DEFENCE CONSTRUCTION CANADA

2018–2019 FIRST QUARTER FINANCIAL REPORT

PERIOD ENDED JUNE 30, 2018

Management's Discussion and Analysis, and Unaudited Interim Condensed Financial Statements

DCC·CDC

Defence Construction Canada
Construction de Défense Canada

Canada

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60 YEARS ANS

DCC | CDC

MANAGEMENT'S DISCUSSION AND ANALYSIS

This management's discussion and analysis (MD&A) outlines the financial results and operational changes for the first quarter ended June 30, 2018, for Defence Construction (1951) Limited (the "Corporation" or "DCC"). This discussion should be read in conjunction with the unaudited interim condensed financial statements for the period ended June 30, 2018. These statements were prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations, and are reported in Canadian dollars. We also recommend that this information be read in conjunction with the Corporation's MD&A and annual financial statements for the year ended March 31, 2018 (the "*Annual Report 2017–2018*"). Financial results reported in the MD&A are rounded to the nearest thousand. Related percentages are based on numbers rounded to the nearest thousand. DCC management is responsible for the information presented in the MD&A and unaudited interim condensed financial statements.

1.0 MATERIALITY

In assessing what information is to be provided in the MD&A, management applies the materiality principle. Management considers information to be "material" when it is probable that its omission or misstatement would influence decisions that users make on the basis of the financial information.

2.0 CORPORATE PROFILE

Defence Construction (1951) Limited, operating as Defence Construction Canada (DCC), is a Crown corporation that provides innovative and cost-effective contracting, construction, contract management, infrastructure and environmental, and lifecycle support services for Canada's defence requirements. It has two primary Client-Partners: the Infrastructure and Environment (IE) community at the Department of National Defence (DND), and the Communications Security Establishment (CSE). The Corporation also provides services to Shared Services Canada relating to the expansion of the electronic data centre at CFB Borden.

From project needs planning to facility decommissioning, DCC's work covers a broad spectrum of activities. DCC's resources are divided among five service lines.

CONTRACT SERVICES

The Contract Services team oversees the procurement of goods and professional, construction and maintenance services to fulfill Canada's domestic and international defence infrastructure needs.

CONTRACT MANAGEMENT SERVICES

The Contract Management Services team supports the creation, renovation and maintenance of facilities for DND's IE program.

ENVIRONMENTAL SERVICES

The Environmental Services team helps DND meet environmental performance targets, comply with regulatory requirements, and manage due diligence and risk.

PROJECT AND PROGRAM MANAGEMENT SERVICES

The Project and Program Management Services team advises on matters such as infrastructure requirements, program planning, and schedule and document control.

REAL PROPERTY MANAGEMENT SERVICES

From needs planning to facility decommissioning, the Real Property Management Services team supports the efficient operation of DND's infrastructure.

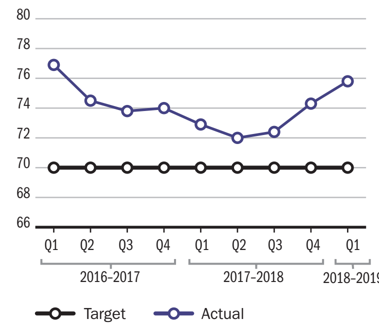
3.0 OPERATIONAL PERFORMANCE INDICATORS

3.1 UTILIZATION RATE

The utilization rate indicates the hours spent directly on service delivery functions that are billable to the Client-Partners, as opposed to administrative functions that are considered overhead support. This rate is an important indicator of efficiency and effectiveness, and a key financial management tool. A higher utilization rate is a positive indicator that DCC is using its resources more for revenue-generating activities and less for overhead administrative functions. DCC's target utilization rate is 70%.

For the first quarter of 2018–19, the Corporation achieved a utilization rate of 75.7%, an increase from the rate of 72.8% for the same period in 2017–18. This increase occurred because the Client-Partner planned its procurement activities in the fourth quarter of 2017–18, so that projects would be ready to implement in the first quarter of 2018–19.

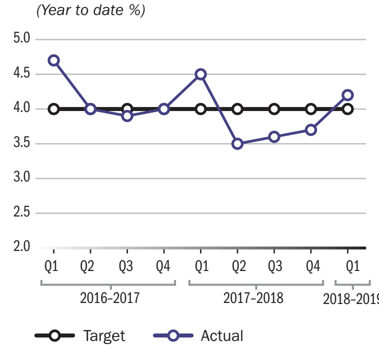
Utilization Rate
(Percentage of employee hours spent on billable contract work — year to date)



3.2 PROFESSIONAL DEVELOPMENT TO SALARY COST RATIO

DCC's ability to serve its Client-Partners depends heavily on the skills of its employees. Maintaining a skilled and professional workforce is a key corporate objective. For 2018–19, DCC has established an annual overall corporate target for spending on training and development of 4% of base salary costs. This target encompasses all costs associated with training and development activities, including internal employee time and third-party costs.

Professional Development to Salary Cost Ratio
(Year to date %)



For the first quarter of 2018–19, the professional development to salary cost ratio was 4.2%, a decrease from 4.5% in the comparable period last year. The decrease was due to the timing of staff training compared to the prior year.

4.0 RISK MANAGEMENT

There have been no material changes to the corporate risks identified by management and discussed in Section 5.0, Risk Management, of the MD&A in DCC's *Annual Report 2017–2018*.

5.0 FINANCIAL PERFORMANCE

5.1 BASIS OF PRESENTATION

The Corporation prepared this quarterly report as per the requirements of the *Financial Administration Act*. This statute requires all federal Crown corporations to prepare and make public a report within 60 days of the end of each fiscal quarter.

This quarterly financial report was prepared in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations.

In the following analysis, all references to the first quarter refer to the three months ended June 30, 2018. All references to the previous year's first quarter relate to the three months ended June 30, 2017.

5.2 REVENUE

SERVICES REVENUE

Services revenue for all activities combined was $28 million in the first quarter, an increase of $3.1 million or approximately 12% from the previous year. This increase resulted from a 4.5% increase in billing rates for all service lines compared to the prior year and from higher DND demand for services.

CONTRACT MANAGEMENT

Revenue from contract management increased by 9% in the first quarter compared to the same period in the previous year, reflecting an increase in billing rates and increased demand from Client-Partners. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

PROJECT PLANNING

Project planning revenue increased by 20% in the first quarter compared to the same period in the previous year. The increase was due to higher billing rates and higher DND demand for this service.

REAL PROPERTY TECHNICAL SUPPORT

Real property technical support revenue increased in the first quarter by 14% compared to the same period in the previous year. The increase was due to an increase in billing rates and higher DND demand for this activity.

PROCUREMENT

Procurement revenue in the first quarter increased by 22% compared to the same period in the previous year. The increase was due to higher billing rates and DND demand, as a result of more projects being procured at the beginning of the year.

CONSTRUCTION TECHNICAL SUPPORT

Revenue from construction technical support increased by 3% in the first quarter compared to the same period in the previous year. The increase was the result of an increase in billing rates, as demand for this service was consistent with that in the prior year.

ENVIRONMENTAL TECHNICAL SUPPORT

Environmental technical support revenue increased by 4% in the first quarter compared to the same period in the previous year. The increase was due to increases in billing rates, as DND demand for this service was the same as in the prior year. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

REVENUE, BY ACTIVITY

			Change	
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%
Contract management	$ 12,263	$ 11,233	1,030	9%
Project planning	7,618	6,329	1,289	20%
Real property technical support	2,472	2,161	311	14%
Procurement	2,035	1,674	361	22%
Construction technical support	2,022	1,966	56	3%
Environmental technical support	1,543	1,485	58	4%
Total revenue	**$ 27,953**	**$ 24,848**	**3,105**	**12%**

TRAVEL AND DISBURSEMENT REVENUE

Travel and disbursement revenue represents the amount the Corporation recovered from DND for travel and other expenses DCC incurred for work it performed on DND's behalf. Travel and disbursement revenue totalled $831,000 in the first quarter, an increase of $480,000, or approximately 137%, over the same period in the previous year. The variance was a result of the timing of travel and other expenses related to the work the Corporation performed for DND.

			Change	
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%
Travel and disbursement revenue	**$ 831**	**$ 351**	**480**	**137%**

INVESTMENT REVENUE

Investment revenue, which is generated from the Corporation's average cash balance in its bank account and from investments, decreased in the first quarter by $26,000 or 14% compared to the same period in the previous year. The decrease was primarily the result of a shift in investments. As bonds have matured, the Corporation has reinvested the funds in guaranteed investment certificates, which pay less interest and are shorter term investments than bonds, to meet anticipated cash requirements in the next few years.

			Change	
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%
Investment revenue	**$ 155**	**$ 181**	**(26)**	**-14%**

5.3 EXPENSES

SALARIES AND EMPLOYEE BENEFITS

Salaries totalled $20.0 million in the first quarter, an increase of $90,000 over the same period in the previous year. The number of full-time equivalents (FTEs) increased by approximately 1% or nine FTEs over the end of the first quarter in 2017–18. Salary pay rates increased by 3.25% over the same period in the prior year due to a cost of living increase of 1.5% and performance pay increases of 1.75%. Even though the number of full-time equivalents rose by 1% and salary pay rates increased by 3.25%, salaries did not rise at the same rate, due to employee turnover. In many cases, new staff started at lower salaries than the employees who departed, which limited overall salary increases.

Employee benefits were $5.6 million in the first quarter, an increase of $638,000 or approximately 13% from the same period in the previous year. The increase was due mainly to the increased costs of extended health care benefits, which rose at renewal in late 2017–18. This also increased the accrual for employee future benefits. In the first quarter of the current fiscal year, employee benefits as a percentage of salaries rose by three percentage points. The combined effect of the increases in health care benefits and employee future benefits increased employee benefits as a percentage of salaries by 2.25 percentage points. The remaining increase was due to overall increases in Canada Pension Plan and Employment Insurance benefit costs.

(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	**Change** $	**Change** %
Salaries	$ 20,069	$ 19,979	90	0%
Employee benefits	5,589	4,951	638	13%
	$ 25,658	**$ 24,930**	**728**	**3%**
Employee benefits as a percentage of salaries	28%	25%		

OPERATING AND ADMINISTRATIVE EXPENSES

Operating and administrative expenses were $1.9 million in the first quarter of 2018–19, a decrease of $102,000 or 5% over the first quarter of 2017–18. Material variances are shown in the following table. Some prior-year amounts have been reclassified to conform with the current year presentation.

			Change		
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%	Variance analysis
Rent	$ 423	$ 481	(58)	-12%	The decrease occurred because the Corporation received a refund from the landlord related to a real estate tax reassessment in the current quarter.
Software maintenance	345	391	(46)	-12%	The decrease occurred because DCC negotiated lower rates for certain software maintenance contracts related to productivity software.
Employee training and development	294	312	(18)	-6%	The decrease was due to the timing of training and development activities.
Professional services	212	222	(10)	-5%	The decrease was due to lower use of professional services for human resources requirements.
Telephone and data communications	197	202	(5)	-2%	The variance was not material.
Travel	165	137	28	20%	The increase was due to the timing of travel requirements.
Office services, supplies and equipment	52	62	(10)	-16%	The decrease was due to the timing of office services and equipment purchases.
Hospitality	49	27	22	81%	The increase was due to the timing of internal meetings where hospitality was provided.
Client services and communications	29	37	(8)	-22%	The decrease was due to lower costs associated with the development of the intranet.
Recruiting	27	–	27	100%	The increase was due to higher recruiting activity in the first quarter compared to last year, as the demand for services increased.
Furniture and fixtures	21	8	13	163%	The increase was due to more purchases of ergonomic equipment and security equipment.
Computer software	17	14	3	21%	The increase was due to more purchases of productivity software.
Memberships and subscriptions	17	18	(1)	-6%	The variance was not material.
Staff relocation	15	56	(41)	-73%	The decrease was due to the timing of activities related to staff relocation.
Printing and stationery	13	12	1	8%	The variance was not material.
Computer equipment	6	24	(18)	-75%	The decrease occurred because the Corporation began leasing personal computing devices rather than buying them.
Postage and freight	6	5	1	20%	The variance was not material.
Other	18	–	18	100%	The increase was due to increased costs related to office equipment rentals, disposal of fixed assets and bank charges.
Total	**$ 1,906**	**$ 2,008**	**(102)**	**-5%**	

TRAVEL AND DISBURSEMENT EXPENSE

Travel and disbursement expense represents the amount the Corporation spent on travel and other expenses related to work performed for DND. This expense totalled $831,000 in the first quarter, an increase of $480,000, or approximately 137%, over the same period in the previous year. The variance was due to the timing of travel and other expenses related to the Corporation's work for DND.

(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	Change $	Change %
Travel and disbursement expenses	**$ 831**	**$ 351**	**480**	**137%**

DEPRECIATION AND AMORTIZATION

Depreciation and amortization decreased by 2% or $6,000 in the first quarter over the first quarter of 2017–18. The decrease in the amortization of intangible assets was due to the low number of additions to the pool of assets in the prior year.

(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	Change $	Change %
Depreciation of property, plant and equipment	$ 259	$ 250	9	4%
Depreciation of assets under finance lease	24	24	0	0%
Amortization of intangible assets	36	51	(15)	-29%
Total	**$ 319**	**$ 325**	**(6)**	**-2%**

5.4 INCOME (LOSS) AND TOTAL COMPREHENSIVE INCOME (LOSS)

The Corporation realized a net income and total comprehensive income of $224,000 for the first quarter compared with a loss and total comprehensive loss of $2.2 million for the same period in the previous year. This was an increase of 110%. The increase from a loss to a gain year over year was due to a 4.5% increase in billing rates and to higher utilization of staff. These increases led to a higher gross margin, which was required to ensure that the Corporation operates at a slightly better than break-even margin.

			Change	
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%
Net Income (loss) and total comprehensive income (loss)	**$ 224**	**$ (2,236)**	**2,460**	**110%**

5.5 LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL AND CASH MANAGEMENT

DCC's financial and cash management policy is discussed in the *Annual Report 2017–2018*.

CASH AND INVESTMENTS

Cash and investments totalled $20.5 million at June 30, 2018, a decrease of $2.2 million from March 31, 2018.

The cash balance at June 30, 2018, was $1.6 million, a decrease of $2.3 million or 59% from the 2017–18 year end. In the three-month period after March 31, 2018, the Corporation used $2.1 million in cash for operating activities, spent $4,000 on capital expenditures, invested $162,000 in investments and spent $20,000 to meet finance lease obligations.

Investments (both current and long term) at June 30, 2018, totalled $18.9 million, an increase of $132,000 from the 2017–18 year end. The increase was due mainly to interest paid on the investments held. Investments consist of non-derivative financial assets with fixed or determinable payments and fixed maturity. The Corporation currently invests in listed bonds, guaranteed investment certificates and mutual funds, which are recorded at cost and amortized using the effective interest method. The investments held meet the requirements of the policy approved by the Board of Directors. It is the Corporation's intention to hold the investments to maturity.

TRADE RECEIVABLES

Trade receivables are due mainly from one of the Corporation's Client-Partners, DND. At June 30, 2018, the amount of trade receivables was $23.9 million, an increase of $1.7 million or 8% from March 31, 2018. The increase was due to the timing of the collection of receivables from DND.

CURRENT LIABILITIES

Current liabilities were $14.3 million at June 30, 2018, a decrease of $1.7 million or 10% from March 31, 2018. The decrease in current liabilities was primarily due to a decrease in accounts payable related to the timing of payments.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands of dollars)		As at June 30, 2018		As at March 31, 2018	Change $	Change %
Cash	$	1,645	$	3,972	(2,327)	-59%
Investments		18,861		18,729	132	1%
Cash and investments	**$**	**20,506**	**$**	**22,701**	**(2,195)**	**-10%**
Trade receivables	**$**	**23,904**	**$**	**22,196**	**1,708**	**8%**
Current liabilities	**$**	**14,332**	**$**	**15,992**	**(1,660)**	**-10%**

5.6 EMPLOYEE BENEFITS

The Corporation records a liability for the estimated cost of sick leave for employees, and health, dental and life insurance benefits for retirees. Every three years, an actuary determines this estimate. The accrued sick leave and other benefits balance as at June 30, 2018, was $33.3 million, an increase of $790,000 or 2% from the 2017–18 year end. The increase reflected the actuary's estimates of accrued benefits for the current fiscal year, minus payments of benefits to retirees.

(in thousands of dollars)		As at June 30, 2018		As at March 31, 2018	Change $	Change %
Current portion	$	2,502	$	2,502	–	0%
Long-term portion		30,753		29,963	790	3%
Total employee benefits	**$**	**33,255**	**$**	**32,465**	**790**	**2%**

5.7 ASSETS UNDER FINANCE LEASE AND FINANCE LEASE OBLIGATION

The Corporation leases multifunctional devices for copying, scanning and faxing. At the end of the first quarter, the value of assets under finance lease had decreased by $27,000 or 11% since the 2017–18 year end. The decrease was the result of depreciation of $24,000 and the removal of a device before the end of its term, which resulted in a decrease of $3,000.

(in thousands of dollars)		As at June 30, 2018		As at March 31, 2018	Change $	Change %
Assets under finance lease	**$**	**208**	**$**	**235**	**(27)**	**-11%**

The finance lease obligation at the end of the first quarter decreased by $23,000, or 9%, from the 2017–18 year end, due to payments of $20,000 and the removal of a device before the end of its term, which resulted in a decrease of $3,000.

			Change	
(in thousands of dollars)	As at June 30, 2018	As at March 31, 2018	$	%
Current portion	$ 96	$ 96	–	0%
Long-term portion	124	147	(23)	-16%
Finance lease obligation	**$ 220**	**$ 243**	**(23)**	**-9%**

5.8 CAPITAL EXPENDITURES

The Corporation's capital expenditures for the first quarter totalled $4,000, a decrease of $65,000 or 94% from the same period in the previous year. The decrease occurred because the Corporation began to lease personal computing devices for employees instead of purchasing such devices.

			Change	
(in thousands of dollars)	Three months ended June 30, 2018	Three months ended June 30, 2017	$	%
Intangible assets	$ –	$ 2	(2)	-100%
Computer equipment	–	60	(60)	-100%
Furniture and equipment	4	7	(3)	-43%
Leasehold improvements	–	–	–	100%
Total	**$ 4**	**$ 69**	**(65)**	**-94%**

5.9 ACTUAL PERFORMANCE VERSUS PLAN

The Corporation's actual overall performance for the three months ended June 30, 2018, was better than forecasted in the Corporate Plan (the Plan).

Services revenue was 3% higher than forecasted in the Plan. This increase was due to higher activity levels in the first quarter resulting from the timing of the Client-Partner's procurement processes and to the timing of project implementation.

Travel and disbursement revenue and expenses were 58% higher than projected in the Corporate Plan, due to the timing of expenses for travel and disbursements related to work the Corporation performed on DND's behalf.

Investment revenue was higher than anticipated in the Plan due to a higher-than-expected return on investment.

Salaries and benefits were higher than anticipated in the Plan due to increases in health benefit costs for active employees.

Operating and administrative costs were 39% lower than projected, due to the timing of expenditures related to the implementation of the Corporation's cyber strategy and other operating expenses, primarily training, development and travel costs.

Capital expenditures were 99% lower than projected, because the Corporation started leasing personal computing devices for employees rather than buying such devices.

ACTUAL PERFORMANCE VERSUS PLAN

(in thousands of dollars)	Actual	Plan	Change $	Change %
Services revenue	$ 27,953	$ 27,021	932	3%
Travel and disbursement revenue	831	527	304	58%
Investment revenue	155	125	30	24%
	28,939	**27,673**	**1,266**	**5%**
Salaries and employee benefits	25,658	25,080	578	2%
Operating and administrative expenses	1,907	3,129	(1,222)	-39%
Travel and disbursement expenses	831	527	304	58%
Depreciation and amortization	319	464	(145)	-31%
	28,715	**29,200**	**(485)**	**-2%**
Gain (loss) and total comprehensive gain (loss)	**$ 224**	**$ (1,527)**	**1,751**	**-115%**
Capital expenditures	**$ 4**	**$ 431**	**(427)**	**-99%**

UNAUDITED INTERIM CONDENSED FINANCIAL STATEMENTS

MANAGEMENT RESPONSIBILITY STATEMENT

Management is responsible for the preparation and fair presentation of these unaudited interim condensed financial statements in accordance with International Accounting Standard 34, Interim Financial Reporting, and the Treasury Board of Canada Standard on Quarterly Financial Reports for Crown Corporations. Management is also responsible for such internal controls as it determines are necessary to enable the preparation of unaudited interim condensed financial statements that are free from material misstatement. In addition, management is responsible for ensuring that all other information in this quarterly financial report is consistent, as appropriate, with the unaudited interim condensed financial statements.

Based on our knowledge, these unaudited interim condensed 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 interim condensed financial statements.

James S. Paul
President and Chief Executive Officer

Juliet Woodfield, CPA, CA
Vice-President, Finance & Human Resources, and Chief Financial Officer

Ottawa, Canada
August 29, 2018

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF FINANCIAL POSITION

Unaudited

(in thousands of dollars)	Notes	**As at June 30, 2018**	As at March 31, 2018
Assets			
Cash		**$ 1,645**	$ 3,972
Investments	7	**2,040**	2,178
Trade receivables	13	**23,904**	22,196
Prepaids and other current assets		**1,296**	2,339
Other receivables		**1,906**	1,954
Accrued revenue		**1,227**	–
Current assets		**32,018**	32,639
Investments	7	**16,821**	16,551
Property, plant and equipment	9	**1,368**	1,623
Intangible assets		**216**	252
Assets under finance lease		**208**	235
Non-current assets		**18,613**	18,661
Total assets		**$ 50,631**	$ 51,300
Liabilities			
Trade and other payables		**$ 11,734**	$ 13,394
Current portion: Finance lease obligation		**96**	96
Current portion: Employee benefits	10	**2,502**	2,502
Current liabilities		**14,332**	15,992
Finance lease obligation		**124**	147
Employee benefits	10	**30,753**	29,963
Non-current liabilities		**30,877**	30,110
Total liabilities		**45,209**	46,102
Equity			
Share capital—authorized: 1,000 common shares of no par value			
Issued: 32 common shares		**–**	–
Retained earnings		**5,422**	5,198
Total equity		**5,422**	5,198
Total liabilities and equity		**$ 50,631**	$ 51,300

Contingent liabilities (Note 14)

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME

Unaudited

(in thousands of dollars)	Notes	Three months ended June 30, 2018	Three months ended June 30, 2017
Services revenue		**$ 27,953**	$ 24,848
Travel and disbursement revenue		**831**	351
Investment revenue		**155**	181
Total revenue		**28,939**	25,380
Salaries and employee benefits		**25,658**	24,930
Operating and administrative expenses	12	**1,906**	2,008
Travel and disbursement expenses		**831**	351
Depreciation of property, plant and equipment	9	**259**	250
Depreciation of assets under finance lease		**24**	24
Amortization of intangible assets		**36**	51
Finance costs		**1**	2
Total expenses		**28,715**	27,616
Net income (loss) and total comprehensive income (loss)		**$ 224**	$ (2,236)

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF CHANGES IN EQUITY

Unaudited

(in thousands of dollars)	Share capital	Retained earnings	Total equity
Balance at March 31, 2018	$ –	$ 5,198	$ 5,198
Gain for the period		224	224
Balance at June 30, 2018	**$ –**	**$ 5,422**	**$ 5,422**
	Share capital	Retained earnings	Total equity
Balance at March 31, 2017	$ –	$ 16,499	$ 16,499
Loss for the period		(2,236)	(2,236)
Balance at June 30, 2017	**$ –**	**$ 14,263**	**$ 14,263**

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF CASH FLOWS

Unaudited

(in thousands of dollars)	Notes	Three months ended June 30, 2018	Three months ended June 30, 2017
Cash flow from (used in) operating activities			
Net income (loss) for the period		**$ 224**	$ (2,236)
Adjustments to reconcile gain (loss) for the period to cash provided or used by operating activities			
Employee benefits expensed		**967**	730
Employee benefits paid		**(177)**	(102)
Depreciation of property, plant and equipment	9	**259**	250
Depreciation of assets under finance lease		**24**	24
Amortization of intangible assets		**36**	51
Amortization of investment premiums		**30**	27
Change in non-cash operating working capital			
Trade receivables		**(1,708)**	(4,041)
Prepaids and other current assets		**1,043**	181
Other receivables		**48**	36
Trade and other payables		**(1,660)**	(1,796)
Deferred revenue (cost)		**(1,227)**	232
Net cash flows used in operating activities		**(2,141)**	(6,644)
Cash flows from investing activities			
Acquisition of investments		**(800)**	(1)
Redemption of investments		**638**	500
Acquisition of property, plant and equipment	9	**(4)**	(67)
Acquisition of intangible assets		**–**	(2)
Net cash flows provided by (used in) investing activities		**(166)**	430
Cash flows from financing activities			
Repayment of finance lease obligations		**(20)**	(23)
Net cash flows used in financial activities		**(20)**	(23)
Decrease in cash during the period		**(2,327)**	(6,237)
Cash at the beginning of the period		**3,972**	7,022
Cash at the end of the period		**$ 1,645**	$ 785

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

NOTICE TO READERS

These interim condensed financial statements have not been audited or reviewed by an external auditor and must be read in conjunction with the most recent financial statements for the year ended March 31, 2018, and with the MD&A included in this quarterly financial report.

DEFENCE CONSTRUCTION (1951) LIMITED

NOTES TO THE UNAUDITED FINANCIAL STATEMENTS

Unless otherwise stated, all amounts are in thousands of Canadian dollars.

NOTE 1: SUMMARY OF BUSINESS AUTHORITY AND OBJECTIVES

Defence Construction (1951) Limited (the "Corporation" or "DCC") was incorporated under the *Companies Act* in 1951 pursuant to the authority of the *Defence Production Act* and continued under the *Canada Business Corporations Act*. The Corporation's Head Office is located at 350 Albert Street, Ottawa, Ontario, Canada. DCC is an agent Crown corporation named in Part 1 of Schedule III to the *Financial Administration Act*. Responsibility for the Corporation rests with the Minister of Public Services and Procurement. The Corporation is not subject to income taxes.

The mandate of the Corporation is to provide procurement, construction contract management, professional, operations and full lifecycle infrastructure support for the defence and security of Canada. The prime, but not exclusive, beneficiary of the Corporation's services has always been the Department of National Defence (DND). Other government departments and agencies that play a role in Canada's defence and security may also avail themselves of DCC's services. Revenue is generated from fees charged for specific services provided.

NOTE 2: BASIS OF PREPARATION AND PRESENTATION

These interim condensed financial statements are prepared by the Corporation in accordance with International Accounting Standard 34 (IAS 34), Interim Financial Reporting, as issued by the Accounting Standards Board, and the Standard on Quarterly Financial Reports for Crown Corporations issued by the Treasury Board of Canada. As permitted under IAS 34, these interim condensed financial statements do not include all of the disclosures required for annual financial statements and should be read in conjunction with the Corporation's audited financial statements for its fiscal year ended March 31, 2018.

The interim condensed financial statements have been prepared according to the International Financial Reporting Standards (IFRS) effective when these statements were prepared.

The statements have been prepared on a historical cost basis, except as permitted by the IFRS and as otherwise indicated in these notes.

NOTE 3: SUMMARY OF ACCOUNTING POLICIES

These interim condensed financial statements follow the same accounting policies and methods of computation described in the notes to the Corporation's audited financial statements for the year ended March 31, 2018, except for the application of new standards, amendments and interpretations effective January 1, 2018, disclosed in Note 5 of these interim condensed consolidated financial statements. The accounting policies have been applied consistently to all periods presented, unless otherwise indicated.

NOTE 4: CRITICAL ACCOUNTING ESTIMATES

Under the Corporation's accounting policies, management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors considered relevant. Actual results may differ from the judgments, estimates and assumptions.

The estimates and underlying assumptions are reviewed regularly. Revisions to accounting estimates are recognized in the period in which the estimates are revised, when the revision affects only that period, or in the period of the revision and future periods, when the revision affects both current and future periods. Critical judgments and key sources of estimation uncertainty are disclosed in the notes to the Corporation's annual financial statements for the year ended March 31, 2018.

NOTE 5: APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

The International Accounting Standards Board (IASB) and the IFRS Interpretations Committee have issued certain pronouncements with mandatory effective dates of annual periods beginning on or after January 1, 2018. The Corporation adopted the following standards on April 1, 2018.

5.1 IFRS 9, FINANCIAL INSTRUMENTS

In the current period ending June 30, 2018, the Corporation has applied IFRS 9, Financial Instruments (as revised in July 2014). IFRS 9 introduces new requirements for the following: the classification and measurement of financial assets and liabilities; impairment for financial assets; and hedge accounting. This section describes these new requirements, as well as their impact on the Corporation's financial statements.

FINANCIAL ASSETS: CLASSIFICATION AND MEASUREMENT

IFRS 9 replaces the classification and measurement models in IAS 39, Financial Instruments: Recognition and Measurement, with a single model. In that single model, financial assets are classified and measured at amortized cost, at fair value through profit or loss (FVTPL), or at fair value through other comprehensive income (FVTOCI). This classification is based on a business model in which a financial asset is managed and its contractual cash flows characteristics and eliminates the IAS 39 categories of held-to-maturity, loans and receivables, and available-for-sale. The adoption of IFRS 9 did not change the measurement base of the Corporation's financial assets.

The impairment of financial assets under IFRS 9 is based on an expected credit loss (ECL) model, as opposed to the incurred credit loss model used under IAS 39. IFRS 9 applies to financial assets measured at amortized cost and contract assets, and requires the Corporation to consider factors such as historical, current and forward-looking information when measuring ECL. The Corporation uses the simplified approach for measuring losses based on lifetime ECL for trade and other receivables.

The Corporation does not expect credit losses from assets such as trade receivables, as all of its revenue is derived from Government of Canada entities. The Corporation concluded that no impairment of financial assets is required by IFRS 9. The Corporation will review the expected credit loss provision annually.

FINANCIAL LIABILITIES: CLASSIFICATION AND MEASUREMENT

IFRS 9 introduced the classification and measurement of financial liabilities to account for changes in the fair value of a financial liability designated as at FVTPL that are attributable to changes in the credit risk of the issuer.

The Corporation's financial assets and financial liabilities were classified and subsequently measured as follows in the Annual Report as at March 31, 2018:

	Classification	Subsequent measurement
Cash	Fair value through profit and loss	Fair value through profit and loss
Investments	Amortized cost	Amortized cost
Trade receivables	Amortized cost	Amortized cost
Other receivables	Amortized cost	Amortized cost
Other current assets	Amortized cost	Amortized cost
Accounts Payable	Amortized cost	Amortized cost
Accrued liabilities	Amortized cost	Amortized cost

5.2 IFRS 15, REVENUE FROM CONTRACTS WITH CUSTOMERS

In the current period, the Corporation has applied IFRS 15, Revenue From Contracts With Customers. The standard specifies how and when revenue should be recognized and requires entities to provide more informative and relevant disclosures to users. The standard—which supersedes IAS 18, Revenue, IAS 11, Construction Contracts, and a number of revenue-related interpretations—applies to nearly all contracts with customers, unless the contracts are within the scope of other IFRS, such as IAS 16, Leases.

IFRS 15 introduces a five-step approach to revenue recognition. The Corporation has applied IFRS 15 in accordance with the fully retrospective transitional approach.

Under the basic principle of IFRS 15, for a corporation to recognize revenue, it must identify when it provides the goods or services promised to customers, and describe what amount of consideration the entity expects to receive in exchange for such goods or services. In particular, the standard proposes a five-step model for recognizing revenue, identifying customer contracts, identifying contractual obligations, determining the transaction price, transaction price between the various contractual obligations and recognizing revenue when the entity has fulfilled a performance obligation.

Under IFRS 15, the Corporation recognizes revenue when a benefit obligation is fulfilled (or as it is met)—that is, when control of the underlying goods or services covered by this obligation of service is transferred to the client.

The Corporation's accounting policies for its revenue streams are disclosed in detail in Note 11. Apart from providing more extensive disclosures regarding the Corporation's revenue transactions, the application of IFRS 15 has no significant impact on the financial position and/or financial performance of the Corporation and no adjustments to comparative periods.

The Corporation has disaggregated revenue recognized from contracts with customers into categories that identify the nature of services rendered. Refer to Note 11 for disclosure on disaggregated revenue.

NOTE 6: NEW AND REVISED IFRS ISSUED BUT NOT YET EFFECTIVE

6.1 IFRS 16, LEASES

In January 2016, the IASB published a new standard—IFRS 16, Leases—to replace IAS 17, Leases. The new standard requires leases to be reported on a lessee's balance sheet as assets and liabilities, provides more transparency, and improves comparability between corporations. Lessor accounting remains similar to current practice—i.e., lessors continue to classify leases as finance and operating leases.

This standard is effective for periods beginning on or after January 1, 2019, with early application permitted for corporations that also apply IFRS 15, Revenue From Contracts With Customers. The Corporation does not intend to apply IFRS 16 early. The Corporation is currently assessing the impact of applying this standard on its financial statements. An initial scoping of the Corporation's lease agreements identified approximately seven leases for office space that must be analyzed. The Corporation has begun this analysis and will continue it in 2018–19.

NOTE 7: INVESTMENTS

Investments consist of Canadian, provincial and corporate bonds with effective interest rates ranging from 2.65% to 4.92% (coupon rates ranging from 2.85% to 7.22%), guaranteed investment certificates (GICs) with fixed interest rates ranging from 1.8% to 2.6%, and mutual funds with variable interest rates. The maturity dates of the bonds vary from 2019 to 2031 and those of the GICs from 2019 to 2023, and the Corporation intends to hold all of them to maturity. The mutual funds can be liquidated on demand. The carrying amounts, measured at the amortized cost and fair value of these investments, are shown in the following table.

The fair values of the investments can be determined by (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., prices) or indirectly (i.e., derived from prices) (Level 2); or (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). The fair values of DCC's investments are not quoted in an active market, but rather are determined from quoted prices from a decentralized, over-the-counter market, which is considered Level 2 in the fair value hierarchy.

The "current portion" of the Corporation's investments consists of instruments maturing in the next 12 months.

	As at June 30, 2018	As at March 31, 2018
Current portion	**$ 2,040**	$ 2,178
Long-term portion	**16,821**	16,551
Total	**$ 18,861**	$ 18,729

	As at June 30, 2018	As at March 31, 2018
Carrying amount at amortized cost:		
Bonds:		
Federal	**$ 503**	$ 504
Provincial	**8,023**	8,032
Corporate	**3,769**	4,290
Total bonds	**12,295**	12,826
Guaranteed investment certificates	**6,525**	5,725
Mutual funds	**41**	178
Total	**$ 18,861**	$ 18,729

	As at June 30, 2018	As at March 31, 2018
Fair value		
Bonds		
Federal	**$ 520**	$ 519
Provincial	**8,189**	8,283
Corporate	**3,901**	4,423
Total bonds	**12,610**	13,225
Guaranteed investment certificates	**6,560**	5,744
Mutual funds	**41**	178
Total	**$ 19,211**	$ 19,147

NOTE 8: ACCRUED REVENUE

Accrued revenue arises when, at a reporting date, the amount of services delivered through fixed-fee service-level arrangements exceeds the amount of revenue invoiced. For the period ended June 30, 2018, accrued revenue was $1,227. The figure as at March 31, 2018, was $0. Timing differences on fixed-fee service-level arrangements can occur during the reporting periods of the fiscal year but are reconciled and reduced to $0 by the year-end reporting date.

NOTE 9: PROPERTY, PLANT AND EQUIPMENT

	As at June 30, 2018	As at March 31, 2018
Cost	$ 6,944	$ 6,940
Less: Accumulated depreciation	5,576	5,317
Net book value	**$ 1,368**	**$ 1,623**
Net book value by asset class		
Computer equipment	$ 1,093	$ 1,317
Furniture and fixtures	227	240
Leasehold improvements	48	66
Net book value	**$ 1,368**	**$ 1,623**

The changes in property, plant and equipment are shown in the following table.

	Computer equipment	Furniture and fixtures	Leasehold improvements	Total
Cost				
Balance as at March 31, 2018	$ 4,497	$ 886	$ 1,557	$ 6,940
Plus: Additions	–	4	–	4
Less: Disposals	–	–	–	–
Balance as at June 30, 2018	**$ 4,497**	**$ 890**	**$ 1,557**	**$ 6,944**

The changes in accumulated depreciation are shown in the table below.

	Computer equipment	Furniture and fixtures	Leasehold improvements	Total
Accumulated depreciation				
Balance as at March 31, 2018	$ 3,180	$ 646	$ 1,491	$ 5,317
Plus: Depreciation	224	17	18	259
Less: Disposals	–	–	–	–
Balance as at June 30, 2018	**$ 3,404**	**$ 663**	**$ 1,509**	**$ 5,576**

There was no impairment of property, plant and equipment.

NOTE 10: EMPLOYEE BENEFITS

POST-EMPLOYMENT AND OTHER LONG-TERM EMPLOYEE BENEFITS

Post-employment and other long-term employee benefits represent the Corporation's estimated costs of sick leave for employees, and health, dental and life insurance benefits for retirees. The benefit plan is not funded and thus has no assets, resulting in a plan deficit equal to the accrued benefit obligation

	As at June 30, 2018	As at March 31, 2018
Current portion of employee benefits	$ 2,502	$ 2,502
Long-term portion of employee benefits	30,753	29,963
Total employee benefits	**$ 33,255**	**$ 32,465**

The significant actuarial assumptions are disclosed in the *Annual Report 2017–2018*. The measurement date for the last actuarial valuation of the provision for employee benefits was April 1, 2017. The next actuarial valuation is planned for April 2020.

NOTE 11: REVENUE RECOGNITION

SERVICE REVENUE

The Corporation derives its revenue from the delivery of services related to contract management, project planning, procurement, and real property management. Revenue is recognized after the service is rendered. The Corporation receives payments from its clients based on a monthly billing cycle, as established in service level arrangements (SLAs). All SLAs have a duration equivalent to the fiscal year and are renegotiated and signed annually based on the nature of the funding for the clients. As the need arises during the fiscal year, the SLAs can be modified and new SLAs signed.

SLAs can be on a time-based or fixed-fee basis. For time-based SLAs, the clients and the Corporation agree to a number of service hours that the Corporation's personnel will provide over the year. Each month, services for the month are invoiced to the client using actual time and the agreed billing rates in the SLAs. For fixed-fee SLAs, a fixed amount is invoiced to the client each month as agreed in the SLAs. Most SLAs have standard 30-day payment terms.

As there are new SLAs annually, there are no liabilities related to payments received in advance of performance nor assets related to performance rendered in advance of payments. There is no risk of bad debt because, under the SLAs, the Corporation bills the client for services already performed, and the *Financial Administration Act* requires government entities to pay for all valid services invoiced.

11.1 TRAVEL AND DISBURSEMENT REVENUE

The Corporation recovers the cost of travel and disbursements related to service delivery from the client as part of the SLAs. No mark-up is added.

11.2 INVESTMENT REVENUE

Investment revenue is recognized on an accrual basis using the effective interest method.

11.3 ACCOMMODATIONS

As per the memorandum of understanding between DND and the Corporation, DND provides the Corporation with office accommodations free of charge for personnel at DND-owned bases and wings, and at other locations. Where space is not provided, the Corporation has established hourly billing rates to recover the accommodation cost. If the accommodation cost is recovered as an out-of-pocket reimbursement, the disbursement reduces the charged amount.

The Corporation does not generate revenue from the sale of goods, from dividends or from royalties.

11.4 SEGMENTED AND DISAGGREGATED REVENUE INFORMATION

In reviewing the performance of the Corporation, management analyses revenue by region, by activity and by type of contract (fixed fee vs. time based). The following table disaggregates revenue by major sources and by region:

Three months ended June 30, 2018			Activity				
Region	Contract management	Project planning	Real property technical support	Procurement	Construction technical support	Environmental technical support	Total revenue, by region
Atlantic Region	$ 2,319	$ 1,062	$ 251	$ 347	$ 177	$ 232	$ 4,388
Quebec Region	2,146	1,320	457	371	349	345	4,988
National Capital Region	708	1,886	1,193	319	146	302	4,554
Ontario Region	3,506	1,292	283	466	683	395	6,625
Western Region	3,546	2,058	288	526	397	269	7,084
Corporate Services	38	–	–	6	270	–	314
Total revenue, by activity	**$ 12,263**	**$ 7,618**	**$ 2,472**	**$ 2,035**	**$ 2,022**	**$ 1,543**	**$ 27,953**

Three months ended June 30, 2017			Activity				
Region	Contract management	Project planning	Real property technical support	Procurement	Construction technical support	Environmental technical support	Total revenue, by region
Atlantic Region	$ 2,157	$ 800	$ 410	$ 268	$ 154	$ 177	$ 3,966
Quebec Region	2,094	1,111	395	340	208	245	4,393
National Capital Region	569	1,616	795	270	140	365	3,755
Ontario Region	3,103	1,049	244	357	735	421	5,909
Western Region	3,271	1,753	315	432	498	277	6,546
Corporate Services	38	–	2	8	231	–	279
Total revenue, by activity	**$ 11,232**	**$ 6,329**	**$ 2,161**	**$ 1,675**	**$ 1,966**	**$ 1,485**	**$ 24,848**

The following table disaggregates revenue by region and contract type:

	Time-based revenue	
Region	Three months ended June 30, 2018	Three months ended June 30, 2017
Atlantic Region	$ 1,332	$ 1,448
Quebec Region	1,109	1,242
National Capital Region/Head Office	4,675	3,867
Ontario Region	1,801	1,952
Western Region	1,686	1,763
Total time-based revenue	**$ 10,603**	**$ 10,272**

	Fixed-fee revenue	
Region	Three months ended June 30, 2018	Three months ended June 30, 2017
Atlantic Region	$ 3,056	$ 2,519
Quebec Region	3,880	3,150
National Capital Region/Head Office	193	168
Ontario Region	4,823	3,957
Western Region	5,398	4,782
Total fixed-fee revenue	**$ 17,350**	**$ 14,576**
Total revenue	**$ 27,953**	**$ 24,848**

NOTE 12: OPERATING AND ADMINISTRATIVE EXPENSES

	Three months ended June 30, 2018	Three months ended June 30, 2017
Rent	**$ 423**	$ 481
Software maintenance	**345**	391
Employee training and development	**294**	312
Professional services	**212**	222
Telephone and data communications	**197**	202
Travel	**165**	137
Office services, supplies and equipment	**52**	62
Hospitality	**49**	27
Client services and communications	**29**	37
Recruiting	**27**	–
Furniture and fixtures	**21**	8
Computer software	**17**	14
Memberships and subscriptions	**17**	18
Staff relocation	**15**	56
Printing and stationery	**13**	12
Computer equipment	**6**	24
Postage and freight	**6**	5
Other	**18**	–
	$ 1,906	$ 2,008

NOTE 13: RELATED-PARTY TRANSACTIONS AND BALANCES

The Corporation is related in terms of common ownership to all Government of Canada departments, agencies and Crown corporations. The Corporation enters into transactions with these entities in the normal course of business under its stated mandate. These transactions are measured at fair value, which is the actual amount of the consideration given or received for the services provided. The Corporation's services revenue, and travel and disbursement revenue, in the first quarter of 2018–19 totalled $28,784 compared with $25,199 in the first quarter of 2017–18. These revenues were generated from services provided to DND (including the Canadian Forces Housing Agency), the Communications Security Establishment and Shared Services Canada.

The Corporation incurred expenses with other departments of the Government of Canada. These transactions totalled $20 in the first quarter of 2018–19 compared with $23 in the same period of 2017–18.

In accordance with a memorandum of understanding between DND and the Corporation, DND is to provide office accommodations free of charge to the Corporation's service delivery personnel at DND-owned bases and wings, and at other locations. Where office space is not provided, and for the Corporation's service delivery personnel who cannot be accommodated at a DND-owned facility, DCC recovers accommodation costs either as an out-of-pocket reimbursable disbursement or through the hourly billing rates established for the services provided.

	As at June 30, 2018	As at March 31, 2018
Due from		
Department of National Defence	$ 21,714	$ 20,186
Canadian Forces Housing Agency	1,792	1,702
Shares Services Canada	90	100
Communications Security Establishment Canada	308	210
Public Services and Procurement Canada	–	(2)
	$ 23,904	**$ 22,196**
Due to		
Shares Services Canada	$ 7	$ 9
Public Services and Procurement Canada	2	–
Department of Justice	–	130
	$ 9	**$ 139**

13.1 COMPENSATION OF KEY MANAGEMENT PERSONNEL

Key management personnel are those persons (including members of the Board of Directors) having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly. The remuneration of DCC's key management personnel is shown in the following table.

		Three months ended June 30, 2018		Three months ended June 30, 2017
Short-term benefits	$	879	$	853
Post-employment benefits		140		92
Total	**$**	**1,019**	**$**	**945**

NOTE 14: CONTINGENT LIABILITIES

14.1 LEGAL CLAIMS

The Corporation's efforts to resolve contract disputes are reflected in the number and value of contract claims before the courts. As at June 30, 2018, there were nine ongoing claims totalling $3,078. As at March 31, 2018, there were eight ongoing claims totalling $2,259.

In accordance with the memorandum of understanding between the Corporation and DND, DND accepts the legal and financial risks associated with claims resulting from third-party contracts put in place by the Corporation. Thus, the financial risk associated with settling these contractual claims does not have any financial impact on the Corporation. As a result, the Corporation does not consider it necessary to record any provision in its financial statements relating to legal claims from third-party contracts.