DEFENCE CONSTRUCTION CANADA

2019–2020 FIRST QUARTER FINANCIAL REPORT

PERIOD ENDED JUNE 30, 2019

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

Defence Construction Canada
Construction de Défense Canada

DCC·CDC

Canada

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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, 2019, 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, 2019. 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, 2019 (the "*Annual Report 2018–2019*"). 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

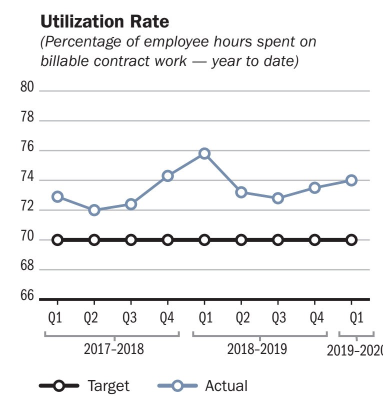
The Real Property Management Service Team supports the efficient maintenance of DND's infrastructure by providing strategic and tactical support throughout the entire real property lifecycle.

3.0 OPERATIONAL PERFORMANCE INDICATORS

3.1 UTILIZATION RATE

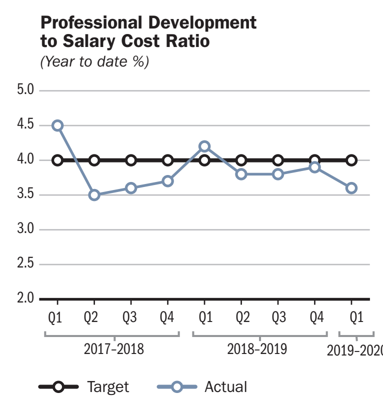
The utilization rate indicates the hours spent directly on service delivery functions that are billable to the Client-Partners, as opposed to administrative functions that are considered overhead support. This rate is an important indicator of efficiency and effectiveness, and a key financial management 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 2019–20, the Corporation achieved a utilization rate of 74.0%, a decrease from the rate of 75.7% for the same period in 2018–19. The decrease was due to lower levels of activity, in some service lines, than in the same period in the prior year.



3.2 PROFESSIONAL DEVELOPMENT TO SALARY COST RATIO

Maintaining a skilled and professional workforce is a key corporate objective. For 2019–20, 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.



For the first quarter of 2019–20, the professional development to salary cost ratio was 3.6% compared to 4.2% for the same period in the prior year. The decrease is due to the timing of internal training activities.

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 2018–2019*.

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, 2019. All references to the previous year's first quarter relate to the three months ended June 30, 2018. All references to the previous year end relate to March 31, 2019.

5.2 REVENUE

SERVICES REVENUE

Services revenue for all activities combined was $29.7 million in the first quarter, an increase of $1.8 million or approximately 6% from the previous year. The increase in the first quarter resulted from a 3.5% increase in billing rates for all service lines compared to the prior year and from higher DND demand for certain services.

CONTRACT MANAGEMENT

Revenue from contract management increased by 5% in the first quarter compared to the same period in the previous year. The increase in the first quarter reflected an increase in billing rates and increased demand from the Client-Partners. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

PROJECT PLANNING

Project planning revenue increased by 10% in the first quarter compared to the same period in the previous year. The increase in the first quarter was due to higher billing rates and higher DND demand for this service.

REAL PROPERTY TECHNICAL SUPPORT

Real property technical support revenue increased by 1% in the first quarter compared to the same period in the previous year. The increase in the first quarter was due to an increase in billing rates, which was offset by lower demand from DND for this activity.

PROCUREMENT

Procurement revenue increased by 14% in the first quarter compared to the same period in the previous year. The increase in the first quarter was due to higher billing rates and increased DND demand.

CONSTRUCTION TECHNICAL SUPPORT

Revenue from construction technical support increased by 2% in the first quarter compared to the same period in the previous year. The increase was the result of an increase in billing rates, offset by lower demand for this service.

ENVIRONMENTAL TECHNICAL SUPPORT

Environmental technical support revenue increased by 5% in the first quarter compared to the same period in the previous year. This increase was due to increases in billing rates and to higher demand from DND for this service. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

REVENUE, BY ACTIVITY

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	**Change** $	%
Contract Management	$ 12,893	$ 12,263	630	5%
Project Planning	8,351	7,618	733	10%
Real Property Technical Support	2,507	2,472	35	1%
Procurement	2,310	2,035	275	14%
Construction Technical Support	2,053	2,022	31	2%
Environmental Technical Support	1,615	1,543	72	5%
Total revenue	**$ 29,729**	**$ 27,953**	**1,776**	**6%**

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 $618,000 in the first quarter, a decrease of $213,000 or approximately 26% 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.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %
Travel and disbursement revenue	**$ 618**	**$ 831**	**(213)**	**-26%**

INVESTMENT REVENUE

Investment revenue, which is generated from the Corporation's average cash balance in its bank account and from investments, increased in the first quarter by $33,000 or 21% compared to the same period in the previous year. The increase was due to higher interest rates and to higher average monthly cash balances in the corporate account compared to the prior year.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %
Investment revenue	**$ 188**	**$ 155**	**33**	**21%**

5.3 EXPENSES

SALARIES AND EMPLOYEE BENEFITS

Salaries totalled $21.6 million in the first quarter, an increase of $1.6 million or approximately 8% over the same period in the previous year. Salary pay rates increased by 3.2% over the same period in the prior year due to a cost of living increase of 1.5% and performance pay increase of 1.7%. The number of full-time equivalents (FTEs) increased by approximately 4.9% or 46 FTEs over the end of the prior year.

Employee benefits were $6.0 million in the first quarter, an increase of $406,000 or approximately 7% from the same period in the previous year. The increase was due mainly to the increased number of employees. In the first quarter, employee benefits as a percentage of salaries were consistent with the prior year.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %
Salaries	$ 21,622	$ 20,069	1,553	8%
Employee benefits	5,995	5,589	406	7%
	$ 27,617	**$ 25,658**	**1,959**	**8%**
Employee benefits as a percentage of salaries	28%	28%		

OPERATING AND ADMINISTRATIVE EXPENSES

Operating and administrative expenses were $2.0 million in the first quarter of 2019–20, an increase of $126,000 or 7% over the first quarter of 2018–19. Material variances are shown in the following table.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %	Variance analysis
Professional services	$ 529	$ 212	317	150%	The increase was due to costs incurred to migrate the information technology (IT) servers to the cloud.
Training and development	322	294	28	10%	The increase was due to the timing of training expenses incurred.
IT maintenance agreements	291	345	(54)	-16%	The decrease was due to DCC reclassifying cloud computing to a separate expense category.
Leased location operating costs	221	–	221	100%	With the adoption of IFRS 16—Leases, accounting for rent and operating costs for 2019–20 changed. Rent expense in prior years included basic rent plus operating costs and taxes. For the current year, basic rent is now accounted for as a right-of-use asset with a corresponding liability. The asset is depreciated and no longer included in operating and administrative expenses. The only portions in operating and administrative expenses are operating costs and taxes.
Rent	–	423	(423)	-100%	

Table continues on next page

OPERATING AND ADMINISTRATIVE EXPENSES (continued)

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %	Variance analysis
Telephone and communications	191	197	(6)	-3%	The variance was not material.
Travel	166	165	1	1%	The variance was not material.
Office supplies	63	52	11	21%	The increase was due to the timing of office services and equipment purchases.
Cloud services	51	–	51	100%	The increase occurred because DCC began reporting cloud computing services separately from software maintenance contracts.
Equipment rental	48	–	48	100%	The increase occurred because DCC now leases employee computing devices instead of purchasing and capitalizing them.
Relocation	38	15	23	153%	The increase was due to DCC relocating staff to temporary assignments to meet client demand.
Hospitality	33	49	(16)	-33%	The decrease occurred because DCC held fewer internal training forums in the quarter than in the same period in the previous year.
Communications	19	29	(10)	-34%	The decrease was due to the timing of printing and other activities related to communications.
Printing and stationery	15	13	2	15%	The variance was not material.
Office furniture and equipment	12	21	(9)	-43%	The decrease was due to the timing of purchases of furniture and fixtures.
Subscriptions	9	17	(8)	-47%	The decrease was due to the timing of purchases of memberships.
IT hardware	7	6	1	17%	The variance was not material.
Postage, freight and courier	7	6	1	17%	The variance was not material.
IT software	3	17	(14)	-82%	The decrease occurred because DCC now leases most employee computing devices.
Recruiting	3	27	(24)	-89%	The decrease was due to lower demand for external recruiting services.
Other	4	18	(14)	-78%	The decrease was due to lower costs related to disposals of fixed assets.
Total	**$ 2,032**	**$ 1,906**	**126**	**7%**	

TRAVEL AND DISBURSEMENT EXPENSE

Travel and disbursement expenses are the amount the Corporation spends on travel and other expenses related to the work it performs for DND. Travel and disbursement expenses totalled $618,000 in the first quarter, a decrease of $213,000, or approximately 26%, over the same period in the previous year. The variances were a result of the timing of travel and other expenses related to the work the Corporation performed for DND.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %
Travel and disbursement expenses	**$ 618**	**$ 831**	**(213)**	**-26%**

DEPRECIATION AND AMORTIZATION

Depreciation and amortization increased by 112% or $356,000 in the first quarter compared to the same period in the prior year. The increase in depreciation was due to the addition of right-of-use assets related to the adoption of IFRS 16—Leases. The increase related to right-of-use assets was $534,000, which was partly offset by lower depreciation of property, plant and equipment of $139,000. That occurred because the Corporation adopted a leasing model for computing devices, which reduced the capital expenditures for this type of asset. The decrease in amortization of intangible assets occurred because the Corporation now favours software-as-a-service over capital software purchases.

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	Change $	Change %
Depreciation of right-of-use assets	$ 534	$ –	$ 534	100%
Depreciation of property, plant and equipment	120	259	(139)	-54%
Depreciation of assets under finance lease	–	24	(24)	-100%
Amortization of intangible assets	21	36	(15)	-42%
Total	**$ 675**	**$ 319**	**$ 356**	**112%**

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

The Corporation realized a net loss and total comprehensive loss of $453,000 for the first quarter compared with an income and total comprehensive income of $224,000 for the same period in the previous year. This was a decrease of 302%. The loss in the first quarter was due to lower utilization of personnel and impacted gross margin, which increased overhead salaries. Operating and administration costs also increased over the same period in the prior year.

			Change	

(in thousands of dollars)	Three months ended June 30, 2019	Three months ended June 30, 2018	$	%
Net Income (loss) and total comprehensive income (loss)	**$ (453)**	**$ 224**	**(677)**	**-302%**

5.5 LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL AND CASH MANAGEMENT

DCC's financial and cash management policy is discussed in the *Annual Report 2018–2019*.

CASH AND INVESTMENTS

Cash and investments totalled $22.8 million at June 30, 2019, a decrease of $5.4 million from March 31, 2019.

The cash balance at June 30, 2019, was $4.6 million, a decrease of $5.5 million or 54% from the 2018–19 year end. In the three-month period after March 31, 2019, the Corporation used $4.9 million in cash for operating activities, invested $115,000 and spent $540,000 to meet finance lease obligations. The decrease is due in part to the increase in trade receivables and the timing of receipt of payments from Client-Partners.

Investments (both current and long term) at June 30, 2019, totalled $18.2 million, an increase of $93,000 from the 2018–19 year end. The increase was due mainly to the interest earned on the corporate account. 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, 2019, the amount of trade receivables was $26.5 million, an increase of $5.2 million or 24% from March 31, 2019. The increase was due to the timing of the collection of receivables from DND. All amounts are expected to be collected.

CURRENT LIABILITIES

Current liabilities were $18.0 million at June 30, 2019, an increase of $1.3 million or 8% from March 31, 2019. The increase in current liabilities was primarily due to an increase in accounts payable related to the timing of payments.

LIQUIDITY AND CAPITAL RESOURCES

(in thousands of dollars)		As at June 30, 2019		As at March 31, 2019	Change $	Change %
Cash	$	4,601	$	10,066	(5,465)	-54%
Investments		18,197		18,104	93	1%
Cash and investments	**$**	**22,798**	**$**	**28,170**	**(5,372)**	**-19%**
Trade receivables	**$**	**26,471**	**$**	**21,321**	**5,150**	**24%**
Current liabilities	**$**	**17,946**	**$**	**16,607**	**1,339**	**8%**

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, 2019, was $28.9 million, an increase of $679,000 or 2% from the 2018–19 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, 2019		As at March 31, 2019	Change $	Change %
Current portion	$	2,863	$	2,863	–	0%
Long-term portion		26,014		25,335	679	3%
Total employee benefits	**$**	**28,877**	**$**	**28,198**	**679**	**2%**

5.7 RIGHT-OF-USE ASSETS

The Corporation leases office space, facilities for IT equipment and multifunction copiers. Assets under finance lease were reclassified to right-of-use assets at April 1, 2019. The decrease from April 1, 2019 was depreciation.

(in thousands of dollars)		
Right-of-use assets — IFRS 16 - Leases adoption	$	8,501
Existing assets under finance lease		141
Opening balance — Right-of-use assets April 1, 2019	**$**	**8,642**
Less: Depreciation		(534)
Ending balance at June 30, 2019	**$**	**8,108**

5.8 LEASE LIABILITY

The lease liabiltiy relates to the right-of-use assets and the finance lease obligation.

(in thousands of dollars)		
Lease obligation — IFRS 16 - Leases adoption	$	8,501

Existing finance lease obligation reclassified		147
Opening balance — lease obligation April 1, 2019	**$**	**8,648**
Less: Payment in the period		(540)
Plus: Interest on liability		46
Ending balance at June 30, 2019	**$**	**8,154**

5.9 CAPITAL EXPENDITURES

The Corporation's only capital activity in the first quarter was related to the addition of right-of-use assets related to the capitalization of leases as a result of adopting IFRS 16 – Leases. Refer to note 5 in the financial statements for more details regarding the adoption of IFRS 16 – Leases.

					Change	
(in thousands of dollars)		Three months ended June 30, 2019		Three months ended June 30, 2018	$	%
Right-of-use assets	$	8,501	$	–	8,501	100%
Intangible assets		–		–	–	0%
Computer equipment		–		–	–	0%
Furniture and equipment		–		4	(4)	-100%
Leasehold improvements		–		–	–	0%
	$	**8,501**	**$**	**4**	**8,497**	**99%**

5.10 ACTUAL PERFORMANCE VERSUS PLAN

The Corporation's actual overall performance for the three months ended June 30, 2019, was consistent with that forecasted in the Corporate Plan (the Plan).

Services revenue was 3% lower than projected in the Plan. The lower revenue was due to lower-than-anticipated demand for services from DND.

Travel and disbursement revenue and expenses were 5% lower than projected in the 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 cash held in the account.

Salaries and benefits were consistent with the amounts forecasted in the Plan.

Operating and administrative costs were 25% lower than projected, due to the timing of expenditures related to the implementation of the Corporation's cyber strategy and the timing of other operating expenses, primarily training, development and travel costs.

Depreciation and amortization was 9% lower than forecasted, due to lower capital expenditures.

Capital expenditures were 24% lower than projected, mainly due to the adoption of IFRS 16 – Leases. The amount capitalized for leases was less than the amount anticipated in the Corporate Plan. Also, the decrease was due to the Corporation starting to lease employee computing devices rather than buying them.

ACTUAL PERFORMANCE VERSUS PLAN

					Change	
(in thousands of dollars)		**Actual**		**Plan**	$	%
Revenue						
Services revenue	$	29,729	$	30,798	(1,069)	-3%
Travel and disbursement revenue		618		648	(30)	-5%
Investments revenue		188		163	25	15%
	$	**30,535**	$	**31,609**	**(1,074)**	**-3%**
Expenses						
Salaries and employee benefits		27,617		27,584	33	0%
Operating and administrative expenses		2,078		2,753	(675)	-25%
Travel and disbursement expenses		618		648	(30)	-5%
Depreciation and amortization		675		739	(64)	-9%
	$	**30,988**	**$**	**31,724**	**(736)**	**-2%**
Loss and total comprehensive loss	**$**	**(453)**	**$**	**(115)**	**(339)**	**-294%**
Capital expenditures	**$**	**8,501**	**$**	**11,116**	**(2,615)**	**-24%**

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.

Melinda Nycholat, P. Eng.
Acting President and Chief Executive Officer

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

Ottawa, Canada
August 29, 2019

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF FINANCIAL POSITION

Unaudited

(in thousands of dollars)	Notes		**As at June 30, 2019**		As at March 31, 2019
Assets					
Cash		**$**	**4,601**	$	10,066
Investments	7		**2,615**		2,502
Accrued revenue	8		**169**		–
Trade receivables	15		**26,471**		21,321
Prepaids and other current assets			**1,550**		1,487
Other receivables			**1,762**		1,805
Current assets			**37,168**		37,181
Investments	7		**15,582**		15,602
Right-of-use assets	10		**8,108**		–
Property, plant and equipment	9		**718**		838
Intangible assets			**110**		131
Assets under finance lease			**–**		141
Non-current assets			**24,518**		16,712
Total assets		**$**	**61,686**	$	53,893
Liabilities					
Trade and other payables		**$**	**13,224**	$	13,664
Current portion: Lease liability	11		**1,859**		–
Current portion: Finance lease obligation			**–**		80
Current portion: Employee benefits	12		**2,863**		2,863
Current liabilities			**17,946**		16,607
Lease liability	11		**6,295**		–
Finance lease obligation			**–**		67
Employee benefits	12		**26,014**		25,335
Non-current liabilities			**32,309**		25,402
Total liabilities			**50,255**		42,009
Equity					
Share capital: Authorized: 1,000 common shares of no par value					
Issued: 32 common shares			**–**		–
Retained earnings			**11,431**		11,884
Total equity			**11,431**		11,884
Total liabilities and equity		**$**	**61,686**	$	53,893

Contingent liabilities (Note 16)

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, 2019	Three months ended June 30, 2018
Services revenue		**$ 29,729**	$ 27,953
Travel and disbursement revenue		**618**	831
Investment revenue		**188**	155
Total revenue		**30,535**	28,939
Salaries and employee benefits		**27,617**	25,658
Operating and administrative expenses	14	**2,032**	1,906
Travel and disbursement expenses		**618**	831
Depreciation of right-of-use assets		**534**	–
Depreciation of property, plant and equipment	9	**120**	259
Depreciation of assets under finance lease		**–**	24
Amortization of intangible assets		**21**	36
Interest expense on lease liabilities		**46**	1
Total expenses		**30,988**	28,715
Net income (loss) for the period and total comprehensive income (loss)		**$ (453)**	$ 224

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, 2019	$ –	$ 11,884	$ 11,884
Loss for the period		(453)	(453)
Balance at June 30, 2019	**$ –**	**$ 11,431**	**$ 11,431**
	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**

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, 2019	Three months ended June 30, 2018
Cash flow from operating activities			
Net income (loss) for the period		**$ (453)**	$ 224
Adjustments to reconcile gain (loss) for the period to cash provided or used by operating activities			
Employee benefits expensed		**831**	967
Employee benefits paid		**(152)**	(177)
Depreciation of right-of-use assets	10	**534**	–
Depreciation of property, plant and equipment	9	**120**	259
Depreciation of assets under finance lease		**–**	24
Amortization of intangible assets		**21**	36
Amortization of investment premiums		**22**	30
Interest paid on lease liabilities		**46**	–
Change in non-cash operating working capital			
Trade receivables		**(5,150)**	(1,708)
Prepaids and other current assets		**(63)**	1,043
Other receivables		**43**	48
Trade and other payables		**(440)**	(1,660)
Accrued revenue		**(169)**	(1,227)
Net cash flows used in operating activities		**(4,810)**	(2,141)
Cash flows from investing activities			
Acquisition of investments		**(115)**	(800)
Redemption of investments		**–**	638
Acquisition of property, plant and equipment	9	**–**	(4)
Net cash flows used in investing activities		**(115)**	(166)
Cash flows from financing activities			
Repayment of lease liabilities		**(540)**	(20)
Net cash flows used in financial activities		**(540)**	(20)
Decrease in cash during the period		**(5,465)**	(2,327)
Cash at the beginning of the period		**10,066**	3,972
Cash at the end of the period		**$ 4,601**	$ 1,645

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, 2019, 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, 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, 2019.

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, 2019, except for the application of new standards, amendments and interpretations effective January 1, 2019, 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, 2019.

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

IFRS 16–LEASES: The Corporation began applying IFRS 16–Leases on April 1, 2019, using the modified retrospective approach. Under this method, the Corporation applied the standard retrospectively only to the most current period presented in the interim condensed financial statements, and the cumulative effect of initial application is recognized in retained earnings at April 1, 2019. Therefore, the comparative information for 2018–19 presented in the interim condensed financial statements for the three months ended June 30, 2018 has not been restated, and leases continued to be reported under the accounting policies disclosed in Note 17 to the Corporation's annual audited financial statements for the year ended March 31, 2019.

The Corporation's leasing activities relate mainly to office space and multi-function copiers.

As a lessee, the Corporation previously classified leases as operating or finance, based on its assessment of whether the lease significantly transferred all of the risk and rewards incidental to ownership of the underlying asset to the Corporation. Under IFRS 16–Leases , the Corporation recognized right-of-use assets and lease liabilities for most of its leases.

At transition, the Corporation had leases for multi-use copiers classified as finance leases under the previous lease standard, IAS 17. The Corporation measured the lease liability for existing operating leases, other than short-term or low-value leases, at the present value of the remaining lease payments, discounted at the Corporation's incremental borrowing rate as at April 1, 2019. Right-of-use assets were measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments, any lease incentives, any initial direct cost incurred, and any estimated costs to be incurred in restoring the site or dismantling and removing the underlying asset.

By electing to use the modified retrospective method, the Corporation calculated the lease liability using its incremental borrowing rate of between approximately 3% to 3.16% as at April 1, 2019.

The Corporation used the following practical expedients when applying IFRS 16–Leases to leases previously classified as operating leases under IAS 17:

- the Corporation did not reassess all its contracts to determine whether they contained a lease at the date of initial application. Only contract previously identified as leases under IFRS 7–Leases and IFRIC 4–Determining whether an arrangement contains a lease were considered;
- applied a single discount rate to a portfolio of leases with similar characteristics;
- applied the exception not to recognize right-of-use assets and liabilities with less than 12 months of lease term on the date of initial application; and
- used hindsight when determining the lease term if the contract contained options to extend or terminate the lease.

The Corporation has elected not to recognize right-of-use assets and lease liabilities for leases with a lease term of less than 12 months and low value assets with asset values under $5,000 and reorganized the lease payments associated with these leases as an expense on a straight-line basis over the lease term, as permitted by IFRS 16–Leases.

As a lessor, the Corporation will continue to classify subleases as operating or finance, after reassessing the nature of subleases as part of the IFRS 16–Leases transition. Under IFRS 16–Leases, this classification is determined with reference to the right-of-use asset rather than the underlying asset. Lessor accounting has also remained substantially unchanged from IAS17, and the Corporation will continue to record lease income from operating leases.

As at April 1, 2019, the impact of adopting IFRS 16–Leases on the interim condensed financial statements of the Corporation was to recognize right-of-use assets and liabilities of $8.5 million. Due to the adoption of IFRS 16–Leases, the Corporation's interest and depreciation have increased, while rent expense has decreased to reflect only the operating expenses of the leases related to office space.

The following table shows the changes from March 31, 2019, to April 1, 2019.

	As at March 31, 2019	IFRS 16 adjustment	As at April 1, 2019
Assets			
Current assets	**$ 37,181**	**$ –**	**$ 37,181**
Right-of-use assets	–	8,501	8,501
Non-current assets	**16,712**	**8,501**	**25,213**
Total assets	**$ 53,893**	**$ 8,501**	**$ 62,394**
Liabilities			
Current portion: Right-of-use lease liability	$ –	$ 1,779	$ 1,779
Current liabilities	**$ 16,607**	**1,779**	**18,386**
Right-of-use lease liability	–	6,722	6,722
Non-current liabilities	**25,402**	**6,722**	**32,124**
Total liabilities	**$ 42,009**	**$ 8,501**	**$ 50,510**
Equity			
Retained earnings	$ 11,884	$ –	$ 11,884
Total equity	**11,884**	**–**	**11,884**
Total liabilities and equity	**$ 53,893**	**$ 8,501**	**$ 62,394**

The amount for commitments related to operating leases for office space has been eliminated because they are all considered leases under IFRS 16–Leases and are presented in the interim condensed statement of financial position.

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

During the quarter, neither the IASB nor the IFRS Interpretations Committee issued any new standards, amendments or interpretations that might affect the Corporation in the future.

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 2.82%, and mutual funds with variable interest rates. The maturity dates of the bonds vary from 2019 to 2031, and those of the GICs vary 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 in 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, 2019	As at March 31, 2019
Current portion	**$ 2,615**	$ 2,502
Long-term portion	**15,582**	15,602
Total	**$ 18,197**	$ 18,104

	As at June 30, 2019	As at March 31, 2019
Carrying amount at amortized cost:		
Bonds:		
Federal	**$ 501**	$ 502
Provincial	**6,961**	6,972
Corporate	**3,746**	3,755
Total bonds	**11,208**	11,229
Guaranteed investment certificates	**6,875**	6,875
Mutual funds	**114**	–
Total	**$ 18,197**	$ 18,104

	As at June 30, 2019	As at March 31, 2019
Fair value		
Bonds		
Federal	**$ 512**	$ 510
Provincial	**7,362**	7,332
Corporate	**4,040**	3,977
Total bonds	**11,914**	11,819
Guaranteed investment certificates	**6,920**	6,912
Mutual funds	**114**	–
Total	**$ 18,948**	$ 18,731

NOTE 8: ACCRUED REVENUE

Accrued revenue arises when, at a reporting date, the amount for services delivered through fixed-fee service-level arrangements exceeds the amount of revenue invoiced. For the period ended June 30, 2019, accrued revenue was $169. The figure as at March 31, 2019, 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, 2019		As at March 31, 2019
Cost	$	5,158	$	5,158
Less: Accumulated depreciation		4,440		4,320
Net book value	**$**	**718**	**$**	**838**
Net book value by asset class				
Computer equipment	$	491	$	590
Furniture and fixtures		220		239
Leasehold improvements		7		9
Net book value	**$**	**718**	**$**	**838**

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, 2019	$	2,643	$	953	$	1,562	$	5,158
Plus: Additions		–		–		–		–
Less: Disposals		–		–		–		–
Balance as at June 30, 2019	**$**	**2,643**	**$**	**953**	**$**	**1,562**	**$**	**5,158**

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, 2019	$	2,053	$	714	$	1,553	$	4,320
Plus: Depreciation		99		19		2		120
Less: Disposals		–		–		–		–
Balance as at June 30, 2019	**$**	**2,152**	**$**	**733**	**$**	**1,555**	**$**	**4,440**

There was no impairment of property, plant and equipment.

NOTE 10: RIGHT-OF-USE ASSETS

The Corporation's right-of-use assets comprise office space and facilities for IT equipment and multifunction copiers. Items related to assets under finance lease from the prior year are added to the opening balance and are included in the total. New additions as of April 1, 2019 are $8,501, related to IFRS 16–Leases, as per note 5, plus, assets under finance lease reclassified to right-of-use assets of $141, for a total of $8,642.

	As at June 30, 2019	As at April 1, 2019
Cost	$ 8,642	$ 8,642
Less: Accumulated amortization	534	–
Net book value	**$ 8,108**	**$ 8,642**

Cost	
Balance as at April 1, 2019	$ 8,642
Plus: Additions	–
Less: Disposals	–
Balance as at June 30, 2019	**$ 8,642**
Accumulated amortization	
Balance as at April 1, 2019	$ –
Plus: Amortization	534
Less: Disposals	–
Balance as at June 30, 2019	**$ 534**

The amount recognized in the statement of comprehensive income related to low-value assets was $48 for employee computing devices.

The Corporation recorded income from subleasing a right-of-use asset of $219 in travel and disbursement revenue, which is recovered from DND.

NOTE 11: LEASE LIABILITY

Lease liability is comprised of amounts owing for right-of-use asset and reclassified amounts for finance lease obligation. Lease liability is $8,501 related to adoption of IFRS 16–Leases, as per note 5, plus $147 for the reclassified amount of finance lease obligation for a total of $8,648.

	As at June 30, 2019	As at April 1, 2019
Current portion	$ 1,859	$ 1,859
Long-term portion	6,295	6,789
Net book value	**$ 8,154**	**$ 8,648**

Cost		
Balance as at April 1, 2019	$	8,648
Less: Payments		540
Plus: Interest expense		46
Balance as at June 30, 2019	**$**	**8,154**

Maturity analysis		
1 year or less	$	1,777
Between 1-2 years		723
Between 2-5 years		2,000
Over 5 years		3,654
Total	**$**	**8,154**

NOTE 12: 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, 2019		As at March 31, 2019
Current portion of employee benefits	$	2,863	$	2,863
Long-term portion of employee benefits		26,014		25,335
Total employee benefits	**$**	**28,877**	**$**	**28,198**

The significant actuarial assumptions are disclosed in the *Annual Report 2018–2019*. 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 13: 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.

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.

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

13.1 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.

13.2 INVESTMENT REVENUE

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

13.3 SEGMENTED AND DISAGGREGATED REVENUE INFORMATION

In reviewing the performance of the Corporation, management analyzes 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, 2019

	Activites						
Region	Contract management	Project planning	Real property technical support	Procurement	Construction technical support	Environmental technical support	Total revenue, by region
Atlantic Region	$ 2,293	$ 1,130	$ 328	$ 359	$ 158	$ 289	$ 4,557
Quebec Region	2,446	1,332	365	339	289	298	5,069
National Capital Region	931	2,211	1,248	289	120	279	5,078
Ontario Region	3,316	1,518	410	511	723	451	6,929
Western Region	3,876	2,157	156	732	465	298	7,684
Head Office	31	3	–	80	298	–	412
Total revenue, by activity	**$ 12,893**	**$ 8,351**	**$ 2,507**	**$ 2,310**	**$ 2,053**	**$ 1,615**	**$ 29,729**

Three months ended June 30, 2018			Activites				
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
Head Office	38	–	–	6	270	–	314
Total revenue, by activity	**$ 12,263**	**$ 7,618**	**$ 2,472**	**$ 2,035**	**$ 2,022**	**$ 1,543**	**$ 27,953**

The following tables disaggregate revenue, by region and contract type.

	Time-based revenue	
Region	Three months ended June 30, 2019	Three months ended June 30, 2018
Atlantic Region	$ 1,506	$ 1,332
Quebec Region	1,399	1,109
National Capital Region	5,052	4,386
Ontario Region	1,944	1,801
Western Region	1,773	1,686
Head Office	369	289
Total time-based revenue	**$ 12,043**	**$ 10,603**

	Fixed-fee revenue	
Region	Three months ended June 30, 2019	Three months ended June 30, 2018
Atlantic Region	$ 3,051	$ 3,056
Quebec Region	3,670	3,880
National Capital Region	26	168
Ontario Region	4,985	4,823
Western Region	5,911	5,398
Head Office	43	25
Total fixed-fee revenue	**$ 17,686**	**$ 17,350**
Total revenue	**$ 29,729**	**$ 27,953**

NOTE 14: OPERATING AND ADMINISTRATIVE EXPENSES

	Three months ended June 30, 2019	Three months ended June 30, 2018
Professional services	**$ 529**	$ 212
Training and development	**322**	294
IT maintenance agreements	**291**	345
Leased location operating costs	**221**	–
Telephone and communications	**191**	197
Travel	**166**	165
Office supplies	**63**	52
Cloud services	**51**	–
Office equipment rental	**48**	–
Relocation	**38**	15
Hospitality	**33**	49
Communications	**19**	29
Printing and stationery	**15**	13
Office furniture and equipment	**12**	21
Subscriptions	**9**	17
IT hardware	**7**	6
Postage, freight and courier	**7**	6
IT software	**3**	17
Recruiting	**3**	27
Rent	**–**	423
Other	**4**	18
Total	**$ 2,032**	$ 1,906

NOTE 15: 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 2019–20 totalled $30,347 compared with $28,784 in the first quarter of 2018–19. These revenues were generated from services provided to DND (including the Canadian Forces Housing Agency), the Communications Security Establishment, Public Services and Procurement Canada, and Shared Services Canada.

The Corporation may incur expenses with other departments of the Government of Canada. These transactions totalled $20 for the first quarter of 2019–20 and the same amount in the comparable period in 2018–19.

		As at June 30, 2019		As at March 31, 2019
Due from:				
Department of National Defence	$	23,757	$	19,522
Canadian Forces Housing Agency		2,490		1,667
Communications Security Establishment Canada		204		137
Shared Services Canada		20		(6)
Public Services and Procurement Canada		–		1
	$	**26,471**	**$**	**21,321**
Due to:				
Shared Services Canada	$	–	$	5
Public Services and Procurement Canada		2		3
	$	**2**	**$**	**8**

15.1 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, 2019		Three months ended June 30, 2018
Short-term benefits	$	984	$	879
Post-employment benefits		146		140
	$	**1,130**	**$**	**1,019**

NOTE 16: CONTINGENT LIABILITIES

16.1 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, 2019, there were 12 ongoing contract claims totalling $10,373, all of which related to DND. These figures can be compared with 13 ongoing claims totalling $10,418 as at March 31, 2019, all of which related to DND.

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.