DEFENCE CONSTRUCTION CANADA

2017–2018 SECOND QUARTER FINANCIAL REPORT

PERIOD ENDED SEPTEMBER 30, 2017

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

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 second quarter ended September 30, 2017, for Defence Construction (1951) Limited (the "Corporation" or "DCC"). This discussion should be read with the unaudited interim condensed financial statements for the period ended September 30, 2017. 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, 2017 (the "*Annual Report 2016–2017*"). 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.

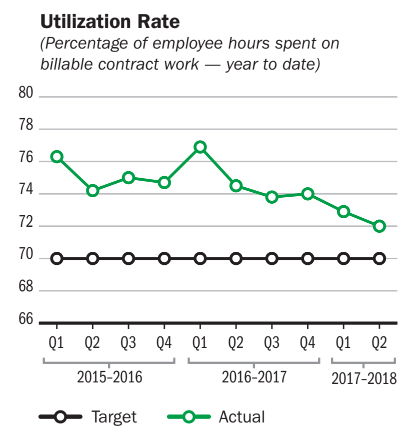
REAL PROPERTY MANAGEMENT SERVICES

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%.

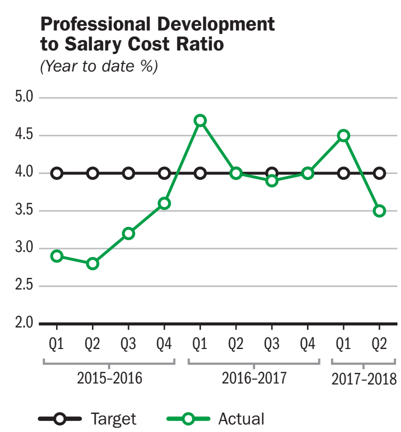


In the second quarter of 2017–18, the Corporation achieved a utilization rate of 71%, a decrease from the rate of 72.5% for the same period in 2016–17. This decrease was due to lower activity levels in the second quarter, resulting from changes to the Client-Partners' funding processes and the timing of projects.

For the year-to-date period of 2017–18, the Corporation achieved a utilization rate of 71.9%, a decrease from the rate of 74.5% for the same period in 2016–17. This decrease was due to lower activity levels, resulting from changes to the Client-Partners' funding processes, the timing of project completions and the near completion of Federal Infrastructure Investment Program (FIIP) projects at the end of fiscal 2016–17.

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 2017–18, 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.



During the second quarter of 2017–18, the professional development to salary cost ratio was 2.5%, a decrease from 3.3% in the comparable period last year. The decrease was due to the timing of staff training compared to the prior year.

For the year-to-date period of 2017–18, the professional development to salary cost ratio was 3.5%, a decrease from 4.0% 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 2016–2017*.

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 second quarter refer to the three months ended September 30, 2017; all references to the year-to-date period refer to the six months ended September 30, 2017. All references to the previous year's second quarter relate to the three months ended September 30, 2016; all references to the previous year's year-to-date period refer to the six months ended September 30, 2016; and all references to the previous year's end relate to March 31, 2017.

5.2 REVENUE

SERVICES REVENUE

Services revenue for all activities combined was $23.9 million in the second quarter, an increase of $718,000 or approximately 3% from the previous year. For the year-to-date period, services revenue was $48.7 million, an increase of $2.5 million or approximately 5% from the previous year. The increases in the second quarter and year-to-date periods were primarily the result of an increase in billing rates of 4.5% compared to the prior year.

CONTRACT MANAGEMENT

Revenue from contract management increased by 2% in the second quarter and 7% in the year-to-date period compared to the previous year. The increase in the second quarter reflected an increase in billing rates, which was partially offset by lower demand in the quarter compared to the previous year. For the year-to-date period, the increase was due to an increase in billing rates and higher demand from Client-Partners. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

PROJECT PLANNING

Revenue from project planning increased by 5% in the second quarter and 3% in the year-to-date period compared to the previous year. The increase in the second quarter reflected an increase in billing rates and slightly higher demand for services from the Client-Partners. The increase in the year-to-date period was due to higher billing rates and was partially offset by lower demand from the Client-Partner for this service.

REAL PROPERTY TECHNICAL SUPPORT

Revenue from real property technical support did not increase in the second compared to the same period in the prior year. This was a result of demand decreasing at the same rate as the billing rate increased. In the year-to-date period, revenue increased by 8% over the same period last year. The increase in the year-to-date period was due to an increase in billing rates and higher demand from DND for this activity.

CONSTRUCTION TECHNICAL SUPPORT

Revenue from construction technical support increased by 10% in the second quarter and 7% in the year-to-date period compared to the same periods in the previous year. The increases in the second quarter and year-to-date periods were the result of an increase in billing rates and were partially offset by lower demand in the quarter and year-to-date periods compared to the previous year.

PROCUREMENT

Revenue from procurement in the second quarter decreased by 2% compared to the same period in the previous year. For the year-to-date period, revenue from procurement decreased by 4% compared to the previous period. The decrease in both periods was due the lower demand for this service due to DND changing systems for purchasing services from DCC.

ENVIRONMENTAL TECHNICAL SUPPORT

Environmental technical support revenue increased by 5% in the second quarter and 11% in the year-to-date period compared to same periods in the prior year. The increases in the second quarter and year-to-date periods were due to an increase in billing rates and to higher demand from DND for these services. Fluctuations in the DND program have a direct impact on the revenue this activity generates.

REVENUE, BY ACTIVITY

			Change				**Change**	
(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	$	%	Six months ended September 30, 2017	Six months ended September 30, 2016	$	%
Contract management	$ 11,046	$ 10,794	252	2%	$ 22,279	$ 20,915	1,364	7%
Project planning	5,858	5,596	262	5%	12,187	11,787	400	3%
Real property technical support	2,024	2,018	6	0%	4,185	3,882	303	8%
Construction technical support	1,789	1,628	161	10%	3,755	3,520	(235)	7%
Procurement	1,714	1,748	(34)	-2%	3,388	3,518	(130)	-4%
Environmental technical support	1,424	1,353	71	5%	2,909	2,622	287	11%
	$ 23,855	**$ 23,137**	**718**	**3%**	**$ 48,703**	**$ 46,244**	**2,459**	**5%**

INVESTMENT REVENUE

Investment revenue, which is generated from the Corporation's average cash balance in its bank account and from investments, decreased in the second quarter by $12,000 or 8% and decreased in the year-to-date period by $7,000 or 2% compared to the same periods in the previous year. The decrease was primarily the result of lower interest earned in the bank account as a result of a decrease of $12 million in the average monthly bank balance compared to the prior period.

INVESTMENT REVENUE

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	%	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	%
Investment revenue	**$ 133**	**$ 145**	**(12)**	**-8%**	**$ 314**	**$ 321**	**(7)**	**-2%**

5.3 EXPENSES

SALARIES AND EMPLOYEE BENEFITS

Salaries totalled $17.8 million in the second quarter, a decrease of $353,000, or approximately 2%, over the same period in the previous year. The decrease in salaries was a result of staff turnover during the period, offset by an increase in salaries, as the number of employees at the end of the quarters was consistent. For the year-to-date period, salaries increased over the prior year by $1.8 million or approximately 5%. The increase in the year-to-date period was a result of salary increases, which averaged 3.4%, and decreased utilization, which resulted in higher overhead costs for the period.

Employee benefits were $4.7 million in the second quarter, an increase of $361,000 or approximately 8% over the same period in the prior year. They rose by $529,000 or approximately 6% in the year-to-date period compared to the prior year. Employee benefits increased mainly due to increased costs related to health and dental benefits and employee future benefits. The increases in health, dental and employee future benefits raised the ratio of benefits to salaries in both periods.

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	%	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	%
Salaries	$ 17,833	$ 18,186	(353)	-2%	$ 37,812	$ 36,055	1,757	5%
Employee benefits	4,725	4,364	361	8%	9,676	9,147	529	6%
	$ 22,558	**$ 22,550**	**8**	**0%**	**$ 47,488**	**$ 45,202**	**2,286**	**5%**
Employee benefits as a percentage of salaries	26%	24%			26%	25%		

OPERATING AND ADMINISTRATIVE EXPENSES

Operating and administrative expenses were $2.1 million in the second quarter of 2017–18, an increase of $195,000 or 10% over the second quarter of 2016–17. The operating and administrative expenses for the year-to-date period increased by $484,000 or 14% from the same period in the previous year. Material variances are shown in the following table.

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	**Change** %	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	**Change** %	Variance analysis
Software maintenance	$ 486	$ 269	217	81%	$ 877	$ 507	370	73%	The increases in both periods compared to the prior year were due to increased use of cyber security solutions, office productivity solutions and storage solutions that require annual maintenance payments.
Rent	431	433	(2)	0%	912	874	38	4%	The variance in the second quarter was not material. The increase in the year-to-date period was due to higher operating and maintenance costs at certain locations.
Professional services	283	227	56	25%	505	372	133	36%	The increases in both periods were due to higher fees related to services for information technology (IT) and human resources (HR) initiatives, such as augmenting cyber security, and supporting HR strategic plan renewal and talent survey development.
Telephone and data communications	255	206	49	24%	457	357	100	28%	The increases in both periods were due to increased costs related in improvements to network communications for DCC offices across Canada.
Employee training and development	163	240	(77)	-32%	475	518	(43)	-8%	The decreases in both periods were due to the timing of training activities.
Office supplies	72	166	(94)	-57%	134	246	(112)	-46%	The decreases in both periods were due to a prior-year program to purchase ergonomic equipment for staff.
Travel	67	105	(38)	-36%	204	246	(42)	-17%	The decreases in both periods were due to the timing of travel.
Client services and communications	62	28	34	121%	99	47	52	111%	The increases in both periods were due to upgrades related to the DCC intranet system.
Computer equipment	54	51	3	6%	78	86	(8)	-9%	The variances were not material.

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OPERATING AND ADMINISTRATIVE EXPENSES (continued)

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	**Change** %	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	**Change** %	Variance analysis
Staff relocation	47	45	2	4%	103	143	(40)	-28%	The variance in the second quarter was not material. The decrease in the year-to-date period related to the timing of relocations.
Hospitality	47	2	45	2250%	74	7	67	957%	The increases in both periods were due to hospitality related to training being recorded in Training in the prior year and in Hospitality in the current year.
Furniture and fixtures	28	16	12	75%	36	20	16	80%	The increases in both periods were due to purchases related to leasehold improvements at certain sites.
Printing and stationery	18	32	(14)	-44%	30	48	(18)	-38%	The decreases in both periods were due to the increased use of electronic document storage solutions and digital signature technology that reduced the need for printing and stationery.
Computer software	17	4	13	325%	31	23	8	35%	The increases in both periods were due to purchases of office productivity software that was below the capitalization threshold.
Memberships and subscriptions	12	9	3	33%	30	21	9	43%	The increases in both periods were due to higher expenditures for corporate memberships.
Recruiting	10	10	–	0%	10	41	(31)	-76%	The variance in the second quarter was not material. The decrease in the year-to-date period was due to lower recruitment requirements in the current year.
Postage and freight	9	11	(2)	-18%	14	17	(3)	-18%	The decreases in both periods were due to the increased use of electronic document delivery.
Other	(3)	9	(12)	-133%	(3)	9	(12)	-133%	The decreases in both periods were due to adjustments to fixed asset balances in the current period.
	$ 2,058	**$ 1,863**	**195**	**10%**	**$ 4,066**	**$ 3,582**	**484**	**14%**	

DEPRECIATION AND AMORTIZATION

Depreciation and amortization for the second quarter and year-to-date were consistent year over year. The decreases in amortization of intangible assets in both periods were due to the low number of additions to the pool of assets in the prior year. The increases in depreciation of property, plant and equipment in both periods were due to an increase in assets in the pool related to computer equipment.

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	**Change** %	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	**Change** %
Depreciation of property, plant and equipment	$ 263	$ 244	19	8%	$ 513	$ 493	20	4%
Depreciation of assets under finance lease	25	27	(2)	-7%	49	53	(4)	-8%
Amortization of intangible assets	51	63	(12)	-19%	102	127	(25)	-20%
	$ 339	**$ 334**	**5**	**1%**	**$ 664**	**$ 673**	**(9)**	**-1%**

5.4 LOSS AND TOTAL COMPREHENSIVE LOSS

The Corporation realized a loss and total comprehensive loss of $969,000 for the second quarter, compared with a loss and total comprehensive loss of $1.5 million for the same period in the previous year—a decrease of approximately 34%. The decrease in the loss for the quarter was a result of the following: the increased gross margin resulting from the increase in billing rates; and an increase in the utilization rate in the second quarter compared to the first quarter of the current year.

For the year-to-date period, the total loss increased by $309,000 compared with the same period last year, to reach $3.2 million. The increase in the loss for the year-to-date period was mainly due to a lower utilization rate in the first quarter of the current year, due to changes from Client-Partners that resulted in delays in program funding.

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	**Change** $	**Change** %	Six months ended September 30, 2017	Six months ended September 30, 2016	**Change** $	**Change** %
Loss and total comprehensive loss	**$ (969)**	**$ (1,467)**	**498**	**-34%**	**$ (3,205)**	**$ (2,896)**	**(309)**	**11%**

5.5 LIQUIDITY AND CAPITAL RESOURCES

FINANCIAL AND CASH MANAGEMENT

DCC's financial and cash management policy is discussed in the *Annual Report 2016–2017*.

CASH AND INVESTMENTS

Cash and investments totalled $24.6 million at September 30, 2017, a decrease of $2.6 million from March 31, 2017.

The cash balance at September 30, 2017, was $5.4 million, a decrease of $1.6 million or 23% from the 2016–17 year end. In the six-month period after March 31, 2017, the Corporation used $2.3 million in cash for operating activities, spent $254,000 on capital expenditures, redeemed $942,000 from investments and spent $48,000 to meet finance lease obligations.

Investments (both current and long term) at September 30, 2017, totalled $19.2 million, a decrease of $995,000 from the 2016–17 year end. The decrease was due mainly to cash from the portfolio being transferred to the cash position. 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 that 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 September 30, 2017, the amount of trade receivables was $19.8 million, an increase of $1.2 million or 6% from March 31, 2017. The increase was due to the timing of the collection of receivables from DND.

CURRENT LIABILITIES

Current liabilities were $15.3 million at September 30, 2017, a decrease of $419,000 or 3% from March 31, 2017. 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 September 30, 2017	As at March 31, 2017	**Change** $	**Change** %
Cash	$ 5,405	$ 7,022	(1,617)	-23%
Investments	19,235	20,230	(995)	-5%
Cash and investments	**$ 24,640**	**$ 27,252**	**(2,612)**	**-10%**
Trade receivables	**$ 19,800**	**$ 18,596**	**1,204**	**6%**
Current liabilities	**$ 15,302**	**$ 15,721**	**(419)**	**-3%**

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 September 30, 2017, was $24.0 million, an increase of $1.3 million or 6% from the 2016–17 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 September 30, 2017	As at March 31, 2017	**Change** $	**Change** %
Current portion	$ 2,277	$ 2,277	–	0%
Long-term portion	21,688	20,433	1,255	6%
Total employee benefits	**$ 23,965**	**$ 22,710**	**1,255**	**6%**

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 second quarter, the value of assets under finance lease had decreased by $37,000 or 12% since the 2016–17 year end. The decrease was the result of DCC replacing part of its inventory of copiers with less expensive machines than it had previously leased.

(in thousands of dollars)	As at September 30, 2017	As at March 31, 2017	Change $	Change %
Assets under finance lease	**$ 272**	**$ 309**	**(37)**	**-12%**

The finance lease obligation at the end of the second quarter decreased by $36,000, or 11%, from the 2016–17 year end, due to acquisitions and adjustments of $12,000 and payments of $48,000.

(in thousands of dollars)	As at September 30, 2017	As at March 31, 2017	Change $	Change %
Current portion	$ 95	$ 95	–	0%
Long-term portion	183	219	(36)	-16%
Finance lease obligation	**$ 278**	**$ 314**	**(36)**	**-11%**

5.8 CAPITAL EXPENDITURES

The Corporation's capital expenditures for the second quarter totalled $185,000, an increase of $113,000 or 157% from the same period in the previous year. The increase was due to leasehold improvements and furniture purchases to increase the usage of space in certain offices.

For the year-to-date period, expenditures totalled $254,000, an increase of $71,000 over the same period in the previous year. The increase was due to leasehold improvements and furniture purchases. It was offset by lower purchases of computer equipment and intangible assets.

(in thousands of dollars)	Three months ended September 30, 2017	Three months ended September 30, 2016	Change $	Change %	Six months ended September 30, 2017	Six months ended September 30, 2016	Change $	Change %
Intangible assets	$ –	$ 3	(3)	-100%	$ 2	$ 15	(13)	-87%
Computer equipment	58	67	(9)	-13%	118	166	(48)	-29%
Furniture and equipment	55	2	53	2650%	62	2	60	3000%
Leasehold improvements	72	–	72	100%	72	–	72	100%
	$ 185	**$ 72**	**113**	**157%**	**$ 254**	**$ 183**	**71**	**39%**

5.9 ACTUAL PERFORMANCE VERSUS PLAN

The Corporation's actual performance compared to the Corporate Plan (the Plan) for the six months ended September 30, 2017, was lower than reported in the Plan.

Services revenue was 8% lower than forecasted in the Plan. This decrease was due to lower activity levels in the first half of the year resulting from changes to the Client-Partners' funding processes, the timing of project implementation and the near completion of FIIP projects at the end of fiscal 2016–17. Investment revenue was higher than anticipated in the Plan due to a higher-than-expected return on investment.

Salaries and benefits were 5% lower than the Plan. The decrease occurred because DCC hired fewer new employees than expected, due to lower-than-anticipated activity.

Operating and administrative costs were 31% lower than projected, due to the timing of the implementation of the Corporation's cyber strategy and other operating expenses, primarily training, development and travel costs.

Capital expenditures were 81% lower than projected, due to the timing of planned acquisitions related to the cyber strategy and IT renewal plan.

ACTUAL PERFORMANCE VERSUS PLAN

					Change	
(in thousands of dollars)		**Actual**		**Plan**	$	%
Revenue						
Services revenue	$	48,703	$	53,068	(4,365)	-8%
Recovered travel and disbursement		828		774	54	7%
Investment		314		252	62	25%
		49,845		**54,094**	**(4,249)**	**-8%**
Expenses						
Salaries and employee benefits		47,488		50,247	(2,759)	-5%
Operating and administrative costs		4,070		5,894	(1,824)	-31%
Recoverable travel and disbursement		828		774	54	7%
Depreciation and amortization		664		725	(61)	-8%
		53,050		**57,640**	**(4,590)**	**-8%**
Loss and total comprehensive loss	**$**	**(3,205)**	**$**	**(3,546)**	**341**	**-10%**
Capital expenditures	**$**	**185**	**$**	**969**	**(784)**	**-81%**

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
November 29, 2017

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF FINANCIAL POSITION

Unaudited

(in thousands of dollars)	Notes	**As at September 30, 2017**	As at March 31, 2017
Assets			
Cash		**$ 5,405**	$ 7,022
Investments	5	**2,152**	3,100
Trade receivables	10	**19,800**	18,596
Other receivables		**2,040**	2,124
Prepaid and other current assets		**1,436**	1,951
Current assets		**30,833**	32,793
Investments	5	**17,083**	17,130
Property, plant and equipment	7	**1,981**	2,242
Intangible assets		**298**	398
Assets under finance lease		**272**	309
Non-current assets		**19,634**	20,079
Total assets		**$ 50,467**	$ 52,872
Liabilities			
Trade and other payables		**$ 11,538**	$ 13,349
Deferred revenue	6	**1,392**	–
Current portion—finance lease obligation		**95**	95
Current portion—employee benefits	8	**2,277**	2,277
Current liabilities		**15,302**	15,721
Finance lease obligation		**183**	219
Employee benefits	8	**21,688**	20,433
Non-current liabilities		**21,871**	20,652
Total liabilities		**37,173**	36,373
Equity			
Share capital—authorized—1,000 common shares of no par value		**–**	–
Issued—32 common shares		**–**	–
Retained earnings		**13,294**	16,499
Total equity		**13,294**	16,499
Total liabilities and equity		**$ 50,467**	$ 52,872

Contingent liabilities (Note 11)

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 September 30, 2017	Three months ended September 30, 2016	Six months ended September 30, 2017	Six months ended September 30, 2016
Services revenue		**$ 23,855**	$ 23,137	**$ 48,703**	$ 46,244
Travel and disbursement revenue		**477**	795	**828**	1,233
Investment revenue		**133**	145	**314**	321
Total revenue		**24,465**	24,077	**49,845**	47,798
Salaries and employee benefits		**22,558**	22,550	**47,488**	45,202
Operating and administrative expenses	9	**2,058**	1,863	**4,066**	3,582
Travel and disbursement expenses		**477**	795	**828**	1,233
Depreciation of property, plant and equipment	7	**263**	244	**513**	493
Depreciation of assets under finance lease		**25**	27	**49**	53
Amortization of intangible assets		**51**	63	**102**	127
Finance costs		**2**	2	**4**	4
Total expenses		**25,434**	25,544	**53,050**	50,694
Loss for the period and total comprehensive loss		**$ (969)**	$ (1,467)	**$ (3,205)**	$ (2,896)

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

DEFENCE CONSTRUCTION (1951) LIMITED

INTERIM CONDENSED STATEMENT OF CHANGES IN EQUITY

Unaudited

(in thousands of dollars)	Share capital	Retained earnings	Total equity
Balance at June 30, 2017	$ –	$ 14,263	$ 14,263
Loss for the period		(969)	(969)
Balance at September 30, 2017	**$ –**	**$ 13,294**	**$ 13,294**

	Share capital	Retained earnings	Total equity
Balance at June 30, 2016	$ –	$ 29,126	$ 29,126
Loss for the period		(1,467)	(1,467)
Balance at September 30, 2016	**$ –**	**$ 27,659**	**$ 27,659**

(in thousands of dollars)	Share capital	Retained earnings	Total equity
Balance at March 31, 2017	$ –	$ 16,499	$ 16,499
Loss for the period		(3,205)	(3,205)
Balance at September 30, 2017	**$ –**	**$ 13,294**	**$ 13,294**

	Share capital	Retained earnings	Total equity
Balance at March 31, 2016	$ –	$ 30,555	$ 30,555
Loss for the period	–	(2,896)	(2,896)
Balance at September 30, 2016	**$ –**	**$ 27,659**	**$ 27,659**

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 September 30, 2017	Three months ended September 30, 2016	Six months ended September 30, 2017	Six months ended September 30, 2016
Cash flow from (used in) operating activities					
Loss for the period		**$ (969)**	$ (1,467)	**$ (3,205)**	$ (2,896)
Adjustments to reconcile loss for the period to cash provided by (used in) operating activities					
Employee benefits expense		**731**	566	**1,461**	1,132
Employee benefits paid		**(104)**	(44)	**(206)**	(87)
Depreciation of property, plant and equipment	7	**263**	244	**513**	493
Depreciation of assets under finance lease		**25**	27	**49**	53
Amortization of intangible assets		**51**	63	**102**	127
Amortization of investment premiums		**26**	42	**53**	71
Change in non-cash operating working capital					
Trade receivables		**2,837**	(1,169)	**(1,204)**	(3,970)
Other receivables		**48**	36	**84**	57
Prepaids and other current assets		**334**	1,250	**515**	171
Trade and other payables		**(15)**	2,061	**(1,811)**	1,243
Deferred revenue		**1,160**	(358)	**1,392**	1,622
Net cash flows provided by (used in) operating activities		**4,387**	1,251	**(2,257)**	(1,984)
Cash flows provided by (used in) investing activities					
Acquisition of investments		**(257)**	(859)	**(258)**	(1,752)
Disposition of investments		**700**	725	**1,200**	1,450
Acquisition of property, plant and equipment	7	**(185)**	(69)	**(252)**	(168)
Acquisition of intangible assets		**–**	(3)	**(2)**	(15)
Net cash flows provided by (used in)investing activities		**258**	(206)	**688**	(485)
Cash flows used in financing activities					
Repayment of finance lease obligations		**(25)**	(23)	**(48)**	(46)
Net cash flows used in financial activities		**(25)**	(23)	**(48)**	(46)
Decrease in cash during the period		**4,620**	1,022	**(1,617)**	(2,515)
Cash at the beginning of the period		**785**	14,841	**7,022**	18,378
Cash at the end of the period		**$ 5,405**	$ 15,863	**$ 5,405**	$ 15,863

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, 2017, 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, 2017.

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 Note 3 to the Corporation's audited financial statements for the year ended March 31, 2017. The accounting policies and methods of computation have been applied consistently to all the periods presented.

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 Note 4 to the Corporation's annual financial statements for the year ended March 31, 2017.

NOTE 5: INVESTMENTS

Investments consist of Canadian, provincial and corporate bonds with fixed interest rates ranging from 2.85% to 7.2%, guaranteed investment certificates (GICs) with fixed interest rates ranging from 1.7% to 2.1%, and mutual funds with variable interest rates. The maturity dates of the bonds vary from 2018 to 2031 and those of the GICs from 2018 to 2021, 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 September 30, 2017	As at March 31, 2017
Current portion	**$ 2,152**	$ 3,100
Non-current portion	**17,083**	17,130
Net book value	**$ 19,235**	$ 20,230

	As at September 30, 2017	As at March 31, 2017
Carrying amount at amortized cost		
Bonds		
Federal	**$ 505**	$ 506
Provincial	**8,053**	9,086
Corporate	**4,302**	4,321
Total bonds	**12,860**	13,913
Guaranteed investment certificates	**5,725**	5,925
Mutual funds	**650**	392
Total	**$ 19,235**	$ 20,230

	As at September 30, 2017	As at March 31, 2017
Fair value		
Bonds		
Federal	**$ 525**	$ 539
Provincial	**8,332**	9,583
Corporate	**4,440**	4,540
Total bonds	**13,297**	14,662
Guaranteed investment certificates	**5,786**	5,947
Mutual funds	**650**	392
Total	**$ 19,733**	$ 21,001

NOTE 6: DEFERRED REVENUE

Deferred revenue arises when, at a reporting date, the amount invoiced exceeds the services delivered through fixed-fee service-level arrangements. For the period ended September 30, 2017, deferred revenue was $1,392. The figure as at March 31, 2017, 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 7: PROPERTY, PLANT AND EQUIPMENT

	As at September 30, 2017	As at March 31, 2017
Cost	$ 7,460	$ 7,208
Less: Accumulated depreciation	5,479	4,966
Net book value	**$ 1,981**	**$ 2,242**
Net book value by asset class		
Computer equipment	$ 1,639	$ 1,979
Furniture and fixtures	240	209
Leasehold improvements	102	54
Net book value	**$ 1,981**	**$ 2,242**

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, 2017	$ 4,395	$ 789	$ 2,024	$ 7,208
Plus: Additions	118	62	72	252
Less: Disposals	–	–	–	–
Balance as at September 30, 2017	**$ 4,513**	**$ 851**	**$ 2,096**	**$ 7,460**

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

	Computer equipment	Furniture and fixtures	Leasehold improvements	Total
Accumulated depreciation				
Balance as at March 31, 2017	$ 2,416	$ 580	$ 1,970	4,966
Plus: Depreciation	458	31	24	513
Less: Disposals	–	–	–	–
Balance as at September 30, 2017	**$ 2,874**	**$ 611**	**$ 1,994**	**$ 5,479**

There was no impairment of property, plant and equipment.

NOTE 8: 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 September 30, 2017	As at March 31, 2017
Current portion of employee benefits	$ 2,277	$ 2,277
Long-term portion of employee benefits	21,688	20,433
Total employee benefits	**$ 23,965**	**$ 22,710**

The significant actuarial assumptions are disclosed in the *Annual Report 2016–2017*. 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 9: OPERATING AND ADMINISTRATIVE EXPENSES

	Three months ended September 30, 2017	Three months ended September 30, 2016	Six months ended September 30, 2017	Six months ended September 30, 2016
Software maintenance	**$ 486**	$ 269	**$ 877**	$ 507
Rent	**431**	433	**912**	874
Professional services	**283**	227	**505**	372
Telephone and data communications	**255**	206	**457**	357
Employee training and development	**163**	240	**475**	518
Office services, supplies and equipment	**72**	166	**134**	246
Travel	**67**	105	**204**	246
Client services and communications	**62**	28	**99**	47
Computer equipment	**54**	51	**78**	86
Staff relocation	**47**	45	**103**	143
Hospitality	**47**	2	**74**	7
Furniture and fixtures	**28**	16	**36**	20
Printing and stationery	**18**	32	**30**	48
Computer software	**17**	4	**31**	23
Memberships and subscriptions	**12**	9	**30**	21
Recruiting	**10**	10	**10**	41
Postage and freight	**9**	11	**14**	17
Other	**(3)**	9	**(3)**	9
	$ 2,058	$ 1,863	**$ 4,066**	$ 3,582

NOTE 10: 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 year-to-date period of 2017–18 totalled $49,531, compared to $47,477 in the comparable period of 2016–17. 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 $47 in the year-to-date period of 2017–18, compared with $39 in the same period of 2016–17.

In accordance with the 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 September 30, 2017	As at March 31, 2017
Due from		
Department of National Defence	$ 17,934	$ 17,325
Canadian Forces Housing Agency	1,591	1,087
Shares Services Canada	163	119
Communications Security Establishment	112	65
	$ 19,800	**$ 18,596**
Due to		
Shares Services Canada	–	12
	$ –	**$ 12**

10.1 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 September 30, 2017	Three months ended September 30, 2016	Six months ended September 30, 2017	Six months ended September 30, 2016
Short-term benefits	$ 824	$ 699	$ 1,677	$ 1,417
Post-employment benefits	103	89	195	166
	$ 927	**$ 788**	**$ 1,872**	**$ 1,583**

NOTE 11: CONTINGENT LIABILITIES

11.1 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 September 30, 2017, there were nine ongoing claims totalling $2,276. As at March 31, 2017, there were eight ongoing claims totalling $1,944.

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.