ANNUAL REPORT

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COOPÉRATIVE
FÉDÉRÉE
DE QUÉBEC

Table of Contents

Highlights	1
The President's Message	2
Board of Directors	8
Consolidated Statement of Savings	9
Consolidated Statement of Retained Savings	9
Consolidated Balance Sheet	10
Consolidated Statement of Changes in Financial Position	11
Notes to Consolidated Financial Statements	12
Management's Reporting Responsibility	15
Auditors' Report	15
Financial Review	16
Management	17
Management Report	18

Ce rapport est disponible en français en vous adressant
au trésorier:
Coopérative fédérée de Québec
Case postale 500, Station Youville
Montréal H2P 2W2

Highlights
(in thousands of dollars)

	1987	1986
Sales	**$1,243,656**	$1,170,160
Savings before patronage refunds and income taxes	**18,301**	17,821
Net savings	**6,306**	7,246
Accounts receivable and inventories	**187,719**	171,647
Current assets	**205,032**	177,193
Working capital	**62,443**	59,096
Fixed assets, at cost	**111,100**	98,090
Fixed assets, net	**45,713**	43,334
Total assets	**276,398**	238,672
Long-term debt	**39,316**	32,674
Members' and Co-operative's equity	**91,136**	83,978

Quebec farmers increasingly produce the cereals that agricultural co-operatives use in the preparation of feeds and supplements required to constantly improve animal production.

THE PRESIDENT'S MESSAGE

It is with pride that I deliver this message to you, at the conclusion of my first year as President of Coopérative Fédérée de Québec. This year has been the best in our history in terms of business. It has ended with the departure of our Chief Executive Officer, Mr. Louis-Philippe Poulin, and the arrival of his successor, Mr. André F. Lizotte.

On behalf of the Board of Directors, I would like to thank Mr. Poulin who took his well-earned retirement on October 31, following a brilliant quarter-century career with Coopérative Fédérée. Mr. Poulin's knowledge of the agricultural and co-operative worlds was exceptional. He judiciously applied his intelligence and judgment, as well as his understanding of economic realities, to the heavy task he assumed. Mr. Poulin, we wish you a long and happy retirement.

Mr. André F. Lizotte, our new Chief Executive Officer, assumed his position on November 2. A seasoned administrator, Mr. Lizotte has accumulated exceptional experience during his career. We invited him to join our team, which operates in an environment where the challenges to meet are numerous. We welcome him and would like to assure him of our support in his duties.

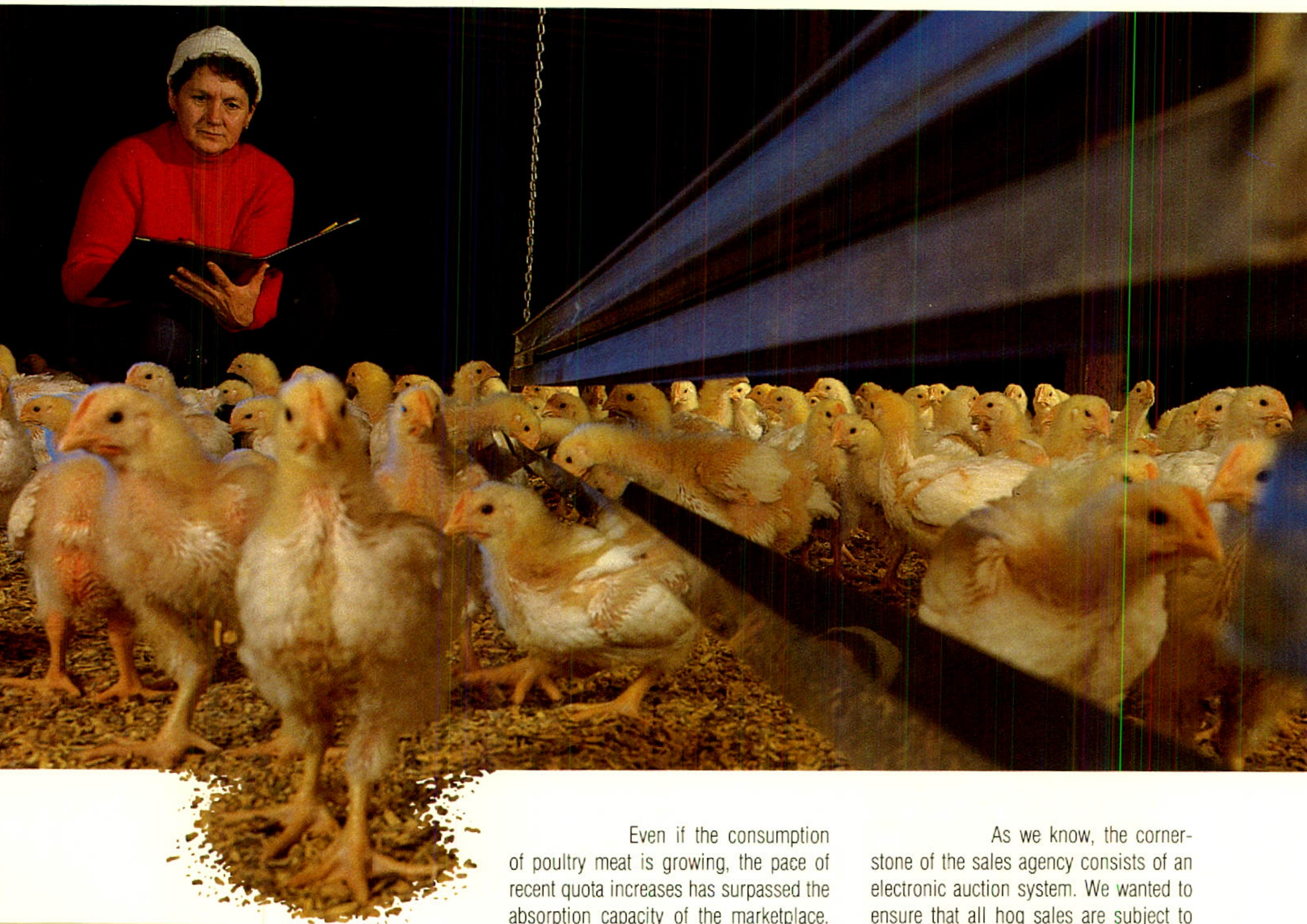
I would like to take this opportunity to pay tribute to our management and our employees. Without their skill and their perseverance, Coopérative Fédérée would not be where it is today. I would like to thank them all for their devotion.

Let's take a quick look at some of the milestones that marked the past year.

Cooperation and Marketing Boards

In the dairy sector last year, the agricultural co-operatives and the Federation of Dairy Producers worked towards achieving a single collective agreement for milk marketing. The main problems that we have experienced in the past, namely the existence of two distinct collective agreements, the lack of control over the use of the milk that was requisitioned, and a system of pricing milk by categories which adversely affected marketing, were settled in negotiations in which both the Federation and the co-operatives acted in good faith. Let us hope the same spirit will prevail throughout the negotiations on transportation.

Women farmers are increasingly playing a leading role in farm management. The same holds true within the co-operative movement; they occupy positions at even the highest decision levels, such as the Board of Directors.



The new rules regulating milk marketing should help dairy co-operatives to better coordinate their efforts to develop and market new products... a desired progress.

During the past year, the poultry industry was profitable for most participants, particularly for processors and producers. On the other hand, this year is shaping up as very poor for all concerned. Management of supply in the poultry sector suffers from major structural problems. For a supply management system to function properly, decision-makers must accept responsibility for the consequences. Production quotas were increased by 8% in 1987 and 5% in 1988 in the poultry meat sector.

Even if the consumption of poultry meat is growing, the pace of recent quota increases has surpassed the absorption capacity of the marketplace. Killing plants have to freeze chicken surpluses, leading to significant losses. The composition of the Management Committee on supply needs to be revised, and a mechanism will have to be put in place to avoid the destabilizing effect that surpluses have on the marketplace.

Coopérative Fédérée met several times with the Federation of Hog Producers to negotiate the sales agency plan that this federation would like to implement. Our position in the negotiations was that we felt it important to preserve our co-operative nature. As well, we wanted to ensure that all processing companies conform to the new marketing mechanisms.

As we know, the cornerstone of the sales agency consists of an electronic auction system. We wanted to ensure that all hog sales are subject to this system, so that all processors are treated on the same basis under the system. We also wanted to ensure that hog producers and their co-operatives could maintain a commercial relationship with Coopérative Fédérée that reflects our co-operative nature. We can conclude from our discussions on this dossier with the Federation that we arrived at a satisfactory mutual agreement. For our part, the only condition that the Federation must fulfil in relation to the inception of the sales agency, is to be able to show that the other players respect the rules of the game.

The Canada-U.S. Trade Agreement

Last December, Coopérative Fédérée identified a number of modifications that the Federal Government could implement aimed at ensuring that the forthcoming trade agreement would be of benefit to the Québec agri-food industry.

We were asking the Federal Government to add yogurt, ice cream and chicken prepared dishes to the list of import-controlled products; to define the policy that will be followed in the food wheat sector to allow us to dispose of our crops and to continue the development of this production; to pay particular attention to the processed horticultural products sector; to distribute import quotas in regulated sectors according to criteria that will treat all such businesses fairly while allowing consumers to save on lower-cost imported goods.

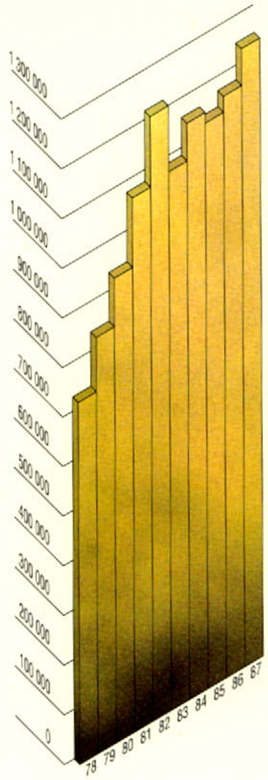
Let us give credit where credit is due. The Federal Government can already be credited with achieving significant results which improve the Free-Trade Agreement to the advantage of the Québec agri-food industry. The final text of the agreement contains a reference to Article 11 of the General Agreement on Tariffs and Trade, which allows a country with a quota system for its internal agricultural production to place quotas on agricultural imports as well.

In January 1988, yogurt and ice cream, as well as some other dairy products, were placed on the list of controlled imports, just as we had requested in December.

We have asked the Federal Government to continue the work it has initiated with such success. The agreement that has been signed need not be altered to incorporate any of our proposals. The issues to be resolved are within the prerogatives of our government.

The Québec agri-food industry exports more than $710 million worth of goods to the United States. The United States is our main market and will continue to be so in the future.

Tomorrow's economic boundaries will be more open than today's. We must prepare to face this reality, in the agri-food industry just as anywhere else. We are willing to make the required effort this situation demands, but government action is also required in order to ensure we can address opportunities. We ask them to take this action.



SALES
($ in thousands)

The GATT Negotiations

During the next few years, and especially this year, at the Uruguay round of the GATT negotiations, agricultural policies will be in the forefront.

In previous talks, treaty signatories have usually agreed to exclude agriculture from the list of sectors slated for trade liberalization. It will not be the case this time. Agriculture is one of the main items on the agenda during these negotiations.

The worldwide trade war that opposes Europeans and Americans is an indication that freeing up trade in the agri-food sector will be quite difficult. The outcome of the treaty vis-à-vis Article 11 and how its ensuing regulations will shape future national agricultural policy is what is primarily at stake at these negotiations. How it is resolved is therefore of prime interest to us.

We share the negotiations' goal of improving the world market. The objectives that we support outright are the elimination of dumping, an egalitarian level of subsidies and the reduction of those that adversely affect trade, and the coordination of the technical modalities that are applied to control imports.

However, the results of these negotiations should not jeopardize farmers' capability to earn a stable and adequate income in return for their labour, the labour of their family, and in recognition of the capital that they invest in their enterprises.

On the other hand, farming and agri-food businesses must not spare any effort to remain efficient and competitive in a world where, doubtless, freer trade will be a dominant influence.

Food Wheat

The domestic market for food wheat has experienced profound transformation over the past few years.

The production of hard spring wheat suitable for bread-making was traditionally concentrated exclusively in the Prairies.

New production techniques (intensive cereal management) and the introduction of new varieties adapted to our climate, have allowed Eastern Canada to establish itself as a producing region in this industry. The double-price policy for food wheat has likewise made this crop attractive for Eastern grain growers.

The Minister responsible for grain and oilseeds, Charles Mayer, announced in November 1987 his intention to replace the existing double-price policy for food wheat with a program under which producers would be paid directly. The rationale for the change in policy is to permit processors access to wheat and flour supplies at a price comparable to those paid by international competitors.

This situation has created a climate of uncertainty in the marketplace. Processors have stopped buying, preferring to use up their inventories while waiting for a reduction in domestic prices. Producers and agents, such as our organization, who hold seed, and who must decide whether to produce more next summer, do not have sufficient data to make a sound decision. The government's primary goal was to base the compensation to producers on historical production levels for each region. We have reacted to this orientation and have made representations to governmental authorities.

We have asked the Minister to dispel without delay the uncertainty his November declaration created, namely that he agrees not to change the ground-rules during a crop year, and that future subsidies not be based on historical levels of production, but rather on the actual production results of each region of the country during the course of one year.

The Federal Government should abandon the notion that grain production, specifically food grain, is an activity reserved to farmers in the Prairies. Government policy should be based on the principle of equity between regions and producers.

Research of excellence in hog production is dependent on a healthy environment and accurate animal performance controls. Agricultural co-operatives participate in this research by supporting new breeding methods, and by making available the new Optiporc Program, which was perfected in Europe by a co-operative member of the Cooperative research farms network.

In this sense, the Federal Government's actual support to grain producers in the Prairies, compared to that provided to producers in other regions, respects this principle less and less.

The Federal Government not only subsidizes transportation of prairie grain, but uses public funds, through the Canadian Wheat Board, to guarantee initial prices. Prairie producers also have access to a stabilizing program for Western grain where two thirds of the financing is insured by the central government. As well, the same government recently allotted a sum of $700 million to make up for the program's deficit. It is time that the producers and their organizations in Eastern Canada call the Federal Government to account, and demand the introduction of more equitable support measures.

These are the main areas that required our attention over the past year.

Our Future

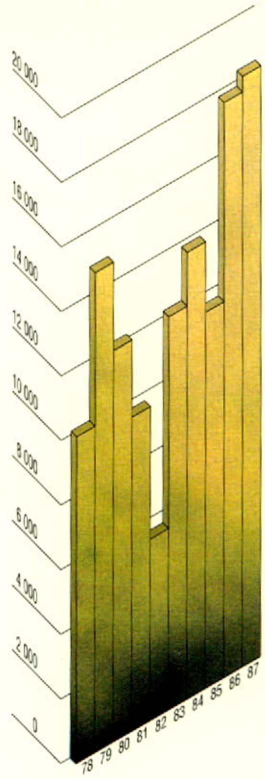
Agricultural co-operatives constitute a network of enterprises that have attained remarkable success. Their revenues exceed $3 billion and they employ more than 10,500 people. Sales for Coopérative Fédérée total $1.2 billion, and it employs 3,000 employees. Coopérative Fédérée is one of the most important industrial and commercial organizations in Québec.

Coopérative Fédérée's success is attributable to its deep roots in the Québec agri-food industry. It has adapted to the changing needs of both farmers and consumers.

We are not harboring illusions, however. Economic reality means that nothing can be taken for granted. Our competitors are fierce, and their size and strength do not permit us to be complacent. If we want to retain our place in the Québec agri-food industry in the year 2000, and this place should be at the forefront, we must continue to work hard.

To achieve this, we must start planning today for our future. This is one of the major tasks facing us in 1988. We must review our mission in the light of today's and tomorrow's realities. Defining objectives and adapting our structures are some of the activities that we have invited upon ourselves.

To prosper, our network of co-operatives must adapt to today's economic environment. At the same time it must remain fully open to the new social realities that characterize the agricultural world. The official recognition of the role of women farmers is provoking a profound transformation in rural life. We must develop attitudes within the agricultural cooperation that encourage women farmers to take the place that is due them. As well, we must ensure that young farmers feel at home in our movement.



SAVINGS
($ in thousands)

In closing, I would like to thank all the members of Coopérative Fédérée, the directors, managers, and farmer-members for the confidence they have shown in our organization throughout the year.

The President,

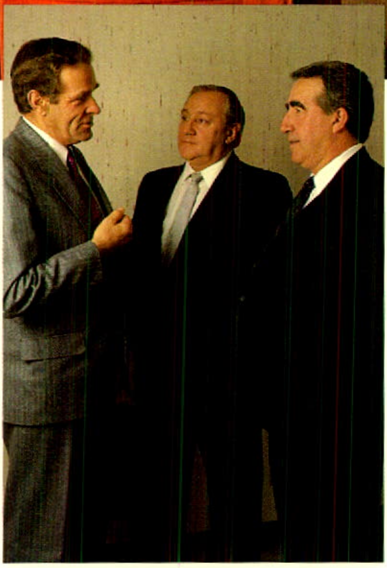
A. Roger Pelletier

Alphonse-Roger Pelletier

BOARD OF DIRECTORS

1

1. *Napoléon Théberge*, *District no. 2, Audit Committee member* *and* *Léon Desautels*, *District no. 9; both Executive Committee members.*



2

2. *Alphonse-Roger Pelletier*, *District no. 3, President,* ***Michel Lemire***, *District no. 8, 1st Vice-President* *and* **Paul Massicotte**, *District no. 13, 2nd Vice-President.*

3

3. *Jean-Guy Demers*, *District no. 1;* ***Yves Perreault***, *District no. 14;* ***Léandre Morin***, *District no. 4;* ***Claude Castonguay***, *District no. 7* *and* ***Claude Couture***, *District no. 10.*

4

4. *Lloyd Meyer*, *District no. 11, Audit Committee member;* ***Florian Vachon***, *District no. 5;* ***Maurice Lapalme***, *District no. 12, Audit Committee member;* ***Raymond Gagnon***, *District no. 15* *and* ***Jean-Marie Girouard***, *District no. 6.*

CONSOLIDATED STATEMENT OF SAVINGS

year ended October 31, 1987
(in thousands of dollars)

	1987	1986
Sales	**$1,243,656**	$1,170,160
Cost of sales	**1,059,193**	999,638
Gross savings	**184,463**	170,522
Expenses		
Salaries and employee benefits	**85,753**	77,843
Operating and selling	**58,824**	52,792
Administrative	**5,231**	7,781
Interest on long-term debt	**3,696**	4,377
Other financial expenses, net	**3,501**	2,828
Depreciation of fixed assets	**7,440**	7,128
Amortization of production licences and rights *(note 5)*	**2,756**	156
Gain on disposal of fixed assets	**(1,039)**	(204)
	166,162	152,701
Savings before patronage refunds and income taxes	**$ 18,301**	$ 17,821
Distribution of savings		
Patronage refunds *(note 10)*	**$ 7,225**	$ 7,000
Income taxes — current *(note 8)*	**5,336**	4,268
Income taxes — deferred	**(566)**	(693)
Retained savings	**6,306**	7,246
	$ 18,301	$ 17,821

CONSOLIDATED STATEMENT OF RETAINED SAVINGS

year ended October 31, 1987
(in thousands of dollars)

	1987	1986
Balance, at beginning of year	**$ 55,373**	$ 48,127
Net savings	**6,306**	7,246
Balance, at end of year	**$ 61,679**	$ 55,373

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

CONSOLIDATED BALANCE SHEET
as at October 31, 1987
(in thousands of dollars)

ASSETS	1987	1986
Current		
Cash	**$ 11,388**	$ —
Accounts receivable	**89,085**	86,725
Inventories	**98,634**	84,922
Prepaid expenses	**4,910**	4,437
Investments — current portion	**1,015**	1,109
	205,032	177,193
Investments *(note 3)*	**17,748**	17,410
Fixed assets *(note 4)*	**45,713**	43,334
Production licences and rights *(note 5)*	**7,905**	735
	$276,398	$238,672

LIABILITIES AND EQUITY	1987	1986
Current		
Loans *(note 6)*	**$ 60,557**	$ 48,613
Accounts payable	**67,883**	53,167
Self-insurance fund	**2,106**	1,152
Patronage refunds *(note 10)*	**5,788**	5,831
Redemption of share capital *(note 10)*	**800**	3,314
Income taxes	**585**	2,495
Current portion of long-term debt	**4,870**	3,525
	142,589	118,097
Long-term debt *(note 7)*	**39,316**	32,674
Deferred income taxes	**3,357**	3,923
Equity		
Members' equity *(notes 9 and 10)*	**29,457**	28,605
Co-operative's equity — Retained savings	**61,679**	55,373
	91,136	83,978
	$276,398	$238,672

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

A. Roger Pelletier

Alphonse-Roger Pelletier, Director

Michel Lemire

Michel Lemire, Director

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

year ended October 31, 1987
(in thousands of dollars)

	1987	1986
Operations		
Savings before patronage refunds and income taxes	**$ 18,301**	$ 17,821
Patronage refunds and income taxes	**(11,995)**	(10,575)
Depreciation and other items not requiring an outlay of working capital	**8,560**	6,391
Funds from operations	**14,866**	13,637
Investment		
Acquisition and merger of businesses, net of working capital *(note 2)*	**(6,589)**	—
Acquisition of investments	**(1,422)**	(1,349)
Disposal of investments	**1,855**	1,122
Acquisition of fixed assets	**(8,641)**	(6,863)
Proceeds from disposal of fixed assets	**1,989**	1,766
Funds used for investment	**(12,808)**	(5,324)
Financing		
New long-term debt	**11,256**	4,500
Reimbursement of long-term debt	**(9,908)**	(8,585)
Issuance of share capital	**2,622**	1,845
Redemption of share capital	**(2,681)**	(3,491)
Funds (used in) provided by financing	**1,289**	(5,731)
Increase in working capital	**3,347**	2,582
Working capital, beginning of year	**59,096**	56,514
Working capital, end of year	**$ 62,443**	$ 59,096

Reconciliation of change in working capital to cash position

Increase in working capital	**$ 3,347**	$ 2,582
Changes in non-cash components of working capital relating to:		
Operations	**(2,828)**	(282)
Investment	**94**	(320)
Financing	**(1,169)**	2,244
Increase (decrease) in cash position	**(556)**	4,224
Cash position, beginning of year	**(48,613)**	(52,837)
Cash position, end of year	**$(49,169)**	$(48,613)

Cash position comprises loans less cash.

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

NOTES
TO CONSOLIDATED
FINANCIAL STATEMENTS

year ended October 31, 1987
(Tabular amounts are expressed in thousands of dollars)

Coopérative Fédérée de Québec was incorporated by a special Act of the Province of Quebec. Its operations consist mainly in providing farm supplies and marketing agricultural products.

Note 1
SIGNIFICANT ACCOUNTING POLICIES

Consolidation — The consolidated financial statements include the accounts of Coopérative Fédérée de Québec and its subsidiaries. Acquisitions of subsidiaries are accounted for on the purchase method and the results of their operations are included in the consolidated financial statements from the dates of acquisitions. All significant intercompany balances and transactions are eliminated.

Inventories — Inventories are valued at the lower of cost and net realizable value.

Investments — Investments are accounted for at cost.

Fixed assets — Fixed assets are recorded at cost net of government grants and investment tax credits. Depreciation is calculated based on the diminishing balance at the following rates:

Buildings	5% and 10%
Machinery and equipment	20%
Automotive equipment	30%

Production licences and rights — Production licences and rights are accounted for at cost and amortized on the straight-line methcd over a five year period.

Foreign currencies — Foreign currencies are translated into Canadian dollars. Monetary assets and liabilities are translated at the rates of exchange prevailing at the balance sheet date. Non-monetary assets and liabilities are translated at the rates of exchange prevailing when the assets are acquired or the liabilities incurred. Revenues and expenses are translated at the rate of exchange prevailing on the dates of the transactions. Gains and losses on translation of foreign currencies are included in the consolidated statement of savings.

Self-insurance fund — From savings realized on premiums, a self-insurance fund is provided for to cover contingent costs resulting from uninsured losses. This provision is stated as a current liability, and its annual variation has been applied to the operating and selling expenses in the consolidated statement of savings.

Income taxes — Coopérative Fédérée de Québec and its subsidiaries provide for income taxes on the basis of tax deferment. Deferred income taxes result in timing differences between the recognition of expenses, mainly depreciation, for accounting and for income tax purposes.

Note 2
ACQUISITION AND MERGER OF BUSINESSES

During the year ended October 31, 1987, the Co-operative acquired all the shares of a corporation involved in hog and poultry production and merged a member Co-operative. These transactions were accounted for as followed:

Net assets acquired:	
Working capital	$ 1,011
Investments	771
Fixed assets	2,142
Production licences and rights	9,881
Long-term debt	(5,294)
	$ 8,511
In consideration of:	
Cash	$ 7,600
Common shares	335
Preferred shares	576
	$ 8,511

Note 3
INVESTMENTS

	1987	1986
Shares of unlisted corporations:		
C.F. Industries, Inc.	**$ 5,842**	$ 5,842
(book value 1987 — $12,933,708; 1986 — $13,589,642)		
Cooperative Energy Corporation	**5,000**	5,000
(book value 1987 — $4,721,183; 1986 — $4,697,855)		
Others	**2,792**	3,894
	13,634	14,736
Mortgages receivable	**2,981**	2,129
Notes receivable	**2,148**	1,654
	18,763	18,519
Current portion	**1,015**	1,109
	$17,748	$17,410

Note 4
FIXED ASSETS

	1987			1986
	Cost	Accumulated depreciation	Net book value	Net book value
Land and improvements	**$ 4,317**	**$ 407**	**$ 3,910**	$ 3,564
Buildings	**38,914**	**18,082**	**20,832**	20,479
Machinery and equipment	**52,690**	**36,231**	**16,459**	15,302
Automotive equipment	**15,179**	**10,667**	**4,512**	3,989
	$111,100	**$65,387**	**$45,713**	$43,334

Note 5
PRODUCTION LICENCES AND RIGHTS

During the year ended October 31, 1987, the amortization period of production licences and rights was revised from ten to five years. This change resulted in an increase in the amortization expense for the year of $1,548,866.

Note 6
LOANS

Unsecured lines of credit are reviewed annually by various banking institutions.

Note 7
LONG-TERM DEBT

	1987	1986
Debentures		
Series "G", 10%, maturing 1987	**$ —**	$ 850
Series "H", 10%, maturing 1988	**2,000**	2,000
Series "J", 10¾%, maturing 1989	**500**	500
Series "K", floating rate, maturing 1990	**2,400**	2,400
Series "M", floating rate, maturing 1993	**2,000**	2,000
Unsecured debts, various rates and maturities	**36,879**	27,654
Term purchase loans, 8½%, maturing 1988	**145**	618
Other	**262**	177
	44,186	36,199
Current portion	**4,870**	3,525
	$39,316	$32,674

The debentures are secured by provisions of a consolidated trust deed dated April 29, 1975. The unsecured debts are subject to a number of covenants.

Long-term debt due in each of the next five years is as follows:
1988 — $4,870,165; 1989 — $1,840,867; 1990 — $420,867;
1991 — $4,620,865; 1992 — $9,423,599.

FINANCIAL REVIEW
(in thousands of dollars)

	1987	1986	1985	1984	1983
Operations					
Sales	**$1,243,656**	$1,170,160	$1,138,101	$1,156,877	$1,084,327
Gross savings	**184,463**	170,522	156,837	145,489	139,377
Salaries and employee benefits	**85,753**	77,843	75,425	71,108	66,153
Depreciation	**10,196**	7,284	6,778	6,405	6,847
Total expenses	**166,162**	152,701	145,184	131,650	127,195
Savings before patronage refunds and income taxes	**18,301**	17,821	11,653	13,839	10,634
Patronage refunds	**7,225**	7,000	5,000	6,000	5,000
Income taxes	**4,770**	3,575	1,414	1,782	1,615
Net savings	**6,306**	7,246	5,239	6,057	4,019
Financial position					
Current assets	**$ 205,032**	$ 177,193	$ 175,730	$ 179,777	$ 174,977
Current liabilities	**142,589**	118,097	119,216	129,767	124,710
Working capital	**62,443**	59,096	56,514	50,010	50,267
Fixed assets, at cost	**111,100**	98,090	95,788	91,130	85,339
Fixed assets, net book value	**45,713**	43,334	45,161	43,345	41,915
Long-term debt	**39,316**	32,674	36,759	32,247	33,659
Total assets	**276,398**	238,672	238,969	240,048	231,138
Total equity	**91,136**	83,978	78,378	73,399	67,828
Financial ratios					
Savings before patronage refunds and income taxes/sales	**1.5%**	1.5%	1.0%	1.2%	1.0%
Working capital ratio	**1.4**	1.5	1.5	1.4	1.4
Debt to equity ratio	**1.9**	1.7	1.9	2.0	2.2
Retained savings/Total equity	**67.7%**	65.9%	61.4%	58.4%	54.3%
Total equity/Total assets	**33.0%**	35.2%	32.8%	30.6%	29.3%
Employees	**3,147**	2,906	2,974	2,777	2,806

MANAGEMENT

1


2


1. *Yvon Mercier,*
   Manager, Meat Packing Division
   and Réjean Nadeau,
   Manager, Poultry Division.

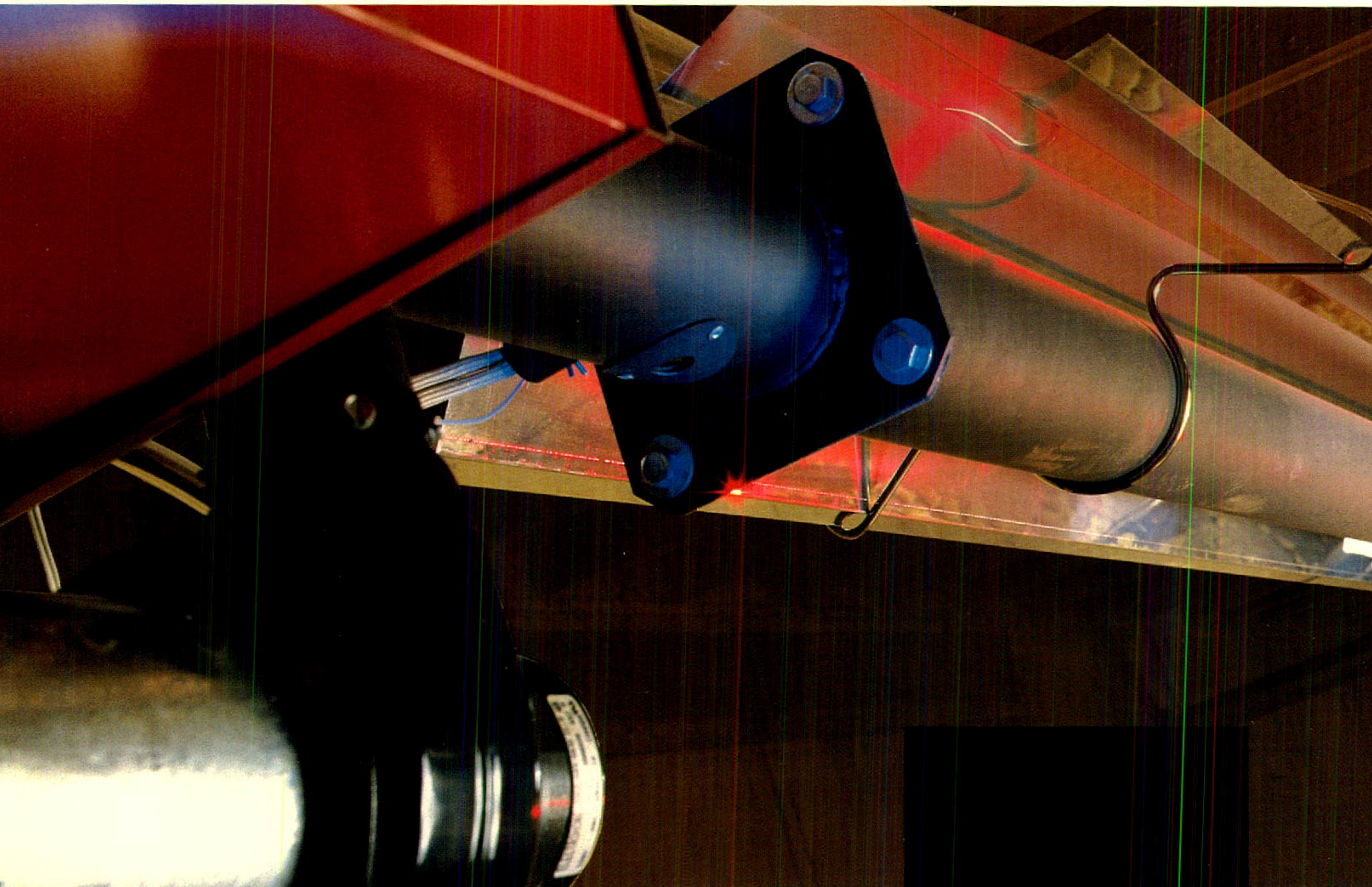
2. *Dominic Scipio,*
   Manager, Petroleum Division
   and Jean-Pierre Deschênes,
   Manager, Farm Supply Group.

3


4

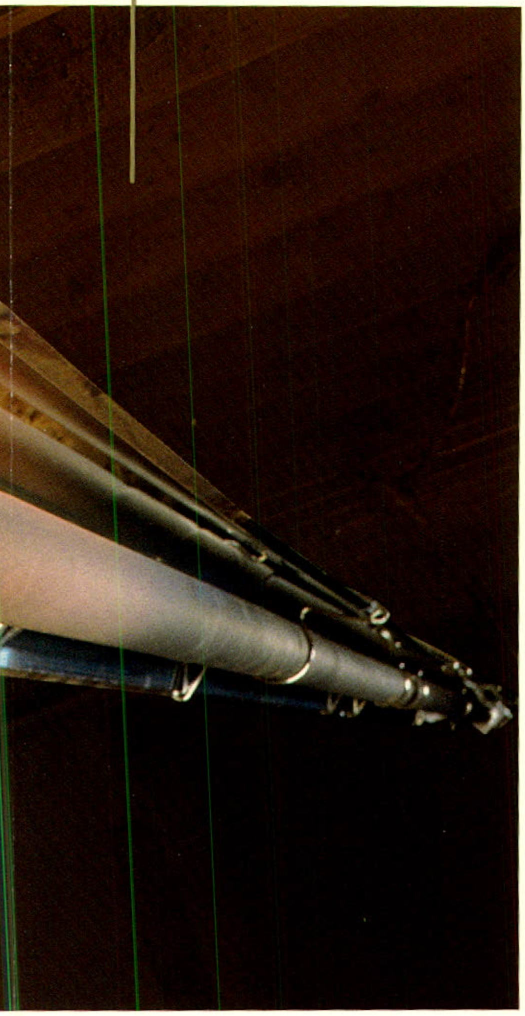

3. *Jean-Marc Bergeron,*
   Manager, Dairy Division
   and Jean-Paul Cadieux,
   Manager, Human Resources Division.

4. *Richard Newberry,*
   Treasurer,
   André F. Lizotte,
   Chief Executive Officer
   and Mario Dumais,
   General Secretary.



To meet henhouse heating requirements, Sonic, the Petroleum Division of Coopérative Fédérée, markets the radiant infra-red heating system. It is a new technology that is evidence of agricultural co-operatives' pursuit of efficiency.

MANAGEMENT REPORT



The 1987 financial year has been the best in the history of our Federation. With quality human, material, and financial resources at our disposal, we have been able to take advantage of the opportunities that were presented, and to attenuate the impact of negative situations in an economic environment that has remained favorable for almost all sectors.

The success obtained during the past year is the result of the quality of work accomplished by both management and employees, and the loyalty of farmers and their member co-operatives. It is important to stress the excellent spirit of collaboration that exists between directors, management, and employees of Coopérative Fédérée and those of member co-operatives.

Sales and revenues reached more than $1.243 billion in 1987, an increase of 6.3% over last year. Gross savings rose to $184.5 million, or 14.8% of sales, which compares favorably with last year's $170.5 million, or 14.6% of sales, an increase of 8.2%.

Total expenses were $166.2 million, an increase of 8.8% over $152.7 million last year. These expenses represent 13.4% of 1987 sales. The same figure was 13% in 1986.

An increase of 8.8% in expenses, in relation to an increase in gross savings of 8.2% and an approximate inflation rate of 4.5% is relatively high, even taking into consideration additional activities and a change in the policy of amortization. Measures have already been taken to curb such expense increases.

Savings from operations, before patronage refunds and income taxes, totalled $18.3 million, an increase of 2.7% over the previous year. At 1.5% of sales, the 1987 savings are quite satisfactory considering the activities in which we operate.

Very specialized computer equipment which feeds dairy cows eight times a day, the Info-lait Program, and the numerous guides prepared by co-operatives help achieve optimum dairy farm performance.

The Meat Division

The Meat Division, overall, had a good year. An increase in sales of 3.9% to $340 million confirms the important position our co-operative holds in this sector. The volume of sales this year represents almost 132 million kilograms of meat, a drop of 2.5% from last year. The increase in sales is attributable to the increase in the average price per pound.

A closer look at our slaughter volume for 1986 shows a temporary increase during a strike at a competitor. Taking this into consideration, we can conclude that the deliveries of hogs in 1987 have generally increased from the preceding year.

Fate has also favoured us due to the custom fees placed on Canadian hogs exported to the United States, which has a significant impact on Ontario. For the moment, as Ontario producers do not have sufficient slaughter facilities to cope with their increasing production, the surplus has become available to slaughterhouses in Québec.

Our export sales volume has dropped by 9.6% over that of the previous year. The United States still represent, by far, our largest and most stable market, with Japan in second place. The Free-Trade Agreement offers us not only the possibility of maintaining our level of exports, but also of increasing exports to a market where consumers are turning to leaner meat products, a market to which Canadian pork production can respond.

Butchershop and delicatessen products we have introduced have been met with considerable success, largely due to our presence, for the first time, in the Toronto market. This sector of our activities, though marginal in terms of volume, presents interesting opportunities.

The Poultry Division

Sales in the Poultry Division, at $218 million, have increased by 15%. A rise in killing volume and growth in the percentage of processed products, are primarily responsible for the increase in sales.

In the context of a quota-controlled production, the effectiveness of supply management remains one of the principal preoccupations of the primary processing industry. A rationalization in the allotment of poultry production quotas in 1986, which has continued into the first few months of 1987, has permitted us to move towards a better balance between supply and demand. We cannot say the same for the second half of the year.

Market steadiness at the beginning of the year, both in chicken and turkey, combined with the market thrust of our ready-to-serve products, allowed us to increase our gross margins.

One of management's major concerns, throughout the year, was to keep unit costs as low as possible. The health and safety area is one example of how expenses can grow significantly over the years. The implementation of safety programs has helped reduce the number of accidents in our plants by 15.3% this year. This is reflected by an increase of 27% in the number of hours worked. There is still room for improvement.

The Dairy Division

Sales in the Dairy Division increased by 14.8% to $333 million. This important growth was achieved solely in the Canadian market, as, one by one, foreign markets closed during the year. The Division has succeeded in maintaining the same level of profitability as last year.

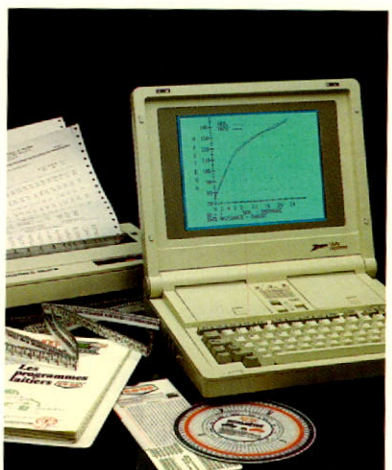
We would like to point out an increase of 31% in sales of butter, following a modification in the Canadian program for the marketing of this product. Within the framework of this new approach, introduced by the Canadian Dairy Commission, dairy co-operatives have mandated the Division to operate a pool for butter sales outside of Quebec. These sales have, for the most part (99.8%), been made directly to customers. Cheese sales have shown a growth of 17.6%, primarily in domestic markets, while the export of evaporated milk, on a brokerage basis, continued its dramatic decline which began two years ago.

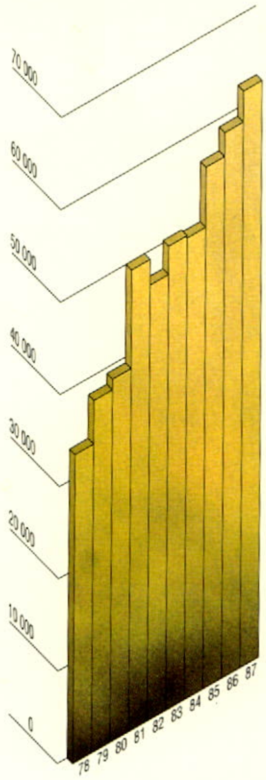
Export sales are encountering serious difficulties. Problems in liquidity and currency exchange rates of importing countries are compounded by the availability of Canadian dairy products for export, at least for exporters other than the Canadian Dairy Commission.

The main activities in the export of whole milk products were due to trade in butter fat, in an effort to reduce the Canadian Dairy Commission's butter inventory, and to the export quota of 1.7 million hectoliters. Export volumes will be reduced further in 1988, as the Canadian Dairy Commission must replenish the butter inventory to a level sufficient to assure supply to Canadian consumers.

On the corporate level, the Division has had a year that will chart the future for the Quebec dairy industry. An arbitrated decision reached on the 1st of April, after a request to review the milk marketing agreements, confirmed, and repaired in large part, damage caused to the dairy cooperation since the 1st of August, 1985.

As well, the Institutional Reseach and Communications Department has intensified its information activities, specifically by the organization of a campaign with the theme "Ideas, expertise... and audacity". Finally, the Dairy Division has worked on the issue of the Canada-U.S. Trade Agreement, in close collaboration with other partners in this sector.





WORKING CAPITAL
($ in thousands)

Fruits and Vegetables

After a two-year decline, sales of the Fruits and Vegetables Department experienced a considerable turnaround this year, with sales increasing 40.2% from $1.6 million to $2.3 million. The total unit volume increase was 7.8%. The Department operates in a difficult environment both within and outside the metropolitan terminal.

After two difficult years, the Fruits and Vegetables Department has recovered its traditional profitability. Its future is tied to the development of the Metropolitan Central Market, which is in dire need of renovation. We are preparing for such an eventuality.

The Petroleum Division

The general trend towards lower petroleum sales, which has been ongoing for the past few years, slowed in 1987. Nevertheless, we experienced a decline in sales of 7.6%, to $155 million. This decline was evident in gasoline, whereas our performance in the middle distillate sector was better than the provincial average.

Organizational changes inaugurated in 1986 allowed us to concentrate our efforts on specific objectives. The Residential and Commercial Department fixed, as an objective, to penetrate first the agricultural, then the residential markets. This year we have targeted the agricultural market. The presence of co-operatives as distributors has been, and will remain, a determining factor.

The multitude of factors affecting the different sectors of the petroleum market, both by product and region, obliges us to continue our strategy of being present in most of the regions in the province, as much in the distribution to farm, business, and residential clients, as to gas stations.

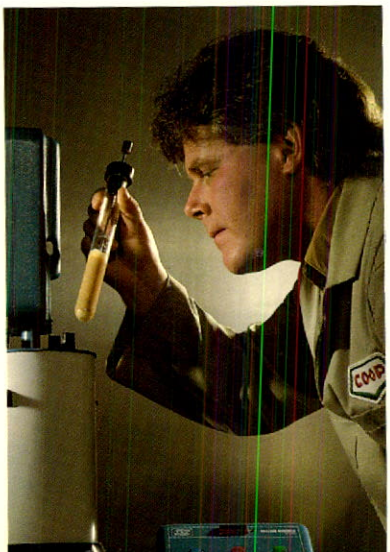
We are pursuing an equilibrium objective between sales to co-operatives, businesses, residential clients and gas stations, that will bring us the best rate of return over the long term.

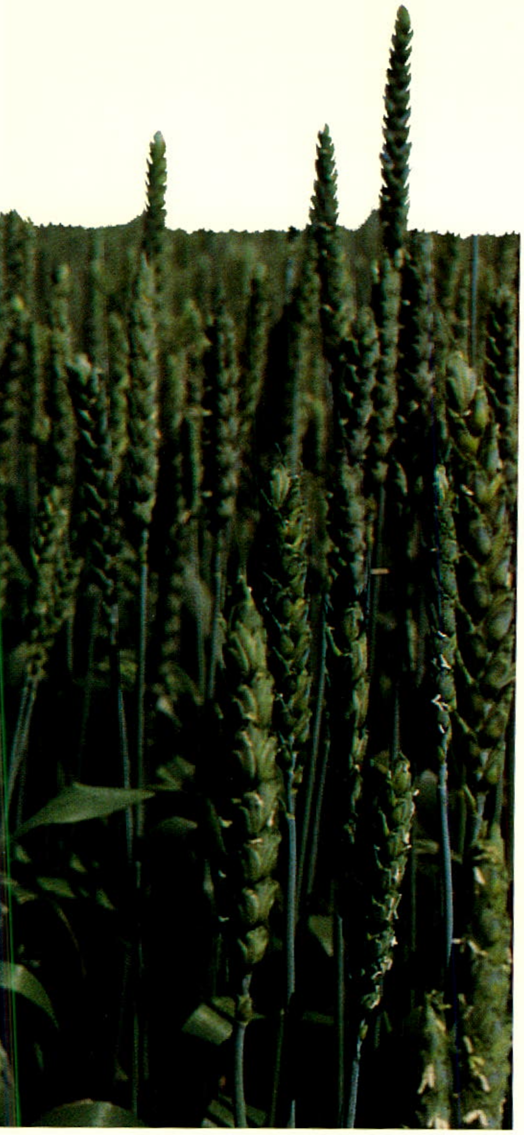
This Division has achieved the best results in its history. This is the sum of many positive elements. The Division continues to expand its activities, and this demands more effort and flexibility than ever before.

The Farm Supply Group

The results achieved by the Farm Supply Group are the best in its history. Sales, up 4.9%, reached $402 million.

Grain sales were down 10.2% over last year. Volume, however, was up by 2%. Gross savings have, in percentage, improved significantly com-





Today, Quebec producers are interested in growing food wheat. Co-operatives support this production by selling seed, developing planting programs, establishing quality controls, and through concerted marketing efforts.

pared to past years, whereas in terms of dollar value, they are similar to the results of previous years.

Sales of feeds and supplements increased by 11.7% to $93 million, whereas the volume increased by 10.1% over the preceding year. The profitability of this department is up over 1986.

Animal health product sales showed an increase of 15.7% this year, due principally to sales of prescribed drugs by our veterinary service. The net savings are similar to those of last year.

In an effort to offer more services to producers and co-operatives, we hired three veterinarians this year, two specializing in hog production and one in poultry.

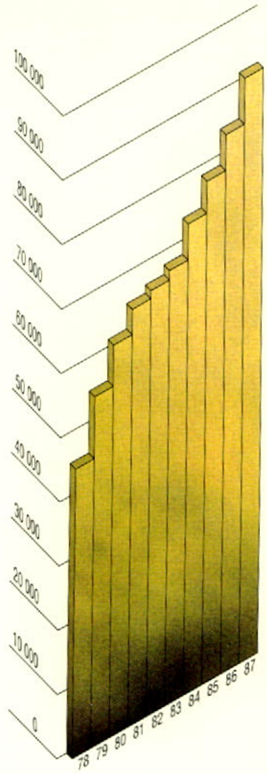
The Hatchery Department had significant supply problems during the year. We were forced to buy the equivalent of 16% of our incubation eggs from outside our network. Sales are up 16.6% over last year, whereas net savings have remained relatively the same.

Sales of fertilizers recovered in 1987. Increases of 2% in sales and 6.9% in volume have resulted in a positive outcome. Additional sales can be accounted for by markets outside of the Quebec co-operative network. Our operations in Ville St-Catherine have contributed significantly to the improvements in gross savings.

The agricultural chemicals sector continues to experience fierce competition. Sales were down 4.7%. We have noted a reduction in the use of corn herbicides, but a significant increase in the use of fungicides. Strict expense controls have helped minimize the reduction in profitability of this sector.

Seed sales have increased by 2.2%, due in large part to wheat and barley sales. Oat sales have experienced a slight decline, and the significant decline in corn sales is attributed to both the reduction in total area seeded and the poor results obtained from some varieties. A reduction in operating expenses of 5.3% allowed us to maintain reasonable net savings.

The Farm Hardware Department has not contented itself with its 1986 record-breaking performance. Sales of $52 million, an increase of 19.7%, and a significant increase in net savings are notable achievements. Wholesale activities are responsible for these results. The Department currently operates three retail outlets, compared with five the previous year.

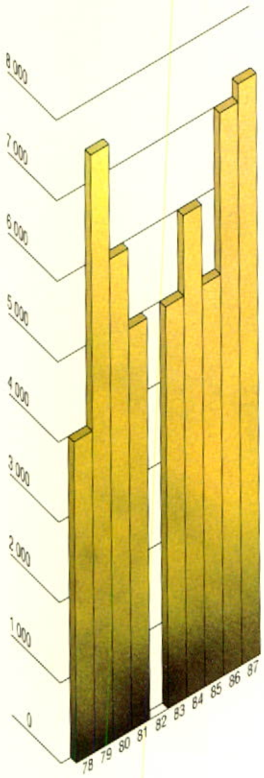


EQUITY
($ in thousands)

The Farm Implements Department has continued its recovery and only a small margin prevents it from declaring a profit this year. Unit and implement sales are constantly progressing. The performance of this sector is evidence of the right decisions made by the Board of Directors over the past few years.

At the end of 1987 financial year, the Farm Supply Group operated nine retail outlets, one more than last year. Of these operations, only those in St-Polycarpe and Haut St-Laurent are not direct member sections.

As these retail outlets were taken over by the Federation following serious difficulties of local co-operatives, normalizing their situation will still require time, energy and money to bring each of them in a profitable situation. We consider this effort very meaningful since their activities have positive financial impact on other sectors of our Federation.



PATRONAGE REFUNDS
($ in thousands)

The Financial Situation

Following a decision by the Board of Directors, relative to patronage refunds and redemption of share capital, the working capital at the end of the financial year was $62.4 million, compared to $59.1 million on the 31st of October, 1986. Accounts receivable, before provision for doubtful accounts, have increased by 0.5%. One must view this increase in the context of a sales growth of 6.3% and the acquisition of new activities. In relation to sales, accounts receivable represent 7.4% at the end of the financial year, whereas the same figure was 7.8% on the 31st of October, 1986.

Compared to last year, inventories, at $98.6 million, are $13.7 million, or 16.1%, higher. This increase is due mainly to the Poultry, Petroleum, and Farm Implements Departments, and are indicative of the growth of activities in these sectors.

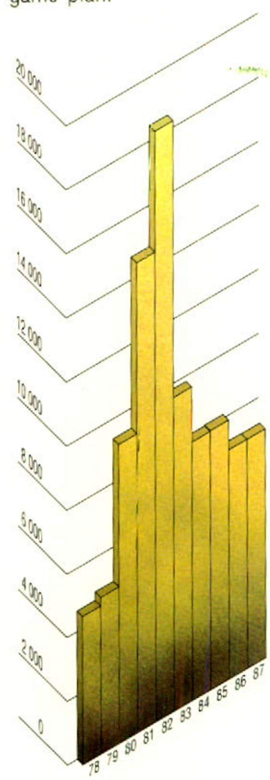
Retained savings increased by $6.3 million to $61.7 million, fulfilling the often voiced objective of having a strong financial situation in a sector subject to many destabilizing factors.

Total equity has reached $91.1 million, compared to $84 million one year earlier and retained savings represent 67.7% of this equity.

Administrative Services

The General Secretariat, Treasury Division, Human Resources Division, Legal Counsel, and Engineering support the activities of the commercial and industrial sectors. These administrative services offer few quantifiable results, but offer a quality of expertise and service that management and directors of our co-operative movement rely upon on a daily basis. Essential as they are in the life of any corporation, their returns are primarily strategic.

Tomorrow's enterprises, like those of yesterday, must, to retain their place, perfectly master and operate commercial and industrial activities. Enterprises who want to keep a lead on the competition, rather than just run with the crowd, must rely on the most qualified, best trained, and most motivated people in their field. Agricultural cooperation has at its disposal all the required resources; what remains is to develop an effective game plan.



FINANCING COSTS
($ in thousands)

In conclusion, our Federation has completed its second most satisfying year in succession. The results compare favorably with those of last year, in spite of a change in the amortization policy for production rights. We feel that this decision by the Board of Directors reflects a cautious and sound administration.

I would like to express my appreciation to those, both near and far who have participated in the success: directors, management and personnel of the member co-operatives, and farmers.

The 1987 results were achieved under the management of my predecessor, who retired at the very end of the fiscal year after having served the agricultural co-operative movement for many years, with dedication and loyalty.

In closing, we would like to reiterate the words of Mr. Louis-Philippe Poulin, who last year, in his management report, reminded us of the raison d'être of our organization: "To serve all owner-users, farmer members and their co-operative economic institutions... That is the first and foremost condition for the continuation of our movement."

Chief Executive Officer

André F. Lizotte

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