Quarterly Financial Report

Second quarter

November 2018 to January 2019

Contents

Quarterly Financial Report

Second quarter (Q2) – November 2018 to January 2019

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 in January 2019 should be read in conjunction with the financial statements enclosed herein and the 2017-2018 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, 2018, 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 the CDC Board of directors.

2. Financial Results

Domestic Activities

	For the quarter ended January 31			For the 6 months ended January 31		
(in thousands)	2019	2018	$ change	2019	2018	$ change
Domestic sales revenue	$ 45,342	$ 73,653	$(28,311)	$ 224,683	$ 168,643	$ 56,040
Cost of goods sold - domestic	$ 40,954	$ 70,226	$(29,272)	$ 217,441	$ 161,056	$ 56,385
Transport and carrying charges	$ 751	$ 1,323	$ (572)	$ 1,714	$ 2,884	$ (1,170)
Finance costs	$ 180	$ 122	$ 58	$ 335	$ 322	$ 13
Gross profit on domestic sales	**$ 3,457**	**$ 1,982**	**$ 1,475**	**$ 5,193**	**$ 4,381**	**$ 812**

The CDC purchases and sells butter in order to regulate the supply of dairy products in the domestic market throughout the year. The CDC is also depleting its remaining inventories of skim milk powder (SMP) through domestic sales.

Though Domestic sales in the second quarter of this year were lower compared to the same period in the previous year, they are higher on a year-to-date basis as a result of higher Plan A and Plan B sales due to higher levels of butter inventories at the end of the previous year. A total of 23,975 tonnes of domestic butter was sold in the first six months of 2019 compared to 16,788 tonnes over the same period last year. Gross profits are higher in the current year mainly as a result of lower transport and carrying charges.

Export Activities

(in thousands)	For the quarter ended January 31 2019	2018	$ change	For the 6 months ended January 31 2019	2018	$ change
Export sales revenue	$ -	$ -	$ -	$ 839	$ -	$ 839
Cost of goods sold - exports	$ -	$ -	$ -	$ 685	$ -	$ 685
Transport and carrying charges	$ -	$ -	$ -	$ 7	$ -	$ 7
Finance costs	$ -	$ -	$ -	$ -	$ -	$ -
Gross profit on export sales	**$ -**	**$ -**	**$ -**	**$ 147**	**$ -**	**$ 147**

As at January 31, 2019, the only sales through export activities in the dairy year 2018-2019 were the small quantity of butter sold in the first quarter.

Other Income

(in thousands)	For the quarter ended January 31 2019	2018	$ change	For the 6 months ended January 31 2019	2018	$ change
Funding from milk pools	$ 2,197	$ 2,048	$ 149	$ 4,119	$ 4,123	$ (4)
Funding from the Government of Canada	$ 988	$ 1,070	$ (82)	$ 1,950	$ 1,868	$ 82
Audit services	$ -	$ -	$ -	$ (1)	$ (11)	$ 10
Total other income	**$ 3,185**	**$ 3,118**	**$ 67**	**$ 6,068**	**$ 5,980**	**$ 88**

Funding from milk pools represents funding received from producers and the marketplace to finance a portion of the CDC's administrative expenses, the Cost of production study, as well as the carrying charges associated with the CDC's butter stocks.

Funding from the Government of Canada represents funding received from parliamentary appropriations and is recognized in the Statement of Operations and Comprehensive Income as government-funded administrative expenses are incurred. Generally, the utilization of the funding varies based on the timing of related expenses.

Audit services income relates to the milk utilization audits performed by the CDC on a cost-recovery basis in plants of 6 provinces. The income is recognized when the audit reports are delivered. The account's credit balance is explained by a small billing correction reported in the first quarter.

Operating and Administrative Expenses

(in thousands)	For the quarter ended January 31 2019	2018	$ change	For the 6 months ended January 31 2019	2018	$ change
Operating expenses						
Industry initiatives	$ 326	$ 108	$ 218	$ 1,377	$ 209	$ 1,168
Cost of Production study	$ 205	$ 202	$ 3	$ 408	$ 403	$ 5
Other charges (recoveries)	$ (17)	$ 284	$ (301)	$ 2	$ 116	$ (114)
Total operating expenses	**$ 514**	**$ 594**	**$ (80)**	**$ 1,787**	**$ 728**	**$ 1,059**
Administrative expenses						
Salaries and employee benefits	$ 1,672	$ 1,612	$ 60	$ 3,291	$ 3,093	$ 198
Other administrative expenses	$ 592	$ 539	$ 53	$ 1,048	$ 1,044	$ 4
Total administrative expenses	**$ 2,264**	**$ 2,151**	**$ 113**	**$ 4,339**	**$ 4,137**	**$ 202**
Total operating and administrative expenses	**$ 2,778**	**$ 2,745**	**$ 33**	**$ 6,126**	**$ 4,865**	**$ 1,261**

Operating Expenses

Expenses relating to Industry initiatives increased compared to the same periods last year. These increases are mainly attributable to disbursements made under the new Workforce Development Initiative announced by the CDC in December 2017.

Expenses relating to the Cost of Production study are similar when compared to the same period in the previous year.

“Other charges (recoveries)” include unrealized gains or losses on outstanding foreign exchange contracts as at the Statement of Financial Position date, which vary in accordance with the fluctuations in exchange rates, as well as the carrying amount of outstanding foreign exchange contracts at the end of a given period. The changes in “Other charges (recoveries)” for the periods reported are mainly due to these variations.

Administrative Expenses

Total administrative expenses are higher when compared to the previous periods, which is mainly explained by the timing of expenses.

Inventories and Loans

The value of inventory as at January 31, 2019, was $117.16 million, which is lower than the value of inventory of $221.97 million as at July 31, 2018.

Butter stocks at the end of the second quarter were approximately 14,090 tonnes, a decrease of approximately 11,810 tonnes since July 31, 2018. The decrease in mainly the result of processors’ decision in the first quarter to repurchase most of the Plan B butter they sold to the CDC prior to the Support Price increase effective September 1st, 2018.

Skim milk powder (SMP) stocks at the end of the second quarter were approximately 145 tonnes, a decrease of approximately 12,561 tonnes since July 2018. This is the result of the CDC no longer purchasing SMP under the Surplus Removal and Domestic Seasonality Programs as of February 1, 2017, following the implementation of some elements of the National Ingredient Strategy.

The loan from the Government at the end of the second quarter was $58.03 million compared to $152.85 million as of July 2018. Lower overall inventory values resulted in lower loan requirements.

Cash Flows

	For the quarter ended January 31		For the 6 months ended January 31	
(in thousands)	2019	2018	2019	2018
Cash flows from (used in) operating activities	$ (28,564)	$ 42,672	$ 88,701	$ 76,235
Cash flows from (used in) financing activities	$ 28,861	$ (45,021)	$ (94,824)	$ (77,263)
Net decrease (increase) in net bank overdraft	**$ 297**	**$ (2,349)**	**$ (6,123)**	**$ (1,028)**
Net bank overdraft at beginning of the period	$ (7,077)	$ (4,463)	$ (657)	$ (5,784)
Net bank overdraft at the end of the period	**$ (6,780)**	**$ (6,812)**	**$ (6,780)**	**$ (6,812)**

The CDC's closing bank cash position for the end of the second quarter was a net overdraft of $6.78 million compared to a net overdraft of $6.81 million as at July 31, 2018. This represents an increase in the net cash position of $0.03 million.

Cash Flows from Operating Activities

Net cash outflows from operating activities occurring during the second quarter this year amounted to $28.56 million compared to net cash inflows of $42.67 million over the same period last year. The near $70 million cashflow difference is mainly explained by increased inventory purchasing activities resulting in additional cash outflows and lower inventory sales resulting in less cash inflows. On a year-to-date basis, the higher net cash inflows are mainly the result of higher than usual sales of Plan B inventories in the first quarter, which are due to a high volume of inventory carrying over from the previous dairy year and the support price increase of September 2018 which prompted processors to repurchase their inventory before the increase.

Cash Flows from Financing Activities

Net cash inflows from financing activities occurring during the second quarter amounted to $28.86 million compared to net outflows of $45.02 million over the same period last year. The CDC's financing activities are directly correlated to its day-to-day commercial operations as Loans from the Government of Canada fluctuates daily depending on the CDC's cash position at the end of a given day. Therefore, the net cash inflow in the second quarter this year is explained by greater loan requirements due to less cash being generated from commercial operations. On a year-to-date basis, the net cash outflows were greater in the first six months of 2019 compared to 2018 since more cash was available during the period, due to the increased sales, and resulted in greater loan repayments.

3. Outlook against the Corporate Plan Summary

Key factors that may impact the budget reported in the Corporate Plan Summary are total industrial milk production, domestic requirements, support prices, and world market conditions for the sale of dairy products. Any significant changes in these key assumptions would affect the budgeted results.

As of January 31, 2019, total milk production for the most recent 12-month period reached 380.9 M kg of BF. Total production will likely be aligned to the forecast by March 31, 2019, as producers use available production credits and the production realigns itself with the quota following the reinstatement of over/under penalties. Total requirements forecast for the end of March 2019 will be slightly lower than initially included in the Corporate Plan summary due to a slowdown in market growth.

Current levels of CDC and private stocks reached 37,491 tonnes on January 31, 2019. The September 1, 2018 change in the support price for butter resulted in a decrease in CDC butter stocks and corresponding increase in private butter stocks. Total butter stocks are expected to increase to 40,000 tonnes by March 31, 2019. The industry has taken several measures to realign production with demand and allow stocks to return to normal levels within the coming year.

4. Appropriations

The following table reconciles the appropriations received and disbursed.

	For the quarter ended January 31			**For the 6 months ended January 31**		
(in thousands)	2019	2018	$ change	2019	2018	$ change
Opening Balance	$ -	$ -	$ -	$ -	$ -	$ -
Parliamentary appropriations	$ 988	$ 1,070	$ (82)	$ 1,950	$ 1,868	$ 82
Amount disbursed	$ (988)	$ (1,070)	$ 82	$ (1,950)	$ (1,868)	$ (82)
Ending Balance	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**

These appropriations were granted via the Main Estimates. Parliamentary appropriations are used to fund part of the CDC's administrative expenses. The remainder of the CDC's administrative expenses are funded by dairy producers, commercial operations, and the marketplace.

Funding from the Government of Canada is granted based on the Government fiscal year of April to March, while the funds are used and reported in accordance with the dairy year of August to July. The CDC reports the use of its appropriations on a Government fiscal year basis in the Public Accounts of Canada.

5. Risk Management

On January 18, 2018, the CDC Board adopted an updated Corporate Risk Profile for dairy year 2018-2019. Cyber security was identified as an important risk and various measures are being implemented to mitigate this risk. The Policy on Government Security will be implemented once it becomes available.

6. Significant Changes

The following significant changes in operations, industry initiatives, programs, personnel, objectives, and Governing Board occurred between November 1, 2018, and January 31, 2019, in comparison with the Corporate Plan Summary.

Operations, industry initiatives, and programs	No significant change occurred in this quarter.
Personnel	No significant changes occurred in this quarter.
Objectives	No significant changes occurred in this quarter.
Governing Board	No change in the membership of the governing board occurred in this quarter.

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 are necessary to enable the preparation of quarterly financial statements that are free from material misstatements. 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

Serge Riendeau, Chief Executive Officer

Chantal Laframboise, Director, Finance and Administration

Ottawa, Canada

March 19, 2019

Canadian Dairy Commission
Statement of Financial Position
(unaudited)
(in thousands of Canadian dollars)

	As at January 31, 2019	As at July 31, 2018
Assets		
Current		
Cash	$ 7	$ 6,925
Trade and other receivables		
Trade receivables	235	467
Advance to provincial milk boards and agencies	6,787	7,582
Milk pools	1,582	1,985
Derivative asset - foreign exchange contracts	32	-
Inventory (Note 4)	117,158	221,970
	125,801	238,929
Non-Current		
Equipment	110	120
Intangible asset	152	170
	$ 126,063	$ 239,219
Liabilities		
Current		
Bank overdraft (Note 5)	$ 6,787	$ 7,582
Trade and other payables		
Trade payables	20,731	15,558
Distribution to provincial milk boards and agencies	-	10,900
Other liabilities (Note 6)	644	17,736
Loans from the Government of Canada (Note 7)	58,028	152,852
	86,190	204,628
Equity		
Retained earnings	39,873	34,591
	$ 126,063	$ 239,219

Commitments (Note 14)

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

These financial statements were approved and authorized for issue on March 19, 2019

Serge Riendeau
Chief Executive Officer

Alistair Johnston
Chairman

Chantal Laframboise
Director, Finance and Administration

Canadian Dairy Commission
Statement of Operations and Comprehensive Income
(unaudited)
(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2019	January 31, 2018	January 31, 2019	January 31, 2018
Sales and cost of sales				
Domestic sales revenue	$ 45,342	$ 73,653	$ 224,683	$ 168,643
Cost of goods sold - domestic	40,954	70,226	217,441	161,056
Transport and carrying charges	751	1,323	1,714	2,884
Finance costs	180	122	335	322
Gross profit on domestic sales	3,457	1,982	5,193	4,381
Export sales revenue	-	-	839	-
Cost of goods sold - exports	-	-	685	-
Transport and carrying charges	-	-	7	-
Finance costs	-	-	-	-
Gross profit on export sales	-	-	147	-
Total gross profit	3,457	1,982	5,340	4,381
Other income				
Funding from milk pools	2,197	2,048	4,119	4,123
Funding from the Government of Canada (Note 11)	988	1,070	1,950	1,868
Audit services	-	-	(1)	(11)
	3,185	3,118	6,068	5,980
Total gross profit and other income	**6,642**	**5,100**	**11,408**	**10,361**
Operating expenses				
Industry initiatives	326	108	1,377	209
Cost of Production study	205	202	408	403
Other charges (recoveries)	(17)	284	2	116
	514	594	1,787	728
Administrative expenses				
Salaries and employee benefits (Note 12)	1,672	1,612	3,291	3,093
Other administrative expenses	592	539	1,048	1,044
	2,264	2,151	4,339	4,137
Total operating and administrative expenses	**2,778**	**2,745**	**6,126**	**4,865**
Profit before distribution to provincial milk boards and agencies	**3,864**	**2,355**	**5,282**	**5,496**
Distribution to provincial milk boards and agencies	-	-	-	-
Total comprehensive income	**$ 3,864**	**$ 2,355**	**$ 5,282**	**$ 5,496**

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

Canadian Dairy Commission
Statement of Changes in Equity
(unaudited)
(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2019	January 31, 2018	January 31, 2019	January 31, 2018
Retained earnings, beginning of the period	$ 36,009	$ 39,109	$ 34,591	$ 35,968
Total comprehensive income for the period	3,864	2,355	5,282	5,496
Retained earnings, end of the period	$ 39,873	$ 41,464	$ 39,873	$ 41,464

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

Canadian Dairy Commission
Statement of Cash Flows
(unaudited)
(in thousands of Canadian dollars)

	For the three months ended		For the six months ended	
	January 31, 2019	January 31, 2018	January 31, 2019	January 31, 2018
Cash flows from (used in) operating activities				
Cash receipts from sales of goods and services	$ 35,400	$ 76,491	$ 209,445	$ 171,693
Cash paid to suppliers and others	(67,052)	(34,385)	(116,532)	(92,121)
Cash receipts from provincial milk boards and agencies (pooling)	2,188	(289)	5,317	3,611
Cash paid to provincial milk boards and agencies	-	-	(10,900)	(8,400)
Cash receipts from the Government of Canada	988	1,070	1,950	1,868
Interest paid on loans	(88)	(215)	(579)	(416)
Net cash flows from (used in) operating activities	**(28,564)**	**42,672**	**88,701**	**76,235**
Cash flows from (used in) financing activities				
New loans from the Government of Canada	56,218	26,050	85,502	68,091
Loan repayments to the Government of Canada	(27,357)	(71,071)	(180,326)	(145,354)
Net cash flows from (used in) financing activities	**28,861**	**(45,021)**	**(94,824)**	**(77,263)**
Net decrease (increase) in net bank overdraft	297	(2,349)	(6,123)	(1,028)
Net bank overdraft at beginning of the period	(7,077)	(4,463)	(657)	(5,784)
Net bank overdraft at the end of the period	**$ (6,780)**	**$ (6,812)**	**$ (6,780)**	**$ (6,812)**
Components:				
Cash	$ 7	$ 40	$ 7	$ 40
Bank overdraft	(6,787)	(6,852)	(6,787)	(6,852)
Net bank overdraft	**$ (6,780)**	**$ (6,812)**	**$ (6,780)**	**$ (6,812)**

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 to obtain a fair return for their labour and investment, and to provide consumers 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 and agencies. 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.

Directive on Travel, Hospitality, Conference and Event Expenditures

In July 2015, the CDC was issued a directive (P.C. 2015-1104) pursuant to section 89 of the *Financial Administration Act* to align its travel, hospitality, conference and event expenditure policies, guidelines and practices with Treasury Board policies, directives and related instruments on travel, hospitality, conference and event expenditures in a manner that is consistent with its legal obligations, and to report on the implementation of this directive in the CDC's next Corporate Plan. As at January 31, 2019, the CDC continues to meet the requirements of this directive.

2. Basis of preparation

Statement of compliance

The CDC prepared these financial statements 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 financial statements were approved and authorized for issue by the CDC Board effective March 19, 2019.

Basis of presentation

The financial statements are prepared on a historical cost basis, as set out in the accounting policies below, except as permitted by IFRS and otherwise indicated within these notes.

Reporting period

The CDC reports 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, 2018 to January 31, 2019. This represents the second quarter (Q2 2018-2019) of operations for the CDC's dairy year ending July 31, 2019.

Key accounting judgments, estimates and assumptions

The preparation of financial statements in accordance with IFRS requires management to exercise judgment and 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, as well as the reported amounts of revenues and expenses during the year. Areas where management has exercised judgment and made significant use of estimates and assumptions are discussed below.

Judgments in determining the timing of satisfaction of performance obligations and incremental costs in contracts with customers

The CDC's contracts each contain a single performance obligation, the majority of which are satisfied at a point in time within a year. The CDC's only contract with a performance obligation satisfied over time pertains to the administration of the pooling agreements. Management has concluded that the satisfaction of this performance obligation is achieved on a monthly basis as pooling calculations are conducted. Given that the CDC's contracts' performance obligations are satisfied within a year, the CDC recognizes the incremental contract costs as an expense when incurred.

Key sources of estimation uncertainty

The CDC has no key sources of estimation uncertainty relating to revenue for the reporting period.

Plan B Inventory

Under section 9(1) of the *Canadian Dairy Commission Act*, the CDC operates domestic seasonality programs, which includes the purchase of Plan B inventory (butter and skim milk powder) from manufacturers who are contractually obligated to repurchase the inventory within the year at the prevailing support prices.

Although the CDC customarily honours manufacturers' requests for repurchase, the CDC has determined that the significant risks and rewards of ownership of the asset are transferred to the CDC when the inventory is initially purchased (until it is sold), given conditions set out in the purchase agreements do not obligate the CDC to sell the inventory to the manufacturers, and the CDC bears all costs of holding the inventory, including theft and damage.

Allowance for inventory write-down

Management determines the allowance for inventory write-down through the use of assumptions. The net realizable value of inventory on hand at year end is estimated using the price of milk on the international market as well as the price of existing contracts at or around year-end. These estimates are reviewed annually and as adjustments become necessary, they are recognized in the Statement of Operations and Comprehensive Income of the period in which they become known.

Functional and presentation currency

These financial statements are reported in Canadian dollars, which is the functional and presentation currency of the CDC.

3. Significant accounting policies

Cash

Cash includes funds on deposit at financial institutions.

Financial Instruments

Financial assets and financial liabilities are initially recognized at fair value. The exception is trade receivables that do not contain a significant financing component, which are measured at the transaction price. The classification and subsequent measurement model of financial instrument categories are described below.

Classifications and subsequent measurements:

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

Financial assets and financial liabilities measured at amortized cost

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

Financial assets or financial liabilities measured at FVTPL

Financial assets or financial 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 instruments classified as and subsequently measured at amortized cost, are capitalized in the period in which they are incurred including at initial recognition. All transaction costs in respect of financial instruments classified as financial assets or financial liabilities measured at FVTPL are expensed in the period in which they are incurred.

Impairment

As the CDC's trade and other receivables' payment terms do not include significant financing components, the simplified approach for trade receivables must be applied when determining an impairment provision. Under the simplified approach, the CDC measures the loss allowance at an amount equal to lifetime expected credit losses.

Derivative financial instruments

The CDC uses derivative financial instruments such as foreign exchange forward contracts to counter the adverse changes 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 does not use 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, when held, are reported 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 are recognized as gains or losses in "Other charges (recoveries)" on the Statement of Operations and Comprehensive Income.

Inventory

Inventory is reported 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 in the year in which it occurs.

Equipment

Equipment is reported at cost less accumulated depreciation. Cost includes all measurable expenditures directly attributable to the acquisition and installation of the equipment.

Depreciation is reported in "Other charges (recoveries)" on the Statement of Operations and Comprehensive Income and begins when the equipment is available for use by the CDC.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset less estimated residual value as follows:

Generator..................................... 10 years
Computer equipment.................... 3-5 years

Equipment is reviewed annually for indications of impairment or changes in estimated future economic benefits. If such impairments or changes exist, the carrying value is adjusted accordingly.

Intangible asset

Software

Internally developed application software is stated at cost less accumulated amortization. Cost includes all measurable expenditures directly attributable to the development of the software including employees' salaries, consultant fees and other identifiable costs specific to the project.

Amortization of the intangible asset is reported in “Other charges (recoveries)” on the Statement of Operations and Comprehensive Income and is calculated on a straight-line basis over its estimated useful life of ten years.

Software is reviewed annually for indications of impairment or changes in estimated future economic benefits. If such impairments or changes exist, the carrying value is adjusted accordingly.

Revenue

Sales revenues

Domestic and export sales of dairy products are recognized as revenue at a point in time when control of the asset is transferred to a customer. Control is typically transferred when the product is loaded into the customer's transportation equipment at the CDC's warehouse facilities – the customer being responsible for the transportation of the product.

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 as the intermediary of the provincial milk marketing boards and agencies. For these services, the CDC receives from producers an annual fixed fee which offsets the costs associated with 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. Funding from milk pools is recognized as revenue over time, which typically occurs on a monthly basis when pooling calculations are completed and producer market returns are collected and redistributed among the provincial milk marketing boards and agencies.

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 at a point in time when the audit reports are delivered.

Distribution to provincial milk boards and agencies and recovery from provincial milk boards and agencies

The CDC administers the Surplus Removal Program and the Domestic Seasonality Programs throughout the year, but operating surplus or deficits generated by these programs are respectively returned to or recovered from the provincial milk boards and agencies. In both cases, they are reported on the Statement of Operations and Comprehensive Income in the year that they are determined. In the event of an operating surplus at year-end, the return is reported under “Distribution to provincial milk boards and agencies”. For an operating deficit, the recovery is reported under “Recovery from provincial milk boards and agencies”.

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 prices. These costs are expensed under 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 receivables and payables in foreign currencies are adjusted to reflect the exchange rate in effect as at the Statement of Financial Position date. Any ensuing exchange gains or losses are recognized in “Export sales revenue” for receivables and “Cost of goods sold – domestic” for payables on the Statement of Operations and Comprehensive Income.

For derivative foreign exchange contracts, changes in fair value are recognized in “Other charges (recoveries)” on the Statement of Operations and Comprehensive Income.

Employee benefits

Pension benefits

Substantially all 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.

Application of new accounting standards

The adoption of the following new accounting standards, issued by the International Accounting Standards Board (IASB), is required for annual accounting periods beginning on or after January 1, 2018. Given the CDC’s year-end of July 31, the initial date of application for the new standards was August 1, 2018. The transition affects disclosures in the notes to the financial statements:

> IFRS 15 – *Revenue from Contracts with Customers* was issued to provide guidance on the recognition of contract revenues. The CDC adopted the full retrospective approach in its adoption of the new standard. However, the CDC established that no amounts reported in the financial statements have been impacted by the adoption and, as such, no restatement of comparative figures is required. The adoption of this standard did result in additional disclosures being required in relation to the use of judgments, revenue recognition and disaggregation of revenue.

> IFRS 9 – *Financial Instruments* was issued to introduce new classification and measurement requirements, a new hedge accounting model, as well as a single forward-looking expected credit loss impairment model. The adoption of this new standard resulted in terminology changes to note disclosures, with no impact on the amounts reported in the financial statements.

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

A number of new accounting standards and amendments applicable for annual accounting periods beginning on or after January 1, 2019 were issued by the IASB. Given the CDC’s year-end of July 31, the initial date of application for the new standards will be August 1, 2019. As at the date of the financial statements, the following applicable standard has been assessed as having a possible impact in the CDC’s financial statements:

> IFRS 16 – *Leases* provides a single lessee accounting model, requiring assets and liabilities to be recognized for all leases, unless the lease term is 12 months or less or the underlying asset has a low value. The CDC has completed its assessment of IFRS 16. The new IFRS will require the recognition of a lease asset and a lease liability on the Statement of Financial Position for the CDC’s office space lease currently classified as an operating lease (see Note 14 –

(In thousands of Canadian dollars, unless otherwise indicated)

Commitments). Based on preliminary estimates, the lease asset and lease liability on transition will both be valued at approximately $2.6M. Additional disclosures will also be required in the notes to the financial statements.

4. Inventory

The CDC's inventory is comprised of butter and skim milk powder purchased under the domestic seasonality and surplus removal programs. Since February 1, 2017, in accordance with the National Ingredient Strategy, the CDC is no longer purchasing skim milk powder under these programs, and the remaining inventory on hand will be liquidated within the next twelve months. The CDC also imports butter under the World Trade Organization (WTO) Agreement on Agriculture.

Inventory:

	January 31, 2019		July 31, 2018	
	in $	in tonnes	in $	in tonnes
Plan B Butter	$ 95,186	11,364	$ 175,254	21,818
Other butter	21,812	2,726	32,520	4,083
Skim milk powder	160	145	15,934	12,706
	117,158		223,708	
Less: allowance for inventory write-down	-		(1,738)	
Total net realizable value	$ 117,158		$ 221,970	

Inventory expensed in the second quarter was $40.95 million (Q2 2017-2018: $70.23 million) and is reported on the Statement of Operations and Comprehensive Income in “Cost of goods sold (domestic and exports)”.

5. Bank overdraft

The CDC has established a line of credit with a member of the Canadian Payments Association. This line of credit was authorized by the Minister of Finance up to a maximum of $50 million with its intended use of advancing funds to the provincial milk marketing boards and agencies. The line of credit is provided in the form of a bank overdraft. As at January 31, 2019 the authorized credit limit from the bank is $10 million. This loan is due on demand and bears interest calculated at the prime rate of 3.95% per annum as at January 31, 2019 (January 31, 2018: 3.45%).

(In thousands of Canadian dollars, unless otherwise indicated)

6. Other liabilities

Other liabilities includes:

	January 31, 2019	July 31, 2018
Deferred revenue	$ 4	$ 16,800
Other liabilities	640	936
Total	$ 644	$ 17,736

Deferred revenue is comprised of revenue received in advance for the sale of butter or skim milk powder inventories not yet transferred to the purchaser as at quarter-end.

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

Loans from the Government of Canada's Consolidated Revenue Fund are available to finance operations, up to a maximum of $225 million (July 31, 2018: $225 million). Individually, the loans mature one year after the funds are advanced. Principal and interest is paid regularly during the year when funds are available. Changes in Loans from the Government of Canada are due to financing activities, limited to changes arising from cash flows, which is reflected in the Statement of Cash Flows.

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

	Three months		Six months	
Interest rates	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Low	1.59%	0.69%	1.21%	0.64%
High	1.79%	1.13%	1.79%	1.13%
Interest expense	$ 180	$ 122	$ 335	$ 322

8. Capital management

The CDC's capital consists of loans from the Government of Canada (see Note 7) and retained earnings. As at January 31, 2019 these accounts totalled $58.03 million (July 31, 2018: $152.85 million) and $39.87 million (July 31, 2018: $34.59 million) respectively. The CDC is not subject to any externally imposed capital requirements.

The CDC's capital management framework ensures sufficient liquidity to settle financial obligations and adequate funding for programs that benefit the dairy industry. The CDC does not utilize any quantitative measurements to monitor its capital, but the CDC adjusts its capital management framework on an ongoing basis as amounts fluctuate during the year. There were no adverse changes made to the capital management framework or its definition thereof.

(In thousands of Canadian dollars, unless otherwise indicated)

9. Disaggregation of revenue from contracts with customers

The CDC derives most of its revenue from the transfer of goods and services to customers in the following segments:

	Three months		Six months	
	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Domestic sales				
Plan B butter	$ 21,432	$ 57,202	$ 188,195	$ 134,400
Other butter	$ 10,855	$ 6,371	$ 16,221	$ 12,412
Skim milk powder	$ 13,055	$ 10,080	$ 20,267	$ 21,831
Domestic sales revenue	$ 45,342	$ 73,653	$ 224,683	$ 168,643
Export sales revenue - butter	$ -	$ -	$ 839	$ -
Milk pools				
Funding for administrative expenses	$ 1,130	$ 1,130	$ 2,260	$ 2,260
Carrying charges associated to butter inventory	$ 856	$ 615	$ 1,432	$ 1,355
Other recoverable expenses	$ 211	$ 303	$ 427	$ 508
Funding from milk pools	$ 2,197	$ 2,048	$ 4,119	$ 4,123
Audit services	$ -	$ -	$ (1)	$ (11)
Total revenue from contracts with customers	$ 47,539	$ 75,701	$ 229,640	$ 172,755

10. Foreign exchange gains and losses

“Export sales revenue” in the Statement of Operations and Comprehensive Income includes exchange net gains or losses arising from currency translation of transactions that transpire in foreign currencies.

“Cost of goods sold – domestic” in the Statement of Operations and Comprehensive Income includes exchange net gains or losses arising from currency translation of import purchase transactions that transpire in foreign currencies.

	Three months		Six months	
Exchange net gain (loss) on:	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Export sales revenue	$ -	$ -	$ (2)	$ -
Cost of goods sold – domestic	$ 75	$ 261	$ 75	$ 317

(In thousands of Canadian dollars, unless otherwise indicated)

11. 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.

Government of Canada funding of total administrative expenses is as follows:

	Three months		Six months	
	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Total administrative expenses	$ 2,264	$ 2,151	$ 4,339	$ 4,137
Funded by Government of Canada	$ 988	$ 1,070	$ 1,950	$ 1,868

12. Salaries and employee benefits

Salaries and employee benefits includes:

	Three months		Six months	
	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Salaries expense	$ 1,363	$ 1,339	$ 2,714	$ 2,609
Pension contributions	$ 209	$ 165	$ 361	$ 274
Medical insurance expense	$ 62	$ 67	$ 133	$ 131
Other expenses	$ 38	$ 42	$ 83	$ 79
Total	$ 1,672	$ 1,612	$ 3,291	$ 3,093

Pension plan

Substantially all CDC employees 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 employee and the CDC. The President of the Treasury Board of Canada sets the required employer contributions based on a multiple of the employee's required contribution. The general contribution rate effective for the quarter ended January 31, 2019 was on average 1.00 times the employee's rate (1.01 times for the year ended July 31, 2018).

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 multiplied by 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.

(In thousands of Canadian dollars, unless otherwise indicated)

13. Financial instruments

In the normal course of operation, the CDC is exposed to the following risks, which are managed and mitigated with corresponding policies and procedures.

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates, will affect the fair value or future cash flows of a financial instrument.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The CDC is exposed to this risk through normal international commercial operations. The CDC mitigates this exposure by only contracting in US and Canadian dollars. Also, the CDC uses foreign exchange forward contracts to lock future exchange rates on certain foreign currency exposures to stabilize the impact of exchange on future cash flows resulting from sales and purchases on existing contracts requiring payment in US dollars.

The fair value of the CDC's derivative financial instruments is measured using the Bank of Canada's published foreign exchange rate as at the date of the Statement of Financial Position. The exchange rate from US to Canadian dollars was 1.3144 as at January 31, 2019 (July 31, 2018: 1.3017).

"Other charges (recoveries)" in the Statement of Operations and Comprehensive Income includes $0.031 million in unrealized exchange net gains (Q2 2018-2019: $Nil in unrealized exchange net gains or losses) on derivative financial instrument.

The CDC's foreign exchange forward contracts as at the Statement of Financial Position date were as follows:

		January 31, 2019		July 31, 2018	
Currency sold	Currency purchased	In USD	In CAD	In USD	In CAD
CAD	USD	$ 3,716	$ 5,011	$ -	$ -
USD	CAD	$ -	$ -	$ -	$ -

(In thousands of Canadian dollars, unless otherwise indicated)

The CDC's exposures to currency risk as at quarter-end are the following, based on Canadian dollar equivalent amounts:

In CAD	January 31, 2019	July 31, 2018
Trade receivables	$ -	$ -
Trade payables	(1,089)	-
Net derivative asset (liability)	32	-
Net exposure	$ (1,057)	$ -

Based on the current net exposure, and assuming that all other variables remain constant, had the Canadian dollar appreciated 10% against the US dollar as at January 31, 2019, net income for Q2 2018-2019 would have been $0.39 million higher than the actual value reported (Q2 2017-2018: no impact). Conversely, a 10% weakening in the Canadian dollar against the US dollar would have resulted in an equal but opposite impact for the same period respectively.

Interest rate risk

Interest rate risk is the risk that a financial asset containing a fixed interest rate component decreases in fair 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. The line of credit, for which interest varies as a function of prime, and Loans from the Government of Canada, for which interest varies as a function of the yield on comparable Treasury bills, expose the CDC to a cash flow risk. The CDC's interest rate risk is not significant given its low interest-bearing loans, for which adverse rate increases are not expected over the next twelve months.

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 significantly 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 at the Statement of Financial Position date, all of the CDC's financial instruments are current and the CDC has a current ratio equal to 1.46 (July 31, 2018: 1.17). In managing liquidity risk, the CDC has access to additional borrowings for commercial operations from the Government of Canada in the amount of $166.97 million (July 31, 2018: $72.15 million), as well as $3.21 million (July 31, 2018: $2.42 million) on its line of credit for the pooling of market returns, both as at January 31, 2019.

Credit risk

Credit risk is the risk of financial loss for one party due to another party failing to meet its financial obligations. The CDC's main credit risk exposure comes from the carrying amount of the pooling and trade receivables balances, net of any allowance for losses. The CDC manages this risk by selling product on a "payment first" basis, securing bank guarantees and obtaining letters of credit. As at January 31, 2019 and July 31, 2018 the CDC does not have an allowance for doubtful accounts and all trade receivables are current.

The CDC is also exposed to credit risk when it holds foreign exchange contracts. This exposure is limited to the notional amount of Derivative asset – foreign exchange contracts. The CDC manages this risk by only entering into foreign exchange contracts with major Canadian financial institutions. To date, no such counterparty has failed to meet its financial obligation to the CDC.

Fair values

The carrying amount of cash, trade and other receivables, bank overdraft, and trade and other payables approximate their fair value due to the immediate or short-term maturity of these financial instruments. Therefore, as at the Statement of Financial Position date, no amounts representing changes in fair value of these financial instruments are reported on the Statement of Operations and Comprehensive Income.

Fair value hierarchy

Financial instruments reported at fair value on the Statement of Financial Position are classified using a fair value hierarchy that reflects the significance of the inputs to valuation techniques used to measure fair value. The fair value hierarchy, which for the CDC only applies to derivative financial instruments, has the following levels:

Level 1: inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: inputs are 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: inputs are unobservable inputs for the asset or liability (i.e. not based on observable market data).

When the CDC holds foreign exchange derivatives, their fair value is calculated using the Bank of Canada's published foreign exchange rate as at the date of the Statement of Financial Position. This input to the valuation technique used to measure fair value is classified as Level 2 on the fair value hierarchy.

(In thousands of Canadian dollars, unless otherwise indicated)

14. Commitments

a) Industry Initiatives

Summary:	Less than one year January 31, 2019	Less than one year July 31, 2018	Later than on year but not later than five years January 31, 2019	Later than on year but not later than five years July 31, 2018
Matching Investment Fund	$ 11,296	$ 7,520	$ 3,756	$ 7,506
Workforce Development Initiative	$ 504	$ -	$ 66	$ -
Total commitments for industry initiatives	$ 11,800	$ 7,520	$ 3,822	$ 7,506

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 an investment matching basis. As at January 31, 2019, the CDC has outstanding contractual commitments of up to $15.05 million.

Workforce Development Initiative

The Workforce Development Initiative encourages productivity, competitiveness, and innovation in the Canadian dairy industry by supporting the education and recruitment of a qualified workforce. The CDC Board adopted this initiative in December 2017 and has agreed to grant $5.00 million over three years to qualifying learning institutions and dairy associations (producers or processors) across Canada. This initiative includes four programs: career promotion, development of full-time education programs, development of continuing education, and graduate scholarships. As at January 31, 2019, the CDC has outstanding contractual commitments of $0.57 million.

b) Purchase Commitments

As at January 31, 2019, the CDC has commitments to purchase predetermined quantities of butter. These commitments amounted to approximately $6.17million (July 31, 2018: $0.40 million) and will be fulfilled by March 2019.

c) WTO Tariff Rate Quotas for Butter

The Government of Canada establishes tariff rate quotas (TRQ) for a number of dairy products, limiting the quantity of product that can enter the country with little or no duty. For butter products, under the terms of the 1994 WTO Agreement, Canada is committed to providing minimum annual market access opportunities totalling 3,274 tonnes, setting the minimum TRQ on butter products at the same level. Since 1995, subject to renewal each quota year (August to July), the CDC is mandated by the Minister of International Trade to ensure that Canada's butter TRQ is fully used, and that imported butter is redistributed to the Canadian food sector through butter manufacturers. As at January 31, 2019, the unused portion of the 2018-2019 TRQ on butter is 3,274 tonnes. The financial impact of this commitment for the remainder of 2018-2019 is affected by the price variability between countries and type of eligible butter products, as well as the foreign exchange rates.

(In thousands of Canadian dollars, unless otherwise indicated)

The total cost to purchase imported butter for the quarter ended:

	Three months		Six months	
	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Cost to purchase imported butter	$ 4,884	$ 4,265	$ 4,884	$ 9,623

d) Operating Lease

The CDC is committed under a long-term lease with Agriculture and Agri-Food Canada for office space ending in March 2022. The lease contains escalation clauses for maintenance costs and taxes. The CDC has the option to renew the lease for an additional period of five years with rates revised to reflect the rental market value pursuant to the Treasury Board's Policy on Real Property.

The minimum lease payments are as follows:

	January 31, 2019	July 31, 2018
Less than one year	$ 370	$ 370
Greater than one year and less than five years	740	986

15. 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 gives the Government of Canada significant influence over the CDC and its activities.

The CDC is related in terms of common ownership to all other Government of Canada departments, agencies and Crown corporations. The CDC enters into transactions with these entities in the normal course of operations and at normal trade terms. These related party transactions are reported at their exchange amounts.

Under IAS 24 – *Related Party Disclosures,* the CDC is exempt from certain disclosure requirements relating to transactions and outstanding balances with:

- a government that has control, joint control or significant influence over the reporting entity; and

(In thousands of Canadian dollars, unless otherwise indicated)

- 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.

Accordingly, the CDC discloses limited information regarding transactions entered into with the Government of Canada and its departments, and with all federal Crown corporations not considered to be individually or collectively significant.

The CDC's transactions with government-related entities that were individually significant are Loans from the Government of Canada (Note 7) and Funding from the Government of Canada (Note 11).

Other transactions with government-related entities that were collectively, but not individually, significant are:

	Three months		Six months	
Government-related entities	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Public Works and Government Services Canada	$ 310	$ 275	$ 619	$ 509
Agriculture and Agri-Food Canada (mainly operating lease – Note 14)	$ 123	$ 99	$ 247	$ 193
Other Government-related entities	$ 41	$ 36	$ 71	$ 57
Total	$ 474	$ 410	$ 937	$ 759

Key management personnel

The CDC's key management personnel are the members of the Commission's Board and the directors.

No loans or similar transactions with key management personnel are outstanding as at January 31, 2019 or July 31, 2018. There were no transactions of this nature during either quarter.

Post-employment benefit liability for key management personnel reported under "Other liabilities" on the Statement of Financial Position amounts to $0.09 million as at January 31, 2019 (July 31, 2018: $0.10 million).

Compensation of key management personnel for the quarter ended:

	Three months		Six months	
	Q2 2018-2019	Q2 2017-2018	Q2 2018-2019	Q2 2017-2018
Compensation of key management personnel	$ 257	$ 290	$ 532	$ 534