits right away.

Revenues obtained for audit services relate to the milk plant utilization audits performed by the CDC in 6 provinces on a cost recovery basis. Revenues from audit services are recognized when the service is rendered. There were none in the first quarter of both years.

Operating and Administrative Expenses

	Q1 ending October 31st		
	2012	2011	\$ change
<i>Operating Expenses</i>			
Industry initiatives	\$ 87	\$ 497	\$ (410)
Cost of production study	\$ 205	\$ 200	\$ 5
Other charges / (recoveries)	\$ 192	\$ (281)	\$ 473
Total operating expenses	\$ 484	\$ 416	\$ 68
<i>Administrative Expenses</i>			
Salaries and employee benefits	\$ 1,466	\$ 1,439	\$ 27
Other administrative expenses	\$ 450	\$ 575	\$ (125)
Total administrative expenses	\$ 1,916	\$ 2,014	\$ (98)
Total	\$ 2,400	\$ 2,430	\$ (30)

Operating Expenses

Expenses relating to “industry initiatives” decreased by \$0.41 million for the first quarter ending October 31, 2012 compared to the same period of the previous year. This decrease is attributable to the timing of expenses mainly for the Dairy Research Cluster.

“Other charges / (recoveries)” include amounts representing unrealized gains or losses on outstanding foreign exchange contracts as of the statement of financial position date. These gains or losses are determined using the difference between the contracted rates and exchange rates as of the statement of financial position date applied to the contract amount. They vary with the movement of exchange rates as well as the value of outstanding foreign exchange contracts at the end of the period.

Administrative expenses

Total administrative expenses decreased by \$0.98 million compared to the first quarter of 2011-2012.

In response to a request from government, the CDC has budgeted and acted to apply fiscal restraint such that administrative expenses for the current year will not exceed the 2010-2011 budget, as outlined in our Corporate Plan Summary.



Inventories and Loans

Inventory value as of October 31, 2012 was \$127.73 million in contrast to \$79.49 million of October 31, 2011. Last year's values were below the norm due to low butter stocks while this quarter the CDC has managed to raise butter stocks to more seasonal levels.

Stock levels have begun to decrease after reaching their peak in June with the lowest point expected at the end of December. This is a normal seasonal cycle as sales of butter increase during the pre-Christmas period and manufacturers repurchase their Plan B butter from the CDC at that time. In direct correlation with this trend, the loan from the Government of Canada will be at its lowest by the end of December. As of the end of the reporting period, the loan was \$98.90 million compared to \$52.30 million at the same period last year.

Cash Flows

(in thousands)	Q1 ending October 31st	
	2012	2011
Cash Flows from operating activities	\$ 29,537	\$ 4,720
Cash Flows used in financing activities	\$ (28,375)	\$ (3,544)
Net increase in cash	\$ 1,162	\$ 1,176
Net bank overdraft at the beginning of the period	\$ (1,660)	\$ (1,008)
Net (bank overdraft) cash at the end of the period	\$ (498)	\$ 168

Overall, CDC's closing bank overdraft position by the end of the first quarter of 2012-2013 increased by \$0.67 million compared to the first quarter of 2011-2012 when cash in bank was \$0.17 million.

Cash flows from operating activities

Net cash inflow from operating activities during the first quarter of 2012-2013 was \$29.54 million compared to a net cash inflow of \$4.72 million during the first quarter of 2011-2012. The change was a result of increased sales coupled with a smaller refund of operating surplus to provincial milk boards and agencies for the comparable period.

Cash flows from financing activities

Net cash outflows from financing activities were \$28.38 million for the first quarter of 2012-2013 compared to net outflows of \$3.54 million for the first quarter of 2011-2012. CDC's financing is directly related to its selling and purchasing activities as the loan from the Government of Canada fluctuates daily depending on the cash position at the end of the day. Greater cash inflows from operations allowed the CDC to pay down its loans on a more frequent basis which translates into greater cash outflows from financing activities.



3. Outlook against Corporate Plan Summary

The key factors that may impact the budget indicated in the CDC's Corporate Plan Summary are total production of industrial milk, domestic requirements, support prices and world market conditions for the sale of dairy products. Any significant changes in the assumptions will affect the budgeted results.

In this first quarter, milk production continued to increase compared to last year. Milk production on a 12-month basis is now above demand, which is relatively flat. CDC butter stocks have been replenished. It is expected that in the coming months, the growth in milk production will slow down. The industrial milk production forecast for the 2012-2013 dairy year remains the same as was forecasted in the Corporate Plan Summary (196 M kg).

Canadian requirements are expected to increase in the coming months for all types of products, especially fine cheeses and further processed products. Canadian requirements are expected to end the year at approximately 190.8 M kg of butterfat, which is slightly lower than the forecast in the Corporate Plan Summary (191.5 M kg).

In the last few months, world prices have increased but it is still too early to tell if this increase will be sustained for the rest of the year and its impact on CDC's financial results.

Support prices have not changed since the publication of the Corporate Plan Summary.

4. Appropriations

The following table reconciles the appropriations received and disbursed.

(in thousands)	Q1 ending October 31st		
	2012	2011	\$ change
Opening Balance	\$ -	\$ -	\$ -
Parliamentary appropriations	\$ 1,026	\$ 1,517	\$ (491)
Amount disbursed	\$ (1,026)	\$ (1,517)	\$ 491
Ending Balance	\$ -	\$ -	\$ -

These appropriations were granted via the Main Estimates and Treasury Board Vote 30 – Paylist requirements. Parliamentary appropriations are used to fund part of the CDC's administrative expenses. The remainder of the CDC's administrative expenses is funded by dairy producers, commercial operations, and the market place.

Government of Canada funding for administrative expenses is appropriated to the CDC based on the Government fiscal year (April to March) while the use of these funds is presented in these statements on a dairy year (August to July) basis. The CDC does present the use of its appropriations on a Government fiscal year basis in the Public Accounts of Canada.

The federal government announced funding reductions in its Federal Budget 2012. The Canadian Dairy Commission's share of this reduction will be \$0.393 million annually by 2014–2015.



5. Risk Management

There have been no changes in the risk that the CDC faces since the publication of the CDC's 2011-2012 Annual Report.

6. Significant Changes

The following significant changes in operations, personnel, objectives, industry initiatives and programs have occurred between August 1 and October 31, 2012, compared to the Corporate Plan Summary.

Operations, industry initiatives and programs	There has been no significant change in operations, industry initiatives or programs compared to the Corporate Plan Summary. At its October meeting, the CMSMC extended the eligibility of ice cream novelty products in the Special Milk Class Permit Program until December 31, 2014 and reconvened the DDPIP Review Committee to look at options regarding the renewal of this program.
Personnel	There has been no significant change in personnel compared to the Corporate Plan Summary.
Objectives	There have been no significant changes in objectives compared to the Corporate Plan Summary. The activities of the P10 Negotiating Committee have been suspended and it is unlikely that a draft agreement will be submitted to provinces this dairy year. Discussions on matters raised by the Committee continue in other forums. The CDC is on track to reach most of its other objectives for dairy year 2012-2013.
Governing Board	There has been no change in the governing board of the CDC in the first quarter. Two commissioners will see their mandate expire in August 2013 therefore the CDC plans to convene its Nominations Committee in early 2013.



Management Responsibility for Financial Statements

Management is responsible for the preparation and fair presentation of these quarterly financial statements in accordance with the requirements of International Accounting Standard 34: *Interim Financial Reporting* (IAS 34), and for such internal controls as management determines is necessary to enable the preparation of quarterly financial statements that are free from material misstatement. Management is also responsible for ensuring all other information in this quarterly financial report is consistent, where appropriate, with the quarterly financial statements. These statements are unaudited and have not been reviewed by an external auditor.

Based on our knowledge, these unaudited quarterly financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the corporation, as at the date of and for the periods presented in the quarterly financial statements.

Original signed by Jacques Laforge, Chief Executive Officer

and Gaëtan Paquette, Senior Director, Finance and operations

Ottawa, Canada

December 13, 2012



Statement of Financial Position

(unaudited)

(in thousands of Canadian dollars)

	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Assets		
Current		
Cash	\$ 946	\$ 134
Trade and other receivables		
Trade	1,256	2,909
Advance to provincial milk boards and agencies	1,444	1,794
Milk pools	1,208	993
Derivative asset - foreign exchange contracts	-	54
Inventory (Note 4)	127,732	159,888
	<u>\$ 132,586</u>	<u>\$ 165,772</u>
Liabilities		
Current		
Bank overdraft (Note 5)	\$ 1,444	\$ 1,794
Trade and other payables		
Trade	14,321	14,321
Distribution to provincial milk boards and agencies payable	-	8,672
Other liabilities	1,939	1,211
Derivative liability - foreign exchange contracts	228	61
Loans from the Government of Canada (Note 6)	98,901	127,277
	<u>116,833</u>	<u>153,336</u>
Long-term		
Post-employment benefits (Note 11)	596	596
Equity		
Retained earnings	15,157	11,840
	<u>\$ 132,586</u>	<u>\$ 165,772</u>

Commitments (Note 13)

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

These financial statements were approved and authorized for issue on December 13, 2012.

Original signed by

Jacques Laforge

Chief Executive Officer

Randy Williamson

Chairman

Gaëtan Paquette

Senior Director, Finance and Operations



Statement of Operations and Comprehensive Income

(unaudited)

(in thousands of Canadian dollars)

	Three months ended	
	October 31, 2012	October 31, 2011
Sales and Cost of Sales		
Domestic sales revenue	\$ 83,623	\$ 72,230
Cost of goods sold - domestic	79,171	64,526
Transport and carrying charges	1,426	1,258
Finance costs	328	133
Gross profit on domestic sales	2,698	6,313
Export sales revenue	5,674	2,209
Cost of goods - exports	5,204	1,793
Transport and carrying charges	118	193
Finance costs	3	-
Gross profit on export sales	349	223
Total gross profit	3,047	6,536
Other income		
	1,644	1,459
Funding from the Government of Canada (Note 10)	1,026	1,517
Audit services	-	-
	2,670	2,976
Total	5,717	9,512
Operating Expenses		
Industry initiatives	87	497
Cost of Production study	205	200
Other charges (recoveries)	192	(281)
	484	416
Administrative Expenses		
Salaries and employee benefits (Note 11)	1,466	1,439
Other administrative expenses	450	575
	1,916	2,014
Total	2,400	2,430
Profit before distribution to provincial milk boards and agencies	3,317	7,082
Distribution to provincial milk boards and agencies	-	-
Total comprehensive income	\$ 3,317	\$ 7,082

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



Statement of Changes in Equity

(unaudited)

(in thousands of Canadian dollars)

	Three months ended	
	<u>October 31, 2012</u>	<u>October 31, 2011</u>
Retained earnings, beginning of the period	\$ 11,840	\$ 14,771
Total comprehensive income for the period	<u>3,317</u>	<u>7,082</u>
Retained earnings, end of the period	<u>\$ 15,157</u>	<u>\$ 21,853</u>

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



Statement of Cash Flows

(unaudited)

(in thousands of Canadian dollars)

	Three months ended	
	October 31, 2012	October 31, 2011
Cash flows from operating activities		
Cash receipts from sales of goods	\$ 90,908	\$ 79,399
Cash paid to suppliers and others	(55,174)	(63,732)
Cash receipts from provincial milk boards and agencies (pooling)	1,779	2,239
Cash paid to provincial milk boards and agencies (operating surplus)	(8,673)	(14,573)
Cash receipts from the Government of Canada	1,026	1,517
Interest paid on loans	(329)	(130)
Cash flows from operating activities	<u>29,537</u>	<u>4,720</u>
Cash flows from financing activities		
New loans from the Government of Canada	43,688	47,737
Loan repayments to the Government of Canada	(72,063)	(51,281)
Cash flows used in financing activities	<u>(28,375)</u>	<u>(3,544)</u>
Net increase in cash	1,162	1,176
Net bank overdraft at beginning of period	(1,660)	(1,008)
Net (bank overdraft) cash at end of period	<u>\$ (498)</u>	<u>\$ 168</u>
Components:		
Cash	\$ 946	\$ 596
Bank overdraft	(1,444)	(428)
	<u>\$ (498)</u>	<u>\$ 168</u>

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



Notes to the unaudited interim financial statements

1. Authority and objectives

The Canadian Dairy Commission (CDC) was established in 1966 through the *Canadian Dairy Commission Act*. It is a federal Crown corporation named in Part I, Schedule III and Schedule IV to the *Financial Administration Act* and is not subject to the provisions of the *Income Tax Act*. It is an agent of Her Majesty the Queen in right of Canada and reports to Parliament through the Minister of Agriculture and Agri-Food.

The objectives of the CDC are to provide efficient producers of milk with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products. To achieve its objectives, the CDC works closely with the Canadian Milk Supply Management Committee (CMSMC), which it chairs, as well as with provincial governments and provincial milk marketing boards. This collaboration is framed by federal-provincial agreements.

The CDC is partly funded by parliamentary appropriations. This is supplemented by funding from milk producers and the market, as well as by the CDC's own commercial operations.

2. Basis of preparation

Compliance with International Financial Reporting Standards

These interim financial statements have been prepared in accordance with the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations and IAS 34 – *Interim Financial Reporting*, using International Financial Reporting Standards (IFRS).

The interim financial statements were approved and authorized for issue by the CDC Board of Directors on December 20, 2012.

The financial statements have been prepared on a historical cost basis except as permitted by IFRS.

Reporting Period

The CDC operates on a dairy year basis which starts August 1 and ends July 31.

The reporting period for these interim financial statements and notes thereto is August 1, 2012 to October 31, 2012. This represents the first quarter (Q1 2012-2013) of operations for the CDC's dairy year ending July 31, 2013.



Key sources of estimation uncertainty

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the year. Valuation of inventories, pension and post-employment benefits, and derivatives are the most significant items where estimates are used. Actual amounts could differ significantly from the current estimates. These estimates are reviewed annually and as adjustments become necessary, they are recognized in the financial statements of the period in which they become known.

Functional and presentation currency

The CDC's functional and presentation currency is the Canadian dollar.

3. Significant accounting policies

Cash

Cash includes only funds on deposit at financial institutions.

Financial instruments

Financial assets and financial liabilities are initially recognized at fair value. Their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the CDC's designation of such instruments.

Classifications:

Trade and other receivable.....	Loans and receivables
Bank overdraft.....	Financial liabilities measured at amortized cost
Trade payable and other payables.....	Financial liabilities measured at amortized cost
Loans from the Government of Canada ...	Financial liabilities measured at amortized cost
Derivative assets and liabilities.....	Financial assets or liabilities measured at fair value through profit or loss (FVTPL)

Loans and receivables

Loans and receivables are recorded at amortized cost using the effective interest method.



Financial liabilities measured at amortized cost

Financial liabilities measured at amortized cost are measured at amortized cost using the effective interest method.

Financial assets or liabilities at FVTPL

Financial assets or liabilities classified as FVTPL are measured at fair value at the statement of financial position date with changes in fair value recorded in profit or loss on the statement of operations and comprehensive income.

Transaction costs

All transaction costs in respect of financial assets and financial liabilities classified as other than held for trading are capitalized in the period in which they are incurred. Transaction costs in respect of financial assets and financial liabilities classified as held for trading are expensed in the period in which they are incurred.

Derivative financial instruments

The CDC uses derivative financial instruments such as forward contracts to counter the adverse movements in foreign exchange related to purchases and sales denominated in foreign currencies, including anticipated transactions, as well as to manage its cash balances and requirements. The CDC's policy is not to utilize freestanding derivative financial instruments for trading or speculative purposes.

The CDC does not designate its foreign exchange forward contracts as hedges of underlying assets, liabilities, firm commitments or anticipated transactions and accordingly does not apply hedge accounting. As a result, foreign exchange forward contracts are recorded on the statement of financial position at fair value as an asset when the contracts are in a gain position and as a liability when the contracts are in a loss position. Changes in fair value of these contracts are recognized as gains or losses within operating expenses.

Inventory

Inventory is recorded at the lower of cost, which is purchase cost, or estimated net realizable value. Cost is determined on a first-in, first-out basis except for Plan B inventories where cost is determined based on specific identification. Write-downs to net realizable value are reversed when there is a subsequent increase in the value of inventory up to a maximum of the purchase cost. The reversal is recognized as a reduction to cost of sales and an increase to the net value of inventory.

Inventory excludes storage charges, which are expensed when incurred.



Distribution to (recoveries from) provincial milk boards and agencies

Distributions to (recoveries from) provincial milk boards and agencies represent gross profit (loss) on sales excluding imported butter. Distributions to (recoveries from) provincial boards and agencies are recorded as expense (revenue) in the year that they are determined.

Revenues

Sales revenues

Domestic and export sales revenues are recognized when product is shipped.

Funding from milk pools

Funding from milk pools is recognized as revenue in the period the services are rendered.

Funding from the Government of Canada

Funding from the Government of Canada is recognized as revenue in the period the expenses are incurred.

Audit services

Revenues from audit services are recognized in the period the services are rendered.

Cost of sales

The CDC purchases all butter and skim milk powder tendered to it at either the Canadian support price or at other prices established by the CDC, depending on the intended resale markets, except for a portion of butter imported by the CDC at international market price. These costs are charged to cost of sales when the goods are shipped to customers.

Foreign currency translation

All foreign currency transactions are translated into Canadian dollars at the exchange rate in effect on the transaction date.

Trade receivable and payable in foreign currencies are adjusted to reflect the exchange rate in effect at the statement of financial position date. Any corresponding gains or losses are recognized in operating expenses.

Most sales and purchases in foreign currencies have corresponding foreign exchange forward contracts (see “Derivative financial instruments” above and Note 12 - Financial Instruments – *Currency risk*).



Employee benefits

Pension benefits

Substantially all of the employees of the CDC are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC to cover current service cost. Pursuant to legislation currently in place, the CDC has no legal or constructive obligation to pay further contributions with respect to any past service or funding deficiencies of the Plan. Consequently, contributions are recognized as an expense in the year when employees have rendered service and represent the total pension obligation of the CDC.

Post-employment benefits

Eligible employees are entitled to post-employment benefits as provided for under labour contracts and conditions of employment. The cost of these benefits is accrued as employees render the services necessary to earn them. The obligation relating to the benefits earned by employees is calculated by management.

Scholarship program

Scholarship program monies are expensed in the year in which educational institutions meet specified eligibility criteria and the agreements are approved.

Future accounting standards (accounting standards issued but not yet applied)

Certain new accounting standards and amendments have been published which are not required to be adopted for the current reporting period. As of the date of these financial statements, the following applicable standards and amendments were issued but are not yet effective:

- IAS 19, *Employee Benefits*, effective for annual periods beginning on or after January 1, 2013;
- IFRS 9, *Financial Instruments*, effective for annual periods beginning on or after January 1, 2015;
- IFRS 7, *Financial Instruments: Disclosures*, effective for annual periods beginning on or after January 1, 2013 for enhancing disclosures about offsetting of financial assets and financial liabilities, and effective for annual periods beginning on or after January 1, 2015 for requiring disclosures about the initial application of IFRS 9;
- IAS 32, *Financial Instruments: Presentation*, effective for annual periods beginning on or after January 1, 2014; and
- IFRS 13, *Fair Value Measurement*, effective for annual periods beginning on or after January 1, 2013.

The CDC is currently assessing the impact of these standards on its financial statements.



4. Inventory

Under section 9(1) of the *Canadian Dairy Commission Act*, the CDC operates domestic seasonality programs, which include the purchase and sale of Plan B inventory (butter and skim milk powder). Under Plan B, as set out in agreements with manufacturers, the CDC purchases products from manufacturers. While manufacturers are contractually obligated to repurchase Plan B inventory during the calendar year at the prevailing support prices, the CDC is not contractually bound to sell to the manufacturers. However, the CDC has customarily honoured all manufacturers' requests.

Inventory in dollars:

	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Plan B:		
Butter	\$63,968	\$107,143
Skim milk powder	3,206	8,785
Other butter	23,320	15,004
Other skim milk powder	<u>37,305</u>	<u>29,396</u>
	127,799	160,328
Less: allowance for inventory write-down	<u>(67)</u>	<u>(439)</u>
Total net realizable value	<u>\$127,732</u>	<u>\$159,888</u>

Inventory in tonnes:

	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Plan B:		
Butter	8,779	14,706
Skim milk powder	504	1,387
Other butter	3,680	2,110
Other skim milk powder	24,095	22,641

Inventory expensed in the first quarter was \$84.38 million (Q1 2011-2012: \$66.32 million) and is presented on the statement of operations and comprehensive income in cost of goods sold (domestically and exported).

5. Bank overdraft

The CDC has established a line of credit with a member of the Canadian Payments Association. The CDC has been granted the authority to establish this line of credit by the Minister of Finance up to a maximum of \$50 million for advancing funds to the provincial milk marketing boards and agencies. During the dairy year, the CDC's available line of credit limit can vary up to \$25 million (July 31, 2012: \$25 million).



The bank overdraft incurred under the CDC's line of credit is due on demand and bears interest at prime, which throughout the reporting period was 3.00% per annum (Q1 2011-2012: 3.00%).

6. Loans from the Government of Canada (Consolidated Revenue Fund)

Loans from the Government of Canada's Consolidated Revenue Fund, to a maximum of \$165 million (Q1 2011-2012: \$165 million), are available to finance operations. Individual loans are repayable within one year from the date the loan is advanced. Principal and accrued interest is repaid regularly during the year when funds are available.

Interest on the loans is at the normal rates established for Crown corporations by the government and based on the latest available yields of comparable Treasury bills plus one-eighth of one percent at simple interest.

Interest rates and interest expense were as follows:

	<u>October 31, 2012</u>	<u>October 31, 2011</u>
<u>Interest rates</u>		
Low	1.05%	1.04%
High	1.25%	1.11%
<u>Interest expense</u>	\$ 331	\$ 133

7. Capital disclosures

The CDC's capital consists of its loans from the Government of Canada (see Note 6) and retained earnings. As of October 31, 2012 these accounts totaled \$98.90 million (July 31, 2012: \$127.28 million) and \$15.16 million (July 31, 2012: \$11.84 million) respectively. The CDC is not subject to any externally imposed capital requirements.

The CDC's primary objective in managing capital is to ensure that it has sufficient liquidity in order to settle its financial obligations as they become due and to fund programs for the benefit of the dairy industry. The CDC adjusts its capital management approach on an ongoing basis as the amounts fluctuate during the course of the year. The CDC does not utilize any quantitative measures to monitor its capital. There were no changes in the CDC's approach to capital management or the definition thereof as compared to the previous period.

8. Foreign exchange gains and losses

Export sales include amounts representing net gains or net losses arising from currency translation relating to transactions incurred in foreign currencies.

As well, domestic cost of sales include amounts representing net gains or net losses arising from currency translation relating to import purchase transactions incurred in foreign currencies.



	<u>October 31, 2012</u>	<u>October 31, 2011</u>
Net gain (loss):		
Export sales	\$ (4)	\$ 120
Domestic cost of sales	\$ (37)	\$ 390

9. Funding from milk pools

As acting agent in carrying-out administrative functions of the Comprehensive Agreement on Pooling of Milk Revenues (a federal-provincial agreement), the CDC collects and redistributes producer market returns. For these services, the CDC receives from producers an annual fixed fee which offsets its cost for the administration of the agreement as well as the estimated carrying charges for normal levels of butter inventory. Furthermore, the CDC is reimbursed for other direct costs as set out in the agreement including carrying charges for surplus butter inventories.

10. Funding from the Government of Canada

Funding of the CDC's administrative expenses is shared among the federal government, dairy producers, commercial operations and the market place. During the reporting period, the Government of Canada funded \$1.03 million (Q1 2011-2012: \$1.52 million) of the CDC's administrative expenses of \$1.92 million (Q1 2011-2012: \$2.01 million).

11. Salaries and employee benefits

Salaries and employee benefits include:

	<u>October 31, 2012</u>	<u>October 31, 2011</u>
Salaries expense	\$1,195	\$1,159
Pension contributions	183	185
Medical insurance expense	57	64
Others	<u>31</u>	<u>31</u>
Total	<u>\$1,466</u>	<u>\$1,439</u>

Pension plan

Substantially all of the employees of the CDC are covered by the public service pension plan (the "Plan"), a contributory defined benefit plan established through legislation and sponsored by the Government of Canada. Contributions are required by both the employees and the CDC. The President of the Treasury Board of Canada sets the required employer contributions based on a multiple of the employees' required contribution. The general contribution rate effective for



the quarter ended October 31, 2012 was 1.74 times the employee's rate (1.86 times for the prior year). Total contributions of \$0.18 million (Q1 2011-2012: \$0.19 million) were recognized as expense in the current quarter.

The Government of Canada holds a statutory obligation for the payment of benefits relating to the Plan. Pension benefits generally accrue up to a maximum period of 35 years at an annual rate of 2% of pensionable service times the average of the best five consecutive years of earnings. The benefits are coordinated with Canada/Québec Pension Plan benefits and they are indexed to inflation.

Post-employment benefits

The CDC provides post-employment benefits to its eligible employees based on years of service and final salary. This benefit plan is not pre-funded and thus has no assets, resulting in a plan deficit equal to the accrued benefit obligation. Benefits are paid from future appropriations and other sources of revenue. Information about this benefit plan, measured as of the statement of financial position date, is as follows:

	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Accrued benefit obligation, beginning of period	\$ 596	\$1,083
Benefits paid during the period	-	(487)
Increase (Decrease) of obligation for the period	-	-
Accrued benefit obligation, end of period	<u>\$ 596</u>	<u>\$ 596</u>

Of the total period end obligation, no amount (July 31, 2012: no amount) is estimated by the CDC to be payable within the next year.

12. Financial instruments

In the course of carrying out its ongoing operations, the CDC faces risks to its financial assets and financial liabilities. The CDC's exposure to risk from its use of financial instruments is presented below along with the CDC's objectives, policies and processes for managing risk.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the CDC's income or the value of its holding of financial instruments.

Currency risk

The CDC operates internationally, exposing itself to market risks from changes in foreign exchange rates. The CDC partially manages these exposures by contracting only in U.S. dollars or Canadian dollars. The CDC's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The



Notes to the unaudited interim financial statements

October 31, 2012

(In thousands of Canadian dollars, unless otherwise indicated)

CDC periodically enters into foreign exchange forward contracts to manage exposure to exchange rate fluctuations between Canadian and U.S. dollars.

As of the statement of financial position date, the notional value of the CDC's outstanding forward exchange contracts totaled \$10.43 million Canadian equivalent (July 31, 2012: \$6.45 million Canadian equivalent). These contracts will mature over the period ending February 8, 2013. The maturity dates of the forward exchange contracts correspond to the estimated dates when the CDC expects to receive the foreign currency proceeds arising from export sales contracts or when payment for purchases in foreign currencies are due.

The fair value of the CDC's derivative financial instruments is determined using the Bank of Canada's published foreign exchange rates as of the statement of financial position date. The CDC's foreign exchange forward contracts as of the statement of financial position date are as follows:

		<u>October 31, 2012</u>		<u>July 31, 2012</u>	
<u>Currency sold</u>	<u>Currency purchased</u>	<u>In USD</u>	<u>In CAD</u>	<u>In USD</u>	<u>In CAD</u>
USD	CAD	\$7,432	\$7,425	\$1,930	\$1,990
CAD	USD	\$3,013	\$3,010	\$4,505	\$4,579

Other charges (recoveries) under Operating expenses on the statement of operations and comprehensive income include \$0.22 million representing losses incurred during the current quarter (Q1 2011-2012: net gains of \$0.22 million) arising from the determination of fair value of the CDC's derivative financial instruments.

The CDC's exposure to foreign currency risk was as follows, based on Canadian dollar equivalent amounts:

<u>In CAD</u>	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Trade receivable	\$ 767	\$2,574
Trade payable	(398)	-
Net derivative asset (liability)	<u>(228)</u>	<u>(7)</u>
Net exposure	<u>\$ 141</u>	<u>\$2,567</u>

Based on the net exposure as of October 31, 2012, and assuming that all other variables remained constant, had the Canadian dollar appreciated 10% against the US dollar, net income for the quarter ended October 31, 2012 would have increased by \$0.71 million (Q1 2011-2012: increased by \$0.09 million). Conversely, a 10% weakening in the Canadian dollar against the US dollar would have had the equal but opposite effect for the same period.



Interest rate risk

Interest rate risk is the risk that a financial asset containing a fixed interest rate component decreases in value with a rise in interest rates or that a financial liability with a floating interest rate component results in increased cash outflow requirements as a result of an increase in interest rates. Other than the line of credit, for which interest expense varies as a function of prime, and loans from the Government of Canada, which vary as a function of the yield on comparable Treasury bills, the CDC does not have any other such financial assets or liabilities exposed to this risk. The CDC's exposure to interest rate risk is not significant given its low interest bearing loans.

Other price risk

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or currency risk. The CDC is not exposed to this type of risk.

Liquidity risk

Liquidity risk is the risk that the CDC will not be able to meet its financial obligations as they fall due. As of the statement of financial position date, virtually all of the CDC's assets and liabilities were current and the CDC had a current ratio equal to 1.13 (July 31, 2012: 1.09). In managing liquidity risk, the CDC has access to additional borrowings for commercial operations from the Government of Canada in the amount of \$66.10 million as of October 31, 2012 (July 31, 2012: \$37.72 million) as well as \$3.56 million (July 31, 2012: \$3.21 million) on its line of credit for the pooling of market returns.

Credit risk

Credit risk is the risk of loss due to a customer failing to meet its financial obligations to the CDC. Maximum credit exposure is the carrying amount of the pooling and trade receivable balances, net of any allowance for losses. The CDC manages this risk using several strategies which include selling product on a "payment first" basis, securing of bank guarantees and obtaining letters of credit. As of October 31, 2012 and July 31, 2012 the CDC did not have an allowance for doubtful accounts and all trade receivables were current.

The CDC is exposed to credit risk when entering into foreign exchange contracts wherein the counterparty fails to perform an obligation as agreed upon, causing a financial loss. Maximum credit exposure is the carrying amount of the derivative asset. The CDC manages this exposure to credit risk by entering into foreign exchange contracts only with major Canadian financial institutions. To date, no such counterparty has failed to meet its financial obligation to the CDC.

Fair values

The carrying value of cash, trade receivable, bank overdraft, trade payable and accrued liabilities approximates their fair values due to the immediate or short-term maturity of these



financial instruments. As of the statement of financial position date, no amounts representing changes in fair value of these financial instruments have been recorded in the statement of operations and comprehensive income.

Fair value hierarchy

Financial instruments recorded at fair value on the statement of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy, which for the CDC is only relevant in the context of derivative financial instruments, has the following levels:

Level 1: valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3: valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value measurement of the CDC's derivative financial instruments is classified as level 2 (July 31, 2012: level 2) in the fair value hierarchy. Changes in valuation methods may result in transfers into or out of levels 1, 2, and 3. For the reporting periods ended October 31, 2012 and July 31, 2012, there were no transfers between levels.

13. Commitments

a) Industry Initiatives

<i>Summary:</i>	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Canadian Quality Milk	\$ 945	\$ 945
Matching Investment Fund	938	938
Dairy Research Cluster	500	500
Iodine Study	116	116
Scholarship Program	<u>1,613</u>	<u>1,700</u>
Total Commitments	<u>\$4,112</u>	<u>\$4,199</u>



Canadian Quality Milk (CQM)

This program is a quality assurance program for raw milk on farms. The CDC has agreed to partially fund this program under an agreement that commenced August 1, 2007 and was extended to July 31, 2014. Under the terms of the agreement, the CDC will contribute up to two hundred dollars per eligible farm until July 31, 2013 and one hundred dollars until July 31, 2014. In addition to the contributions per farm, the CDC has agreed to provide funding of \$0.10 million towards the CQM's National Electronic Administration system.

Matching Investment Fund

The CDC funds and administers the Matching Investment Fund which provides non-repayable contributions to Canadian-registered companies or food technology centres for product development, on a matching investment basis. The program expires on July 31, 2014.

Dairy Research Cluster

This Dairy Farmers of Canada initiative enables key industry-led agricultural organizations to mobilize a critical mass of scientific and technical resources to support innovation strategies for enhanced profitability and competitiveness in their sector. The CDC has agreed to partially fund this project under an agreement that commenced on July 1, 2010 and expires on March 31, 2013. Under the terms of the agreement the CDC will contribute \$1.50 million during the period of January 1, 2010 to March 31, 2013 towards the \$11.80 million project proposed by Dairy Farmers of Canada and approved under the Agriculture and Agri-Food Canada, Growing Canadian Agri-Innovations Program, Canadian Agri-Science Cluster Initiative.

Iodine Study

The CDC has agreed to contribute a maximum of \$0.34 million to Dairy Farmers of Canada towards conducting an analysis for determining the level of iodine in bulk tank milk of individual dairy farms over a period of three years from August 1, 2010 to July 31, 2013.

Scholarship Program

As of August 1, 2011, the CDC funds a graduate Scholarship Program. The CDC grants \$3.00 million in scholarships over five years to participating institutions across Canada.

b) Purchase Commitments

As of October 31, 2012, the CDC was committed to purchase certain quantities of butter and skim milk powder. These commitments amounted to approximately \$2.79 million (July 31, 2012: \$2.01 million) and are due to be fulfilled by December 2012.



c) *WTO Tariff Rate Quotas for Butter*

Under the terms of the 1994 WTO Agreement, Canada has established tariff rate quotas (TRQ) for a number of dairy products. TRQs are the quantities of products that can enter Canada with little or no tariff. With the support of the industry, the CDC has acted as the receiver of imports of butter under federal permit since 1995 and has directed this product through butter manufacturers to the food sector. The 2013 TRQ for butter remains at 3,274 tonnes. World prices at the time of purchase will determine the total financial commitment.

Total cost to purchase imported butter under the WTO requirements for the quarter ended October 31, 2012 was \$3.00 million (Q1 2011-2012: \$12.33 million).

d) *Operating Lease*

The CDC is committed under a long term lease with Agriculture and Agri-Food Canada for office accommodation ending in March 31, 2017. The lease contains escalation clauses regarding maintenance costs and taxes. This lease may be automatically renewed at the CDC's option for another period of five years with rates possibly revised in order to reflect the rental market value pursuant to Treasury Board's Policy on Real Property.

The minimum lease payments are as follows:

	<u>October 31, 2012</u>	<u>July 31, 2012</u>
Less than one year	\$ 351	\$ 351
Greater than one year and less than five years	\$1,172	\$1,289

14. Related party transactions

Government of Canada entities

The CDC, as per the *Canadian Dairy Commission Act*, is an agent of Her Majesty the Queen in right of Canada. This effectively makes the Government of Canada *de jure* owner of the CDC, having significant influence over its activities.

The CDC is related in terms of common ownership to all other Government of Canada-created departments, agencies and Crown corporations. The CDC enters into transactions with these entities in the normal course of business and at normal trade terms.

In accordance with disclosure exemption regarding "government related entities", the CDC is exempt from certain disclosure requirements of IAS 24 relating to its transactions and outstanding balances with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.



Based on this exemption, the CDC has not disclosed any further details of its transactions with the Government of Canada and departments thereof, and all federal Crown corporations not considered to be individually or collectively significant entered into in the normal course of operations.

Related party transactions such as employee benefit expenses for contributions to the Plan (Note 11), accommodations, and professional services are recorded at their exchange amounts and totaled \$0.46 million during the reporting period (Q1 2011-2012: \$0.49 million).

Loans from the Government of Canada at terms available to Crown corporations (Note 6), which are recorded at carrying value due to the absence of an observable market rate, represent the CDC's largest related party transaction.

Significant transactions, excluding loans, were with the following related parties:

<u>Government entity</u>	<u>October 31, 2012</u>	<u>October 31, 2011</u>
Public Works and Government Services Canada	\$ 264	\$ 281
Agriculture and Agri-Food Canada	\$ 164	\$ 185

Key management personnel

The CDC's key management personnel are the CEO, the Chairman, the Commissioner and the three directors.

No loans or other such transactions with key management were outstanding as of October 31, 2012 or occurred at any time during the reporting period.

The post-employment benefit liability for key management personnel as of October 31, 2012 was \$0.22 million (July 31, 2012: \$0.21 million) and is included in post-employment benefits on the statement of financial position.

Compensation of key management personnel for the quarter ended October 31, 2012 was \$0.18 million (Q1 2011-2012: \$0.16 million).